An Analysis of Trusts and Partnerships as Members of Australian Tax Consolidated Groups – Good or Flawed Tax Policy?

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Statement of originality

I certify that the content of this thesis is my own work. This thesis has not been submitted for any degree or other purposes.

I certify that the intellectual content of this thesis is the product of my own work and that all the assistance received in preparing this thesis and sources have been acknowledged.

No content produced by generative AI tools has been used in the preparation of this thesis.

Peter Stinson

Statement of Currency

This thesis was written based on my knowledge of the law up until 15 June 2025

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The part time PhD is an arduous solo journey with the end always coming but a dim light barely flickering for most of the time.

My nine year journey has transcended my sons' Honours degrees, even though my candidature commenced before theirs, the Covid-19 pandemic, my initial lead supervisor's retirement, and my auxiliary supervisor's retirement from full-time teaching.

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Abstract

This thesis analyses trusts and partnerships as members of Australian tax consolidated groups under which the parent (head) entity is taxed on the taxable income of all members of the group which are deemed to be parts of the head entity. The inclusion of trusts and partnerships in Australian tax consolidated groups is a unique feature of the Australian tax consolidation regime and not paralleled in other countries' tax consolidation regimes.

There is little academic literature that has analysed in any detail the eligibility of trusts and partnerships to become members of tax consolidated groups and the tax consequences of their joining and leaving a consolidated group. The research undertaken in this thesis fills that gap.

The first research question asked does the Australian tax legislation adequately and effectively provide for the inclusion of trusts and partnerships in tax consolidated groups?

Using the legal research methodology of 'doctrinal analysis' (which, broadly, consists of identifying relevant case law and statutory provisions and then interpreting and critically analysing them), the eligibility requirements for trusts and partnerships (the meaning of both considered initially) as members of consolidated groups and MEC groups were analysed with certain issues arising from that analysis considered including recommending legislative amendments.

Next, the consequences of trust and partnerships joining consolidated groups and MEC groups upon their formation and upon joining an existing group were analysed. The special regimes relating to trusts and partnerships were outlined and analysed. Various issues arising from the analysis in relation to trusts and partnerships joining consolidated groups and MEC groups were noted and discussed.

The consequences of trusts and partnerships leaving a consolidated group and a MEC group were analysed with various issues arising from that analysis noted and discussed.

The second research question asked what legislative reforms are required to better achieve the policy intent of the inclusion of trusts and partnerships in the Australian tax consolidation regime? From the doctrinal analysis undertaken in relation to the first research question, some legislative amendments were recommended as part of the consideration of the various issues that had arisen in relation to the eligibility requirements for trusts and partnerships to become members of consolidated groups and MEC groups and in relation to the tax consequences of their joining and leaving tax consolidated groups.

The third research question asked does the inclusion of trusts and partnerships in Australian tax consolidation regime promote a stronger enterprise doctrine and represent good tax policy?

In answering the third research question, first, the history, meaning and implications of the enterprise doctrine (which, broadly, relates to the phenomenon of modern medium to large business enterprises comprising a group of entities with a controlling parent carrying on business as a group rather than as single legal entities) was outlined and analysed to

determine whether the inclusion of trusts and partnerships in Australian tax consolidated groups promoted a stronger enterprise doctrine. The conclusion was reached that the inclusion of trusts in tax consolidated groups did theoretically and in practice promote a stronger enterprise doctrine. However, although theoretically the inclusion of partnerships did promote a stronger enterprise doctrine, in practice, due to the very low incidence of partnerships in Australian tax consolidated groups, the inclusion of partnership has not promoted a stronger enterprise doctrine.

The second part of the third research question was answered by examining and considering the long-established and well-accepted factors (that is, simplicity, neutrality and efficiency, fairness and competitiveness) that are regarded as the hallmarks of a 'good' tax system. It was concluded that Australia's decision to include trusts and partnerships in consolidated groups and MEC groups represented good tax policy.

Table of Contents

Chapter 1 - Introduction

1.1 Introduction

This chapter introduces the thesis and outlines the context and background of the research including its objectives and identifies the research questions that it addresses.

At 1.2 an overview of the Australian taxation regime for corporate groups is provided noting that group taxation regimes are consistent with modern business being carried on by a corporate group or enterprise which is known as the 'enterprise doctrine'.

The objectives of the thesis are set out at 1.3 including the focus of the thesis being on trusts and partnerships within Australian tax consolidated groups which are a unique feature of the Australian tax consolidation regime.

The research questions that the research addresses are set out at 1.4 and the structure of this thesis is outlined at 1.5.

1.2 Overview – Australian Group Taxation Regime

A feature of the modern business economy is that medium to large businesses are carried on by corporate groups or enterprises (comprising many juridical entities), both domestically and internationally, under the common control of a parent entity rather than being conducted by stand-alone entities.[1]

The above feature has given rise to an 'enterprise doctrine' or 'enterprise theory'. Ting indicates that the 'doctrine focuses on the business enterprise as a whole …. [and] economic substance overrides the legal form of individual companies'.[2]

Corporate law, having its historical roots in limited liability of a company which is treated as a separate and distinct entity, has had to adapt to accommodate, in some areas, the 'unitary

[1] See, generally, in relation to the rise of corporate groups or enterprises, Antony Ting, *The Taxation of Corporate Groups under Consolidation: An International Comparison* (Cambridge University Press, 2013) 3–4, 13–18; Phillip Blumberg, 'The Transformation of Modern Corporation Law: The Law of Corporate Groups' (2005) 37(3) *Connecticut Law Review* 605; Kurt A Strasser and Phillip Blumberg, 'Legal Form and Economic Substance of Enterprise Groups: Implications for Legal Policy' (2011) 1(1) *Accounting, Economics, and Law*, Article 4.

[2] Ting (n 1) 5.

character of large business enterprises'[3] rather than continue its sole focus on a group consisting of separate legal entities.[4]

The rise of corporate groups and the emergence of the enterprise doctrine has led to the introduction of tax consolidation regimes in many countries.[5] Australia introduced a consolidation regime into the income tax law from 2002. The design of each country's consolidation regime differs with varying eligibility requirements and effects.[6]

The Australian income tax law contains[7] an elective regime for the taxation of consolidated groups and MEC (multiple entry consolidated) groups ('MEC groups').[8]

The tax consolidation regime has become an integral part of Australia's taxation of business taxpayers. By 2011 almost 83% of wholly owned groups in the medium to large business sector (groups with turnover exceeding $50 million but less than $250 million) and 93% of wholly owned groups in the large business sector (groups with turnover greater than $250 million) had entered tax consolidation.[9] In contrast, there was a lower election into tax consolidation for small to medium enterprise groups (turnover $2million-$50million) – 42%, and for the micro-enterprise group (turnover below $2million) – 20%.[10]

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[3] Strasser and Blumberg (n 1) 2.

[4] There have been many articles and book written, from both a United States corporate law perspective and an Australian corporate law perspective, in relation to the need for corporate law to adapt and embrace an enterprise analysis or doctrine rather than the single entity approach and its limited liability: see below (n 255).

[5] Ting (n 1) 5-7.

[6] Ibid.

[7] The legislative provisions relating to consolidated groups are largely contained in Part 3-90 of the *Income Tax Assessment Act 1997* (Cth) ('*ITAA 97*'). Certain transitional provisions are contained in Part 3-90 of the *Income Tax (Transitional Provisions) Act 1997* (Cth). Broadly, a consolidated group consists of an Australian resident company (or an entity treated as a company under the taxation law, for example, certain limited partnerships and certain unit trusts), referred to as the 'head company', and its wholly owned entities that are eligible to be subsidiary members of the consolidated group. Broadly, a MEC (multiple entry consolidated) group ('MEC group') consists of eligible wholly foreign owned Australian entities that do not have a common Australian resident head company. Broadly, the membership of a MEC group is determined by reference to a 'top company', the ultimate foreign parent company. Those Australian resident companies (each referred to as an eligible 'tier-1 company') that represent the first level of investment in Australia and their wholly owned subsidiaries may choose to form a MEC group: see *ITAA 97* s 719-5.

[8] Consolidated groups and MEC groups were able to be formed from 1 July 2002. The tax consolidation regime was originally enacted by the *New Business Tax System (Consolidation) Act (No 1) 2002* (Cth) which received Royal Assent on 22 August 2002. Within the next eleven months, further enactments added to and refined the tax consolidation regime: *New Business Tax System (Consolidation, Value Shifting, Demerger and Other Measures) Act 2002* (Cth), which received Royal Assent on 24 October 2002; *New Business Tax System (Consolidation and Other Measures) Act (No 1) 2002* (Cth), which received Royal Assent on 2 December 2002; *New Business Tax System (Consolidation and Other Measures) Act 2003* (Cth), which received Royal Assent on 11 April 2003; and the *Taxation Laws Amendment Act (No 6) 2003* (Cth), which received Royal Assent on 30 June 2003.

[9] See The Board of Taxation, *Post-Implementation Review into Certain Aspects of the Consolidation Regime*, A Report to the Assistant Treasurer, June 2012, Executive Summary, 3, para 2 and 69-71, [6.6]–[6.10] ('Report').

[10] Ibid [6.8].

By 30 June 2011, 10,212[11] tax consolidated groups and MEC groups had been formed and 20,054[12] had been formed by 30 June 2024.[13]

Broadly, the tax consolidation regime is elective[14] and the 'head entity' of those wholly owned eligible entities ('subsidiary members') that comprise the tax consolidated group or MEC group is taken to be the taxpayer entity for the group for certain purposes (referred to as 'head company core purposes'[15]) including for the purpose of working out the amount of the head company's income tax liability for an income year.[16]

The subsidiary members, for the period they are subsidiary members of a consolidated group or MEC group, are taken for certain purposes (referred to as 'entity core purposes'[17]) to be parts of the head entity, rather than separate taxable entities.[18] The consequences of this

[11] Comprising 9,488 consolidated groups and 724 MEC groups.

[12] Comprising 18,879 consolidated groups and 1,175 MEC groups.

[13] The statistics were provided to the author by a Director in the Taxation Statistics Division of the Revenue Analysis Branch of the Australian Taxation Office by email dated 24 January 2025.

[14] For a consolidatable group, the head company makes a choice for it to be consolidated: *ITAA 97* (n 7) s 703-50(1). However, once the choice is made to form a consolidated group, the consolidatable group is required to include all eligible wholly owned entities: this is the so-called 'one in all in' or 'all in' rule: see *ITAA 97* s 703-10(1) and Antony Ting, 'Policy and Membership Requirements for Consolidation: A Comparison between Australia, New Zealand and the US' (2005) 3 *British Tax Review* 311, 322-3 ('Policy and Membership Requirements'). *ITAA 97* s 703-5(3) provides that at any time while a consolidated group is in existence it consists of the head company and all of the subsidiary members (if any) of the group at that time. For a potential MEC group, two or more eligible tier-1 companies of a top company jointly choose for the potential MEC group to be consolidated: *ITAA 97* s 719-50(1). It is not a requirement that all eligible tier-1 companies of a top company be members of a MEC group. New eligible tier-1 companies, that is, those companies that were not eligible tier-1 companies at the earlier time that the MEC group came into existence, may later join that MEC group: *ITAA 97* s 719-5(4). However, eligible tier-1 companies of a top company that did not join the MEC group cannot later join that MEC group (s 719-5(2)) but may, however, choose to form a consolidated group, choose to form another MEC group (if there is more than one eligible tier-1 company that is not within a MEC group), or remain outside consolidation. It is possible, however, for an eligible tier-1 company that was not included in the MEC group to later become a subsidiary member of the MEC group if the top company 'transfers down' all its shares to another eligible tier-1 company that is a member of the MEC group. The absence of an 'all-in' principle for eligible tier-1 companies was identified as an advantage by a Working Group that reviewed various aspects of MEC groups. The Report of the Working Group identified that by choosing which eligible tier-1 companies to join a MEC group and which to remain outside the MEC group, there may be an opportunity to undertake intra-group transactions to generate tax advantages and may also be able to generate advantages in relation to tax losses and thin capitalisation: see Australian Government and the Tripartite Working Group, 'Multiple Entry Consolidated Groups – Review' (Report of the Working Group, April 2014) 10, [4.6] <https://treasury.gov.au/sites/default/files/2019-03/MEC-groupsreview.pdf>. The Working Group recommended no action be taken in respect of this advantage 'either because there is no clear solution to address ..[it].. within the current legislative framework or because any solution would impose significant compliance costs on business': 15, [15.3].

[15] *ITAA 97* s 701-1(2).

[16] *ITAA 97* s 701-1(2)(a). It is noted that s 701-1(2)(a) applies to the head company of a MEC Group since s 719-2(1) provides that Part 3-90 of the *ITAA 97* (other than Division 703 and Division 719) has effect in relation to a MEC Group in the same way as it has effect in relation to a consolidated group.

[17] *ITAA 97* s 701-1(3).

[18] This statutory outcome, a fiction, is known as the 'single entity rule' (or 'SER'): *ITAA 97* s 701-1. For an analysis of the scope, effect and purpose of the SER see Peter Scott, 'The Single Entity Rule: The Need to Clarify the Effects and Limits of the Cornerstone of Australia's Tax Consolidation Regime' (2020) 35(3) *Australian Tax Forum* 296; Norman Hanna, 'Revisiting the Scope of the Single Entity Rule' (2018) 47 *Australian Tax Review* 190; Des Maloney and Peter Walmsley, 'ATO Perspective on Consolidation – Unravelling the Mysteries of the Single Entity Rule', (2009) (Conference Paper, Tax Institute of Australia National Consolidation Symposium, 1 May 2009). The Commissioner of Taxation's views as to the

deeming by the 'single entity rule' (or 'SER')[19] include that intra-group transactions (such as loans, transfer of assets or payment of dividends) are ignored for tax consolidation purposes and subsidiary members do not work out their own liability to income tax during the period that they are members of a consolidated group or MEC group.[20] The explanatory memorandum ('2002 EM') to the New Business Tax System (Consolidation) Bill (No 1) 2002, indicated that the SER had the consequence that assets and liabilities of a subsidiary member are treated for income tax purposes as if they were owned by the head company, as this is the only entity the income tax law recognises.[21]

Commonly, a tax consolidated group consists of companies, however, the Australian tax consolidation regime provides for certain trusts, subject to various requirements, to be members of consolidated groups and MEC groups. The regime also provides for certain partnerships, subject to various requirements, to be members of consolidated groups and MEC groups.

The *ITAA 97* contains detailed provisions governing the eligibility requirements for a trust and a partnership to be a head company or a subsidiary member of a consolidated group or MEC group.

meaning, scope and application of the SER is set out in Taxation Ruling TR 2004/11: 'Income Tax: Consolidation: The Meaning and Application of the Single Entity Rule in Part 3-90 of *the Income Tax Assessment Act 1997*'.

[19] *ITAA 97* (n 7) s 701-1.

[20] As a matter of tax administration, the Commissioner of Taxation requires a single income tax return to be lodged for a consolidated group or MEC group for each income year. The head entity lodges the return. Where a consolidated group or MEC group was in existence for only part of an income year, the head entity's return includes tax information for the consolidated group or MEC group whilst it was in existence and includes tax information relevant to its own income tax liability for that part of an income year in which the consolidated group or MEC group did not exist. In addition, a subsidiary member of a consolidated group or MEC group may need to lodge an income tax return in respect of its own income tax liability for the part of an income year that it was not a subsidiary member of the consolidated group or MEC group. See Australian Taxation Office, 'Determining Annual Liability' (Consolidation Reference Manual, B3-3, 1-3) <https://www.ato.gov.au/api/public/content/814c8be7-218e-42d7-8a0a-1a3d10aa3095_b7b1c69a_de9d_4931_8506_0444bb58483d_pdf>; Australian Taxation Office, *Lodgment Obligations* (Web Page) <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/consolidation/in-detail/consolidation-income-tax-returns-and-consolidation/lodgment-obligations>.

[21] Explanatory Memorandum, New Business Tax System (Consolidation) Bill (No 1) [2.20] ('2002 Consolidation EM').

1.3 Objectives of Thesis

Ting[22] has indicated that Australia's inclusion of trusts and partnerships as members of consolidated groups is a 'unique feature' among the eight countries' tax consolidation regimes that he examined.

The number of trusts entering into tax consolidation has continued to grow since the introduction of the tax consolidation regime in 2002. By 30 June 2003 there were 759 trusts in tax consolidated groups with 3,566 by 30 June 2011 and 7,187 by 30 June 2024.[23] Contrastingly, 55 partnerships had entered into consolidation by 30 June 2003 with 208 by 30 June 2011 and 200 by 30 June 2024.[24] The total number of partnerships in consolidation in the period 2011-2024 ranged from a low of 196 by 30 June 2014 and a high of 224 by 30 June 2020.[25]

Extensive research in respect of Australia's policy of including trusts and partnerships within tax consolidated groups and MEC groups is warranted since little academic research[26] has been undertaken in respect of this feature of Australia's tax consolidation regime. This thesis will analyse and evaluate the legislative provisions relating to the inclusion of trusts and partnerships including making recommendations for legislative reform. It will also consider whether the inclusion of trusts and partnerships within Australian tax consolidated groups and MEC groups achieves a stronger enterprise doctrine and represents good tax policy.

This thesis is intended to fill the gap in knowledge described above.

1.4 Research Questions

This thesis addresses the following research questions.

1. Does the Australian tax legislation adequately and effectively provide for the inclusion of trusts and partnerships in tax consolidated groups?

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[22] Ting (n 1) 106. See also Ting, 'Policy and Membership Requirements' (n 14) 324-5. Ting examined the tax consolidation regimes in Australia, France, Italy, Japan, the Netherlands, New Zealand, Spain and the United States. See also Antony Ka Fai Ting, 'The taxation of corporate groups under the enterprise doctrine: a comparative study of eight consolidation regimes' (PhD Thesis, The University of Sydney, 2011).

[23] See above (n 13).

[24] Ibid.

[25] Ibid.

[26] See below (n 27) which identifies academic journal articles and other literature that have considered various aspects of Australia's tax consolidation regime including, far less extensively, a consideration of trusts and partnerships within Australia's tax consolidation regime.

2. What legislative reforms are required to better achieve the policy intent of the inclusion of trusts and partnerships in the Australian tax consolidation regime?
3. Does the inclusion of trusts and partnerships in Australia's tax consolidation regime promote a stronger enterprise doctrine and represent good tax policy?

1.5 Structure of Thesis

This thesis comprises eleven chapters including the current introduction chapter.

Chapter 2 reviews the literature that has considered trusts and partnerships in Australian tax consolidated groups and MEC groups.

Chapter 3 examines the origins and content of the enterprise doctrine, including the corporate law and accounting response to the doctrine, and the extent to which Australia's tax consolidation regime can be viewed as consistent with and facilitative of the enterprise doctrine.

Chapter 4 sets out the three research questions that this thesis addresses and the research methodology utilised in answering each of the research questions.

Chapter 5 outlines business tax reform in Australia, particularly in relation to the ultimately abandoned so-called 'entity taxation' proposal under which trusts were to be taxed like companies, and the impetus for, and introduction of, the tax consolidation regime.

Chapter 6 analyses the eligibility requirements for trusts to be members of Australian tax consolidated groups and MEC groups.

Chapter 7 analyses the eligibility requirements for partnerships to be members of Australian tax consolidated groups and MEC groups.

Chapter 8 analyses the consequences of trusts joining and exiting Australian tax consolidated groups and MEC groups.

Chapter 9 analyses the consequences of partnerships joining and exiting Australian tax consolidated groups and MEC groups.

Chapter 10 examines whether the inclusion of trusts and partnerships within tax consolidated groups and MEC groups in Australia's tax consolidation regime promotes a stronger enterprise doctrine and represents good tax policy.

Chapter 11 summarises the findings of the thesis and concludes the thesis.

1.6 Conclusion

This introduction chapter at 1.2 provided an overview of the Australian group taxation regime noting that it is an integral part of the taxation of business taxpayers and can be seen as consistent with the 'enterprise doctrine' under which medium to large businesses are carried on by corporate groups or enterprises under the common control of a parent entity, rather than as a group of single stand-alone entities.

The object of the thesis is set out in 1.3 which indicates that Australia's tax consolidation regime includes trusts and partnerships as members of tax consolidated groups which is a unique feature amongst other tax consolidation regimes. Since little research has been undertaken in respect of this feature, the current research intends to fill that gap in knowledge.

The research questions which the thesis addresses are set out in 1.4 which seek to first, examine the adequacy and the effectiveness of the legislative provisions relating to trust and partnerships in Australian tax consolidated groups and, secondly, to determine whether the policy intent to include trusts and partnerships may be better achieved by legislative reform. Thirdly, the research will analyse whether the inclusion of trusts and partnerships in tax consolidated groups promotes a stronger enterprise doctrine and represents good tax policy.

The structure of this thesis was outlined at 1.5.

Chapter 2 - Literature Review

1.1 Introduction

As indicated in Chapter 1, little literature (academic or otherwise) exists that considers in any detail the inclusion of trusts and partnerships in the Australian tax consolidation regime. Much of the academic journal literature focuses on the tax consolidation regime as it applies to companies and the issues that arise for a tax consolidated group with relatively little analysis of the position of trusts or partnerships in tax consolidated groups.[27]

There have been some higher degree research theses that have considered certain aspects of the Australian tax consolidation regime (including a comparative analysis of certain other countries consolidation regimes) but little analysis has been undertaken in relation to the inclusion of trusts and partnerships in Australian tax consolidated groups.[28]

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[27] See, for example, Paul O'Donnell and Ken Spence, 'Branch Report: Subject II, Group Taxation Australia', International Fiscal Association, Cahiers de Droit Fiscal International Volume 89b (2004); Anthony Slater and Peter Murray, 'Tax Consolidation and the Single Entity Rule' (2004) 7(4) *The Tax Specialist* 206; Teresa Dyson, 'Consolidation Issues For Financiers' (2005) 8(1) *Journal of Australian Taxation* 69; Aldrin De Zilva, 'Tax Consolidation: Key Mergers and Acquisition Issues' (2005) 8(1) *Journal of Australian Taxation* 181; Anton Joseph, 'Consolidation and Group Taxation' (2005) *Asia-Pacific Tax Bulletin* 25; Antony Ting, 'Definition of Control in Consolidation and Controlled Foreign Company Regimes: A Comparison between Australia, New Zealand and the US' (2006) 12(1) *New Zealand Journal of Taxation Law and Policy* 37; Antony Ting, 'Australia's Consolidation Regime: A Road of No Return?' (2010) 2 *British Tax Review* 162 ('A Road of No Return'); Graeme S Cooper, 'Policy Forum: A Few Observations on Managing the Taxation of Corporate Groups – The Australian Experience' (2011) 59(2) *Canadian Tax Journal* 265; Antony Ting, 'The Unthinkable Policy Option? Key Design Issues under a System of Full Consolidation' (2011) 59(3) *Canadian Tax Journal* 421 ('Key Design Issues'); Alexis Kokkinos, 'SMEs – The Forgotten Souls' (2007) 11(1) *The Tax Specialist* 12; Cameron Rider, 'Cutting Consolidation to the Core' (2007) 11(1) *The Tax Specialist* 42–54; Rob Bentley and Peter Collins, 'MEC (Multiple Entry Consolidated) groups and evolving international tax issues' (2007) 11(1) *The Tax Specialist* 4; Peter Scott, 'The Single Entity Rule: The Need to Clarify the Effects and Limits of the Cornerstone of Australia's Tax Consolidation Regime' (2020) 35(3) *Australian Tax Forum* 296; Michael Charles and Lucy Goldwater, 'Unknown Unknowns with Unconsolidated Clients' (2022) 25(4) *The Tax Specialist* 200; Norman Hanna, 'Revisiting the Scope of the Single Entity Rule' (2018) 47 *Australian Tax Review* 190; Daniel Sydes and Andrew Hirst, 'Tax Consolidation Changes' (2015) 19(1) *The Tax Specialist* 25; Simon How, 'Tax Consolidation for SMEs' (2019) 23(1) *The Tax Specialist* 2; Antony Ting and Peter Stinson, Australian Branch Report in 'A: Group Approach and Separate Entity Approach in Domestic and International Tax Law', International Fiscal Association, Cahiers de Droit Fiscal International Volume 106A (2022) 107. The following journal articles and seminar papers have, in varying detail, considered trusts and partnerships in consolidated groups: Ting, 'Policy and Membership Requirements' (n 14) 311; Mark Poole, 'Types of Consolidatable Groups and Membership (Seminar Paper, The Tax Institute, 30 October 2002); Alexis Kokkinos, 'SMEs – The Forgotten Souls' (2007) 11(1) *The Tax Specialist* 12, 25-34; Cameron Rider, 'Cutting Consolidation to the Core' (2007) 11(1) *The Tax Specialist* 42, 50–51; Adrian O'Shannessy, 'Treatment of Trusts and Partnerships Under the Consolidation Regime', (Conference Paper, Taxation Institute of Australia, Consolidation Intensive, 18 July 2003); Richard Hendriks, 'Partnerships and Trusts' (Conference Paper, Taxation Institute of Australia, 3-4 February 2003); Kseniia Gasiuk, 'Discretionary Trusts in Tax Consolidated Groups' (2023) 58(6) *Taxation in Australia* 345; Elizabeth Allen and Hayden Bentley, 'Trusts and Tax Consolidations' (Seminar Paper, Queensland Tax Forum, The Tax Institute, 29-30 May 2024). The Board of Taxation considered some aspects of trust as members of consolidated groups in its post-implementation review into certain aspects of the consolidation regime: see below (n 90) and accompanying text.

[28] See, for example, Thomas Schostok, 'Legal Policies Affecting the Initial Consolidation Decision' (Doctor of Legal Science Thesis, Bond University, 2004); Tim Sherman, 'The Introduction of the Consolidation Regime into the *Income Tax Assessment Act 1977* (Cth): An Analysis of the Effect on the Subsidiary Disposal Decision for a Corporate Group' (SJD Thesis, The University of Melbourne, 2007); Antony Ka Fai Ting, 'The taxation of corporate groups under the enterprise doctrine: a comparative study of eight consolidation regimes' (PhD Thesis, The University of Sydney, 2011); Wesley Maurice

The following analysis synthesises some of the literature, academic and otherwise, in the area of trusts and partnerships as members of tax consolidated groups and MEC groups.

2.2 Policy Justification for Trusts and Partnerships inclusion in Tax Consolidated Groups

At the time of the introduction of Australia's tax consolidation regime, the inclusion of trusts as subsidiary members of a consolidated group was considered appropriate by the Government[29] 'on the basis that income generally maintains its character as it flows through the trust to the beneficiaries or objects'. Similarly, a partnership's inclusion (other than corporate limited partnerships that are treated as companies for tax law purposes) was also appropriate since they 'are simply conduits through which amounts flow-through to the partners'.[30]

Ting[31] has criticised the 'flow-through' justification, indicating that the accumulated income in a discretionary trust does not maintain its character when finally distributed to the beneficiary and doubted 'whether the flow-through concept is a valid reason to allow trusts and partnerships to consolidate', noting that, if they are perfect flow-through entities, the consolidation regime should count the beneficiaries and partners as 'members, instead of the entities themselves'.[32] Ting[33] cites the example of contractual joint ventures,[34] that is, a joint venture between parties based on contractual terms rather than using a joint venture entity, such as a company, which are flow-throughs but are not eligible to be a member of a consolidated group.[35] In this situation, the members for tax consolidation purposes are the venturers themselves subject to their satisfaction of the eligibility requirements to be members of a consolidated group.

Hamilton-Jessop, 'Accounting for tax consolidation: An investigation into the development and associated reporting requirements under the Australian group taxation system' (MPhil Thesis, The University of Sydney, 2014).

[29] See Explanatory Memorandum, New Business Tax System (Consolidation) Bill (No 1) 2002 [3.55] ('Consolidation Bill No 1 EM').

[30] Ibid.

[31] Ting, 'Policy and Membership Requirements' (n 14) 325.

[32] Ibid.

[33] Ibid.

[34] Referred to in the tax legislation as a 'non-entity joint venture' and arises, broadly, where, under a contractual arrangement between two or more parties, an economic activity subject to the joint control of the parties is entered into to obtain individual benefits for the parties in the form of a share of the output of the arrangement rather than joint or collective profits: *ITAA 97* (n 7) s 995-1.

[35] It is perhaps appropriate that a 'non-entity joint venture' as defined in the tax legislation is not eligible (it does not satisfy the membership requirements) to be a member of a consolidated group since it is a contractual arrangement to share output of an economic activity of the contracting parties.

Ting's criticism of the 'flow-through' justification is valid. It is not particularly clear why flow-through taxation of itself justified the inclusion of trusts and partnerships in tax consolidated groups. The concept of flow-through taxation is often contrasted with entity taxation: the two principal methods for taxing the income derived through entities.[36] Broadly, under a flow-through taxation design, tax is applied at the owner level and the tax calculation is based on the owner's tax attributes. Fairly pure flow-through designs attribute both net income and losses to the owners such as occurs for the taxation of partnerships in Australia.[37] Under flow-through designs, tax preferences that arise generally flow through to the owner such as net capital gains and franking credits under Australian legislation.[38] Broadly, under an entity taxation design, tax is applied at the entity level based on the entity's attributes, but tax is also applied at the owner level, usually with some method by which double taxation is precluded (such as the imputation system in Australia).[39] Evans indicates that the Australian rules for taxing partnerships embody a fairly pure flow-through model as both net income and losses are attributed to partners and tax is only applied at the partner level.[40] Evans indicates that there are two sets of rules by which trusts are taxed in Australia. The first set[41] applies to all trusts and embody a flow-through design as amounts are allocated to beneficiaries who are 'presently entitled'[42] to a share of the 'income of the trust estate'.[43] The rules also incorporate elements of entity taxation: tax losses are trapped at the trust level, and the trustee can be taxed as a proxy in particular circumstances, including where no beneficiary has the requisite entitlement, or the beneficiary is subject to a legal disability or is a non-resident of Australia for income tax purposes.[44] The second set of rules[45] apply to a

[36] For a detailed discussion of flow-through taxation and entity taxation and their design elements see: Alex Evans, 'The Design Elements of Flow-Through Taxation' (2019) 48(1) *Australian Tax Review* 42 ('Design Elements of Flow-Through Taxation'); Alex Evans, 'The Design Elements of Entity Taxation', (2018) 47(3) *Australian Tax Review* 167.

[37] Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' (2019) 41(2) *Sydney Law Review* 217, 226-7.

[38] See below n 41 and accompanying text.

[39] Evans (n 37) 226.

[40] Ibid 227. The partnership taxation rules are contained in the *Income Tax Assessment Act 1936* (Cth) pt 3 div 5 ('*ITAA 36*'). However, for the purposes of the taxation of capital gains in relation to partnerships, broadly, the partners individually make a capital gain or loss from a 'CGT event' happening in relation to a partnership or one of its CGT assets: *ITAA 97* (n 7) s 106-5(1): see below (n 182).

[41] Contained in *ITAA 36* (n 40) pt 3 div 6 and, in relation to beneficiaries of trusts that are entitled to capital gains and franking credits included in a trust's net income, these amounts are taxed under *ITAA 97* sub-div 115-C pt 3-1 and sub-div 207-B pt 3-6, respectively.

[42] The concept of 'present entitlement' is discussed below at (n 120).

[43] The reference to 'income of the trust estate' is the income of a trust determined according to the general law of trusts and the trust deed: see below n 121 and accompanying text.

[44] Evans (n 37) 227-8.

[45] Contained in *ITAA 97* div 276.

particular type of widely held trust called the Australian managed investment trust ('AMIT').[46] The Explanatory Memorandum to the amending Bill[47] introducing the AMIT regime indicated that the attribution taxing model would provide benefits for members of an AMIT because, inter alia, the 'character flow-through' model will ensure that amounts derived or received by the trust that are attributed to members retain the character they had in the hands of the trustee for income tax purposes.[48]

Accordingly, it is not clear why flow-through taxation was necessarily seen by the Government as justifying partnerships and trusts in tax consolidated groups and, moreover, although partnerships can be seen as a 'pure flow-through' entity, the same conclusion cannot be made in respect of trusts.

As mentioned above,[49] the Government also justified the inclusion of trusts in consolidated groups on the basis that income generally maintains its character as it flows through a trust to beneficiaries. An inveterate and much debated issue in Australian taxation law has been whether income retains its character as it passes through a trust. Schabe, after analysing relevant case law, concluded 'that there is no sound jurisprudential foundation for such a general trust conduit principle'.[50]

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[46] Evans (n 37) 228.

[47] Explanatory Memorandum, Tax Laws Amendment (New Tax Business System For Managed Investment Trusts) Bill 2015 (Cth). The Bill was enacted as *Tax Laws Amendment (New Tax System For Managed Investment Trusts) Act 2016* (Cth) and effective from the 2016 income tax year.

[48] Ibid [1.15], [7.4] and [7.9]. For an analysis of the AMIT amendments see: Gary Howard, 'MIT Tax Reform' (2016) 20(1) *The Tax Specialist* 21, 23-34; Craig Marston, 'AMIT Regime, Where Are We At?'(2017) 21(1) *The Tax Specialist* 28; Karen Rooke, 'The New AMIT Regime' (Conference Paper, Annual Tax Forum, The Tax Institute, 2-3 June 2016). See also Evans, 'Design Elements of Flow-Through Taxation' (n 36) 42-3.

[49] See above n 29 and accompanying text.

[50] David Schabe, 'The Trust Conduit Principle: A Foundationless Theory?' (1999) 2(4) *Journal of Australian Taxation* 194. See also Michael Dirkis, 'Humpty Dumpty's Rule: Income Streaming and Trusts' (1995) 5(1) *Revenue Law Journal* 141 who, in relation to discretionary trusts, found no clear legislative basis for a conduit theory (that is income that passes through the trust to beneficiaries retain its character) (at 148) and concluded that 'the use of income streaming by discretionary trusts is dependent upon a concessionary course of action by the Commissioner based upon administrative action rather than clear legislative support' (at 149-150). Schabe (at 194) and Dirkis (at 148) both noted that the Commissioner of Taxation had in Taxation Ruling 'TR 92/13 - Income Tax: Distribution By Trustees of Dividend Income Under the Imputation System' (released on 5 November 1992) ruled that '[i]ncome distributed by a trustee of a discretionary trust estate retains the character it had when it was derived by the trustee unless a statue or the trust deed provides otherwise' (at [4]). The Ruling explained that the imputation provisions, in providing for the flow-on of imputation credits when dividend income derived by a trustee is distributed to a beneficiary, are consistent with the so-called 'conduit' theory of trust taxation (at [16]). The Ruling also explained that '[u]nder that theory, an amount of trust income distributed by a trustee to a beneficiary retains the character it had when it was derived by the trustee, unless a provision of the trust deed or of any relevant statute provides otherwise. There is judicial authority to support this theory: see *Syme v. C of T (Vic)* (1914) 18 CLR 519 and *FC of T v Tadcaster Pty. Ltd*. (1982) 13 ATR 245 at 249; 82 ATC 4316 at 4319.' (at [16]). Both Schabe and Dirkis rejected the existence of a general conduit theory of trust taxation, finding it had no clear legislative support. See also Sonali Walpola, 'The Taxation of Capital Gains in Trusts after Bamford: A Critical Evaluation of the Streaming Regime in

The character retention issue has arisen, directly or indirectly, in many circumstances under the taxation law with the ultimate result depending on the nature of the trust, the nature of the taxpayer's interest in the trust and the relevant taxing provision. Where, for example, an Australian resident beneficiary receives a trust distribution, the beneficiary's tax liability is determined by their share of the taxable income of the trust fund for that period.[51] There is now clear authority[52] that for income tax purposes (regardless of what the trust deed may provide) the beneficiary's share of the trust's taxable income is a share of the blended net income, that is, streaming of particular types of income to beneficiaries is not possible unless expressly provided for by legislation.[53]

Subdivision 115-C *ITAA 97*' (2020) 35(3) *Australian Tax Forum* 314, 322-3, [2.3.3]. TR 92/13 was withdrawn on 22 June 2011 on the basis that since the time of its publishing, there have been significant developments in the law relating to trusts, including the decisions in *Commissioner of Taxation v Bamford* (2010) 240 CLR 481 ('*Bamford*') and *Colonial First State Investments Ltd v Commissioner of Taxation* (2011) 192 FCR 298 (at [3]). Also, 'since TR 92/13 deals with repealed legislation and there is new legislation proposed to ensure appropriate character attribution for capital gains and franked dividends of trusts, it is no longer current and is accordingly withdrawn' (at [5]). Income character retention is possible, however, under the withholding tax provisions (contained in *ITAA 36* (n 40) pt III div 11A) under which foreign residents are taken to have derived dividend income, interest income or royalty income: *ITAA 36* s 128A(3). Pursuant to s 128A(3), a non-resident beneficiary of a trust that is 'presently entitled' to a dividend, to interest or to a royalty included in the income of a trust estate is deemed to have derived income consisting of that dividend, interest or royalty at the time when it was so entitled. It is accepted that the meaning of 'presently entitled' in s 128A(3) has the same meaning as 'presently entitled' contained in *ITAA 36* s 97(1): see *ABB Australia Pty Ltd v Federal Commissioner of Taxation* (2007) 162 FCR 189, 228-9 [180]-[185] (Lindgren J); Income Tax Ruling IT 2680 'Income Tax: Withholding Tax Liability of Non-resident Beneficiaries of Australian Trusts' [11]. The meaning of 'presently entitled is considered below at (n 120). Income character retention is also possible under the AMIT regime: see above nn 45-8 and accompanying text.

[51] Broadly, the taxable income (referred to as 'net income': *ITAA 36* s 95(1)) of a trust is allocated to 'presently entitled' beneficiaries on a proportional basis, according to their proportionate share of income of the trust for trust law purposes: *ITAA 97* s 97(1). See *Bamford* (n 50) 507-8.

[52] *Bamford* (n 50); *Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134; *Peter Greensill Family Co Pty Ltd (Trustee) v Commissioner of Taxation* (2021) 285 FCR 210. In Income Tax Determination TD 2012/22 the Commissioner of Taxation accepts that beneficiaries are assessed 'on a proportionate share of the totality of the net income...', at [79]. This position is statutorily altered for capital gains and franking credits which can be streamed to beneficiaries under sub-div 115-C of pt 3-1 and sub-div 207-B of pt 3-6 of the *ITAA 97* (n 7). For an analysis of these provisions and their complexities see: Brett Freudenberg and Dale Boccabella, 'Streaming of Franking Credits Curtailed by Bamford-Induced Amendments – An Unintended Consequence?' (2019) 48(3) *Australian Tax Review* 190; Dale Boccabella, 'Net Capital Gains of Trusts: A Systematic Method of Allocating Those Gains and Other Taxable Income and Analysis of Problematic and Anomalous Issues' (2018) 47(2) *Australian Tax Review* 128; Dale Boccabella, 'Franked Distributions of Trusts: Systematic Method of Allocating Them and other Taxable Income, with Analysis of Defective Provisions' (2021) 36 *Australian Tax Forum* 277; Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' 41(2) (2019) *Sydney Law Review* 217; Sonali Walpola, 'The Taxation of Capital Gains in Trusts after Bamford: A Critical Evaluation of the Streaming Regime in Subdivision 115-C ITAA97' (2020) 35(3) *Australian Tax Forum* 314; Ann Kayis-Kumar and C John Taylor, 'The Application of Capital Gains to Trusts: Conceptual, Technical and Practical Issues, and a Proposal for Reform' (Conference Paper, Australasian Tax Teachers Association, 16-18 January 2019); Ken Schurgott, 'Practical Issues with Trusts: Important Updates' (2016) 20(1) *The Tax Specialist* 2, 4.

[53] See above (n 52) for the legislative provisions that apply in respect of the streaming of capital gains and franking credits.

The Government also justified the inclusion of partnerships and trusts in consolidated groups since those entities had formed 'part of the ownership structure' of wholly owned groups that had hitherto been able to access certain tax concessions.[54]

Ting[55] suggested that the above justification, the 'historical reason', seems 'illogical' and he indicates that the concessions applied to companies, not trusts or partnerships, but that the existence of trusts or partnerships in the ownership chain did not disentitle the companies in the wholly owned group to the concessions. Ironically, the benefits[56] of the tax consolidation regime can now be accessed by partnerships and trusts that previously were not available to them under the former grouping concessions.

Historically, as initially proposed under business tax reform, the inclusion of trusts within a consolidated group was on the basis that trusts were to be taxed like companies. Partnerships, except limited partnerships, were not included in the entity regime or the tax consolidation regime as originally proposed. Chapter 5 outlines the history of business tax reform in Australia and the initial proposal for almost all trusts to be included in the proposed tax consolidation regime on the basis of a proposed 'consistent entity' regime (or 'entity taxation' regime) that would have taxed trusts as companies. Gradually, as outlined in Chapter 5, upon further consideration and consultation, the entity taxation reform proposal was amended including some entities (such as fixed trusts) remaining outside the entity taxation regime. Ultimately the Government abandoned the entity taxation proposal and the tax consolidation rules were further developed with trusts and partnerships being included within consolidated groups and MEC groups by the time the tax consolidation regime was first enacted.

The above discussion suggests that the stated policy justifications for the inclusion of trusts and partnerships in Australian tax consolidated groups are unconvincing, with some only partly correct in fact. Historically, trusts were initially included in a consolidated group by reason of the proposal to tax them as companies under the proposed entity taxation regime. Initially, it was not intended that partnerships would be eligible to join a consolidated group.

[54] Consolidation Bill No 1 EM (n 29) [3.56]. The tax concessions included the transfer of tax losses between group companies, capital gains tax roll-over relief for certain intra-group asset transfers and inter-company dividend rebates.
[55] Ting, 'Policy and Membership Requirements' (n 14) 325.
[56] For example, the potential reset of the cost base of assets for tax purposes and ignoring transactions (for example, asset transfers, loans, distributions) between members within the consolidated group pursuant to the SER.

Whether or not the inclusion of trusts and partnerships in Australian tax consolidated groups can be defended on other policy grounds is considered in chapter 10.[57] Also, it is necessary to consider whether the inclusion of trusts and partnerships is otherwise justified by reason of promoting a stronger enterprise doctrine which is also discussed in chapter 10.[58]

2.3 Trusts within consolidated groups: classification issues

A requirement ('trust requirement') for a trust to be a subsidiary member of a consolidated group is that it must come within the meaning of 'trust' within the legislative provisions.[59] A 'trust' is included in the definition of 'entity' for the purposes of the *ITAA 97*.[60] Since the term 'trust' is not defined in the *ITAA 97*, it is necessary to determine its meaning for the purposes of the *ITAA 97*. Statutory interpretation or construction is the process governed by both the common law and relevant statute law applying to the interpretation of legislation,[61] by which the meaning (often referred to as the 'legal meaning')[62] of the language or text of a statute is determined.

The modern approach to statutory interpretation considers the meaning of a word or words in a statute having regard to their context and purpose.[63] It has been recently reiterated by the High Court that the 'language which has been actually used in the text, in light of its context and purpose, is the surest guide to legislative intent'.[64] Context is used in its widest sense and includes the existing state of the law and the mischief which the statute was intended to remedy, both of which can be ascertained by considering appropriate extrinsic

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[57] Cooper provides an interesting analysis from a tax policy perspective on Australia's move from an 'aggregation' system for corporate taxation represented in part by the wholly owned group concessions for corporate groups to an aggregation system represented by Australia's tax consolidation regime: Graeme S Cooper, 'Policy Forum: A Few Observations on Managing the Taxation of Corporate Groups – The Australian Experience' (2011) 59(2) *Canadian Tax Journal* 265.

[58] The enterprise doctrine is discussed in Chapter 3.

[59] *ITAA 97* (n 7) s 703-15(2)(b), column 2, item 2 of the table. The trust requirement is in addition to an Australian residence requirement and an ownership requirement (see *ITAA 97* s 703-15(2)(b), columns 3 and 4, item 2 of the table). There are similar requirements in relation to trusts within a potential MEC group: see *ITAA 97* s 719-10(1)(b)(i), columns 1, 2 and 3 of the table.

[60] *ITTA 97* s 960-100(1)(f). The meaning of 'trust' in s 703-15(2)(b), column 2, item 2 of the table of the *ITTA 97* should be the same as the meaning of 'trust' in s 960-100(1)(f) of the *ITTA* 97 as they both refer to trusts as an entity for the purposes of the *ITTA 97*.

[61] For Commonwealth legislation, the interpretation statute is the *Acts Interpretation Act 1901* (Cth).

[62] *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 384 (McHugh, Gummow, Kirby and Hayne JJ); *Taylor v The Owners – Strata Plan No 11564* (2014) 253 CLR 531, 557-8 (Gageler and Keane JJ).

[63] *ENT19 v Minister for Home Affairs (*2023) 278 CLR 75, 105-6 [86] –[87] (Gordon, Edelman, Steward and Gleeson JJ); *Port of Newcastle Operations Pty Ltd v Glencore Coal Assets Australia Pty Ltd* (2021) 274 CLR 565, 593-4; *SAS Trustee Corporation v Miles* (2018) 265 CLR 137, 149 [20] (Kiefel CJ, Bell and Nettle JJ), 157 [41] (Gageler J), 162-3 [64] (Edelman J); *Momcilovic v The Queen* (2011) 245 CLR 1, 52 [56] (French CJ), 92 [170] (Gummow J), 123 [280] (Hayne J agreeing with Gummow J), 175-6 [441]–[443] (Heydon J), 210 [544] (Crennan and Kiefel JJ); *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 381.

[64] *DZY (a pseudonym) v Trustees of the Christian Brothers* [2025] HCA 16 [23] (Gageler CJ, Gordon Eelman and Gleeson JJ).

materials (including reports of law reform bodies and parliamentary materials).[65] The purpose of legislative provisions is also examined by considering relevant extrinsic materials.[66]

It is not relevant that the statute being construed is a revenue raising statute, that is, the statutory interpretation principles do not differ because the statute being interpreted is a revenue raising statute.[67] Often the legal meaning will accord with the literal or grammatical meaning of the word or words but not always. Another meaning may, taking into account the context, the purpose of the legislation and the consequences of the grammatical meaning, be reasonably open which requires the words to be construed in a way that does not correspond to their literal or grammatical meaning.[68] Also, where the text read in context permits of more than one potential meaning, the choice of those meanings may eventually turn on an evaluation of the relative coherence of each with the scheme of the statute and its identified objects or policies.[69]

However, if the word used in a statute has acquired a technical legal meaning, it is assumed that the legislature has intended it to have that meaning unless a contrary intention is evinced from the context.[70] It is submitted that, taking into account the context and purpose of the legislative provisions,[71] the word 'trust' is used in its technical legal sense and its meaning for

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[65] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 408 (Brennan CJ, Dawson, Toohey and Gummow JJ); *Harvey v Minister for Primary Industry and Resources* (2024) 278 CLR 116, 160-1 [111] (Edelman J). See, generally, Jacinta Dharmananda, 'Outside the Text: Inside the Use of Extrinsic Materials in Statutory Interpretation' (2014) 42(2) *Federal Law Review* 333 and Jacinta Dharmananda, 'Using Parliamentary Materials in Interpretation: Insights from Parliamentary Process' (2018) 41(1*) University of New South Wales Law Journal* 1.

[66] *Minister for Immigration and Citizenship v SZJGV* (2009) 238 CLR 642, 649 (French CJ and Bell J); *Lacey v Attorney General (Qld)* (2011) 242 CLR 573 [45] (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ). Section 15AA of the *Acts Interpretation Act 1901* (Cth) requires that, in interpreting a provision of a Commonwealth Act, the interpretation that would best achieve the purpose or object of the Act is to be preferred to each other interpretation.

[67] *Carr v Western Australia* (2007) 232 CLR 138,143 [6] (Gleeson CJ); *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27, 49 [57] (Hayne, Heydon, Crennan and Kiefel JJ); *Sunlite Australia Pty Ltd v Federal Commissioner of Taxation* (2023) 296 FCR 600, 602 [6] ('*Sunlite Australia*').

[68] *R v A2* (2019) 269 CLR 507, 521 (Kiefel CJ and Keane J), 545 (Bell and Gageler JJ); *Mondelez Australia Pty Ltd v Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union* (2020) 94 ALJR 818, 838 (Edelman J).

[69] *SAS Trustee Corporation v Miles* (2018) 265 CLR 137, 149 (Kiefel CJ, Bell and Nettle JJ), [41]; *Taylor v Owners - Strata Plan No 11564* (2014) 253 CLR 531, 557 (Gageler and Keanne JJ); *SZTAL v Minister for Immigration and Border Protection* (2017) 262 CLR 362, 375 (Gageler J).

[70] *Webb v McCracken* (1906) 3 CLR 1018, 1027–8 (O'Connor J); *Attorney-General (NSW) v Brewery Employees Union of New South Wales* (1908) 6 CLR 469, 531 (O'Connor J); *Bathurst City Council v PWC Properties Pty Ltd* (1998) 195 CLR 566 (Gaudron, McHugh, Gummow, Hayne and Callinan JJ); *Palgo Holdings Pty Ltd v Gowans* (2005) 221 CLR 249, 261; Wik Peoples v Queensland (1996) 187 CLR 1, 151 (Gaudron J). See also DC Pearce, Statutory Interpretation in Australia (LexisNexis, 10th ed, 2024) 180-3 [4.31]-[4.34] and Perry Herzfeld and Thomas Prince, Statutory Interpretation Principles (Thomson Reuters, 2nd ed, 2021) 39-40 [2.170].

[71] The meaning of 'trust' in its technical legal sense is not inconsistent with the references to 'trust' in the Consolidation Bill No 1 EM (n 29) which introduced the consolidation regime into the *ITAA 1997*. The references to 'trust' at [3.55]-[3.56] and [3.60]-[3.61] of the Consolidation Bill No 1 EM are consistent with the meaning of trust according to its technical legal meaning. The Consolidation Bill No 1 EM is relevant extrinsic material that can be taken into account in considering context and purpose: see above nn 63-6 and accompanying text.

the purposes of the trust requirement in the tax consolidation legislation should be governed by its technical legal meaning under the general law of trusts.[72] The word 'trust' is a term, originating in medieval England and the Court of Chancery,[73] that describes the relationship between a trustee and a beneficiary in respect of property. A trust exists 'when the owner of a legal or equitable interest in property is bound by an obligation, recognised by and enforced in equity, to hold that interest for the benefit of others, or for some object or purpose permitted by law.'[74]

Although a trust is not a legal person,[75] it is included in the definition of 'entity' for the purposes of the *ITAA 97*.[76] The Full Federal Court in *Sunlite Australia Pty Ltd v Commissioner of Taxation*[77] noted that the definition of entity in s 960-100(1) included legal persons, such as a company or an individual, and also included particular types of legal relationships, such as a partnership or a trust, which are not separate persons nor have separate legal personality.[78] Slater has criticised this legislative drafting, that is, the inclusion of the term 'trust', which describes 'a relationship among trustee, property and beneficiary or purposes',[79] within the definition of an entity.

[72] The general law of trusts has often been used by the Courts to determine the meaning of provisions of the Australian income tax legislation. For example, French notes that the High Court in *Bamford* (n 50) 505 held that the phrase 'income of a trust estate' in s 97(1) of the *ITAA 97* (n 7) was to be understood according to the general law of trusts: Robert French, 'Trusts and Statutes' (2015) 39(2) *Melbourne University Law Review* 629, 640. The High Court in *Bamford* also held that the language of 'present entitlement [in *ITAA 97* s 97(1)] is that of the general law of trusts': 505 [37] (French CJ, Gummow, Hayne, Heydon and Crennan JJ). Also, in *Bamford* the High Court said the references to 'a trust estate' and a 'beneficiary' in s 97(1) 'bespeaks the general law of trusts': 505 [38]. In *Frigger v Trenfield (No 3)* [2023] FCAFC 49 the Full Federal Court held that '[d]espite the regulatory framework established by the *Superannuation Industry (Superannuation) Regulations 1994* (Cth) and the *Superannuation Industry (Supervision) Act 1993* (Cth), the general law of trusts has a significant role to play in the regulation of superannuation funds. This is because many superannuation funds continue to be constituted by way of a trust deed, with the result that the general law of trusts applies to them': [241] (Allsop CJ, Anderson and Feutrill JJ).

[73] See Michael Evans, Theresa Power and Joseph Power, *Equity & Trusts* (LexisNexis, 5th ed, 2024) 9–11 [1.11]–[1.17] for a brief history of the origin of trusts. See also French (see above (n 72)), 635–38; David J Seipp, 'Trust and Fiduciary Duty in the Early Common Law' (2011) *Boston University Law Review* 1011, 1011–18; Geoffrey Nettle, 'Trust and Commerce in Historical Perspective' (2021) 15 *Journal of Equity* 2, 7-11 and Mark Leeming, 'Trusts and Trustees: Their Successes and Successors' (2023) 53 *Australian Bar Review* 97, 100–105.

[74] JD Heydon and ML Leeming, *Jacobs' Law of Trusts in Australia* (LexisNexis Butterworths, 8th ed, 2016) ch 1 [1-01]. See also, Mark Leeming, 'What is a Trust?' (2009) 7 *Trusts Quarterly Review* 5.

[75] Ibid.

[76] *ITTA 97* s 960-100(1)(f).

[77] (2023) 296 FCR 600.

[78] Ibid 604 [16] (Colvin, O'Sullivan and Feutrill JJ). The Note at the end of *ITAA 97* s 960-100(1) indicates, perhaps not with clarity, that the term entity 'covers all kinds of legal persons... [and] groups of legal persons, and other things, that in practice are treated as having a separate identity as a legal person does.'

[79] AH Slater QC, 'Unit Trusts: Law and Lore' (2006) 35 *Australian Tax Review* 185, 186.

Slater notes that a trust 'is not the trustee, nor the trust property, nor the beneficiary, nor any aggregation of them; it is not a thing or person, but a relationship …'.[80]

The issue arises as to whether a trust that is within the definition of 'entity' should be regarded, in effect, as a statutory 'personification' of the general law trust concept. The trustee of a trust in its trustee capacity is an 'entity' for the purposes of the *ITAA 97*.[81] A legal person, to the extent that they have different capacities, is a separate entity in respect of each of those capacities.[82] Thus, a company that is the trustee of a trust is an entity in its own right as a company[83] and is also an entity in its capacity as a trustee. Where a provision of the *ITAA 97* refers to an entity of a particular kind, it refers to the entity in its capacity as that kind of entity and not in any other capacity.[84] The example at the end of s 960–100(4) of the *ITAA 97* provides that a 'provision that refers to a company does not cover a company in a capacity as trustee, unless it also refers to a trustee.'

From the above discussion, it can be concluded that it is a 'trust' (not the trustee) within the general law of trusts concept that is an entity under s 960-100(1)(f) of the *ITAA 97* and that it is also a 'trust' within the general law of trusts concept that satisfies the trust requirement in the tax consolidation provisions.[85] For tax consolidation purposes it is the trust and not the trustee that is potentially[86] eligible to be a subsidiary member.[87] The trustee of a trust is an 'entity' in its trustee capacity and is also an entity in its own right (for example, as a company[88] or an individual[89]).

Issues arise under tax consolidation by reason of a trust being the entity which is a member of a tax consolidated group but the trustee that (legally) owns the assets of the trust in its

[80] Ibid.

[81] *ITAA 97* (n 7) s 960-100(2). The Full Federal Court in *Sunlite Australia* (n 67) 607, [36]–[37] said that s 960-100(2) does not have the effect that in the case of a trust, the trustee is the relevant entity, rather in the case of a trust the trustee is also an entity, that is, there is not a single entity comprising the trust and the trustee.

[82] Ibid s 960-100(3).

[83] Ibid s 960-100(1)(b).

[84] Ibid s 960-100(4).

[85] See above nn 59-60 and accompanying text.

[86] The Australian residence requirement and the ownership requirement also need to be satisfied for the trust: see above (n 59).

[87] Whether the entity that is the trustee of a trust is eligible to qualify as a subsidiary member of a consolidated group will depend on whether it satisfies the membership requirements in *ITAA 97* s 703-15(2)(b) item 2 column 2.

[88] Ibid s 960-100(1)(b).

[89] Ibid s 960-100(1)(a).

trustee capacity may not be a member of the consolidated group. The implications and desirability of only allowing a trust to be a member of a consolidated group as distinct from a trust and the trustee of that trust has been the subject of consideration in the literature.

Membership of consolidated groups by trusts was an issue considered, inter alia, by the Board of Taxation ('Board') as part of its post-implementation review ('Review') into certain aspects of the consolidation regime.[90]

As part of its Review the Board raised for consideration, inter alia, the issue of the membership of trusts in consolidated groups. In its discussion paper[91] ('Discussion Paper'), the Board raised the question whether the trustee of a trust also needed to be a member of the consolidated group that included that trust as a member.[92] In relation to this question, the Discussion Paper indicated that it was unclear how the single entity rule applied to income tax provisions that operate on the basis of legal ownership and raised issues concerning the workability of certain provisions of the tax legislation (such as the decline in value and the CGT provisions) which operate on the basis of legal ownership of assets which rests with the trustee.[93] Additionally, concern was raised with the operation of the tax cost setting rules upon a trust joining or leaving a consolidated group where the assets and liabilities are those of the trustee but not the trust.[94]

From the analysis above, it was concluded that it is trusts within the general law of trusts concept that are potentially[95] eligible to be subsidiary members of a consolidated group. That potential eligibility of the trust to be a member of a consolidated group is not affected by whether the trustee is a member of the consolidated group. A trustee of a trust that is an Australian resident company may be eligible to join a consolidated group in its entity capacity

[90] On 3 June 2009 the Assistant Treasurer, The Hon Chris Bowen, announced that the Board of Taxation would undertake a post-implementation review of certain aspects of the consolidation regime including the interaction between the consolidation provisions and other parts of the income tax law: Assistant Treasurer, Department of The Treasury (Cth), 'Board of Taxation to Conduct Two Post Implementation Reviews', Media Release, 058, 3 June 2009.

[91] The Board of Taxation, *Post-Implementation Review into Certain Aspects of the Consolidation Regime*, Discussion Paper, December 2009 ('Discussion Paper').

[92] Ibid 38, question 4.3(a).

[93] Ibid 4.27.

[94] Ibid 4.28.

[95] The Australian residence requirement and the ownership requirement also need to be satisfied for the trust: see above (n 59).

as a company if it is a wholly owned subsidiary of the head company[96] otherwise the trustee company remains outside the consolidated group. The ownership requirement[97] for trusts necessitates that all beneficiaries (other than nominees)[98] of a trust are required to be subsidiary members of the consolidated group otherwise the wholly-owned requirement will not be satisfied.[99]

The Board in its Position Paper[100] ('Position Paper'), after receiving submissions from stakeholders to its Discussion Paper, considered that a trustee, in its capacity as a trustee of a trust that was a member of a consolidated group, should be treated as a member of the same consolidated group as the trust.[101] This position had not been favoured by some stakeholders in their submissions to the Discussion Paper. For example, the Corporate Tax Association and Minerals Council of Australia joint submission[102] raised the issue of a trustee that was the trustee of more than one trust and that some trusts had an individual as a trustee which would preclude the trust from being a member of a consolidated group.[103] Other submissions noted that there were technical difficulties with the legislative provisions due, primarily, to the trustee (legally) owning the relevant assets but only the 'trust' being a consolidated group member and recommended legislative clarification.[104]

[96] *ITAA 97* (n 7) s 703-15(2)(b), column 4, item 2 of the table.
[97] Ibid.
[98] Nominees holding membership interest in a trust cannot be subsidiary members but can be an interposed entity between members: *ITAA 97* s 703-45.
[99] It is noted that in respect of a trust, a member is a 'beneficiary, unitholder, or object of the trust' (*ITAA 97* s 960-130(1), item 3) and their interest in, or in relation to, the trust by virtue of being a member is a 'membership interest' in the trust (*ITAA 97* s 960-135). Although the term 'beneficiary' would usually include a discretionary object under a discretionary trust (see *Kafataris v Deputy Commissioner of Taxation* (2008) 172 FCR 242, 250 (Lindgren J); Mark Leeming, 'Chameleon-Hued Words: A Note on Discretionary Trusts' (2015) 89 *Australian Law Journal* 371, 373) and a unitholder under a unit trust, the definition of member in relation to trusts expressly includes a beneficiary, a unitholder and an object, presumably out of abundant caution.
[100] The Board of Taxation, *Post-Implementation Review into Certain Aspects of the Consolidation Regime*, Position Paper, October 2010 ('Position Paper').
[101] Position Paper (n 100) 45 Position 4.4.
[102] Corporate Tax Association and Minerals Council of Australia, Submission to The Board of Taxation, *Post-Implementation Review into Certain Aspects of the Consolidation Regime* (12 March 2010) 18 <https:taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/08/Corporate_Tax_Assoc_and_MCA.pdf>.
[103] Position Paper (n 100) 44, [4.24].
[104] See, for example, the submission by BDO (Australia) Limited, 5 March 2010, 4-5 <https:taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/08/BDO_Australia_Limited.pdf>.

Submissions to the Position Paper reiterated the view that a trustee should not be a member of a consolidated group only because the relevant trust was a member of the group and many were of the view that the issue could be clarified by legislative amendment.[105]

The Board in its Report[106] to Government recommended that the tax consolidation law should be amended to clarify that 'a trustee, in its capacity of trustee of a trust that is a member of a consolidated group, will be treated as a member of the same consolidated group as the trust', and that 'a change in trustee will not result in a trust joining or leaving a consolidated group'.[107] The Board's justification for the legislative amendment was based on uncertainty about the operation of the current law and its desire that legislation under review should be 'expressed in a clear, simple, comprehensible and workable manner.'[108]

Although the Government agreed in principle to the Board's recommendation,[109] the amendment remains unlegislated.[110]

2.4 Trusts joining or leaving a consolidated group during an income year

Complex interaction[111] issues arise where a trust either joins[112] or leaves[113] a consolidated group during an income year such that it is a member of a consolidated group (or MEC group) for part of an income year and not a member of a consolidated group for another part of the income year.

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105 See, for example, submissions by Ernst & Young, 3 December 2010, 15 <https:taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/08/Ernst_and_Young.pdf)>; Institute of Chartered Accountants in Australia, 8 December 2010, 14–15 <https:taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/08/ICAA_and_TIA_2.pdf>; Minerals Council of Australia and the Corporate Tax Association, 30 November 2010, 17 <https:taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/08/CTA_and_MCA.pdf>.

106 See above (n 9).

107 Report (n 9) 59 Recommendation 5.3.

108 Ibid 58 [5.20].

109 Assistant Treasurer, The Department of the Treasury (Cth), 'The Board of Taxation's Review of the Consolidation Regime', Press Release, 068, 14 May 2013 ('Assistant Treasurer's May 2013 Press Release')

110 See Wayne Plummer, 'Tax Consolidation Update: Still Grappling with These Rules?' (2016) 19(5) *Tax Specialist* 214.

111 The interaction is between the consolidation legislative provisions and the taxation of trust legislative provisions in the period of the income year that the trust is a member of a consolidated group and in the period of the income year that the trust is not a member of the consolidated group.

112 This may occur, for example, if the head company ('HC') of a tax consolidated group ('TCG') and/or subsidiary members of the TCG acquire all the membership interests in the Trust, or the HC and/or subsidiary members of the TCG acquire further membership interests in the Trust, with the consequence that the Trust becomes wholly owned (within the meaning of *ITAA 1997* (n 7) s 703-30) by the HC.

113 This may occur, for example, if the HC and/or subsidiary members of the TCG dispose of all their membership interests in the Trust, or HC and/or subsidiary members of the TCG dispose of some but not all of the membership interests in the Trust, with the consequence that the Trust ceases to be wholly owned by the HC and therefore ineligible to be a subsidiary member of the TCG.

Absent the tax consolidation regime, the taxation of trusts is, for the most part,[114] governed by the provisions in Division 6 of Part III of the *Income Tax Assessment Act 1936* (Cth) ('*ITAA 36*'). Broadly, pursuant to Division 6, the 'net income'[115] of a trust (referred to in Division 6 as a 'trust estate') is determined which is the trust's total assessable income less all allowable deductions (determined as if the trustee were an Australian resident taxpayer). The trustee is subject to tax[116] on any part of the net income of an Australian resident trust that is not included in the assessable income of a beneficiary[117] or otherwise assessed to the trustee.[118]

Where an Australian resident beneficiary (who is not under a legal disability)[119] is 'presently entitled'[120] to a share of a trust's trust income, which is determined according to trust law principles and the terms of the trust,[121] the beneficiary must include in their assessable income a proportion of that trust's 'net income'.[122] The phrase 'is presently entitled to a share of the income of the trust estate' is directed to the position existing immediately before the end of the income year for the purposes of identifying the beneficiaries who are to be assessed in relation to the income of the trust.[123] The proportion of 'net income' to be included in the beneficiary's assessable income is equal to the proportion that the amount of 'trust income' to which the beneficiary is entitled bears to total trust income.[124]

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114 An exception is in relation to beneficiaries of trusts that are entitled to capital gains and franking credits included in a trust's net income: these amounts are not taxed under Division 6 of Part III of the *ITAA 36* (n 40) but under sub-div 115-C of pt 3-1 and sub-div 207-B of pt 3-6 of the *ITAA 97* (n 7), respectively.

115 *ITAA 36* (n 40) s 95(1) (definition of 'net income').

116 Ibid s 99A(4). A tax rate of 45% applies to net income subject to tax under s 99A(4): *Income Tax Rates Act 1986* (Cth) s 12(9) ('*Rates Act*').

117 Ibid s 97.

118 Ibid ss 98 and 99.

119 A beneficiary is under a legal disability if they cannot give the trustee an immediate valid discharge for the trust distribution such as a person that is under 18 years of age, is an undischarged bankrupt, or is lacking mental capacity: see *Taylor v Commissioner of Taxation* (1970) 119 CLR 444,452 (Kitto J); *Harmer v Commissioner of Taxation* (1989) 91 ALR 550, 564 (French J).

120 Broadly, a beneficiary is presently entitled to trust income where it has an interest in the income of the trust which is vested both in interest and in possession and has a present legal right to demand and receive payment of that income: *Federal Commissioner of Taxation v Carter* (2022) 274 CLR 304, 313-314 [19]–[20] (Gageler, Gordon, Steward and Gleeson JJ) ('*Carter*'). See also *Bamford* (n 50) 505 [37] (French CJ, Gummow, Hayne, Heydon and Crennan JJ) ; *Harmer v Federal Commissioner of Taxation* (1991) 173 CLR 264, 271. For an analysis of the general law meaning of vested and contingent interests, mere expectancies and indefeasibly see: John V Edstein, 'Superannuation Funds: A Beneficiary's Interest and Accrued Benefits' (2010) 13(3) *The Tax Specialist* 122, 124-127; *Dwight v Commissioner of Taxation* (1992) 37 FCR 178, 192 (Hill J). For an analysis of the meaning of 'present entitlement' within *ITAA 36* pt 3 div 6 including deemed 'present entitlement' in *ITAA 36* s 95A(2) see Alex Evans, 'Dispelling the Urban Myth Around s 95A(2)' (2012) 41(4) *Australian Tax Review* 173.

121 *Bamford* (n 50) 506 [39].

122 *ITAA 36* s 97(1)(a)(i).

123 *Carter* (n 120) 313 [19] (Gageler, Gordon, Steward and Gleeson JJ).

124 *Bamford* (n 50) 507-8.

A trust, whilst a subsidiary member of a consolidated group, is treated for the 'head company core purposes'[125] and the 'entity core purposes'[126] as part of the head entity rather than as a separate entity[127] with the consequence that income and expenses of the trust are taken to be those of the head entity and therefore Division 6 does not operate in respect of the trust whilst the trust is a member of the tax consolidated group. However, for those periods, including part of an income year, that a trust is not a member of a consolidated group, Division 6 operates to determine tax liability of the beneficiaries and trustee in respect of the net income of the trust.

The issue ('part year issue') arises for a trust that joins or leaves a tax consolidated group within an income year of how to calculate the trust's net income for a period ('non-membership period') in which it is not a member of the consolidated group and the determination of the liability of the beneficiaries to tax in respect of that net income for the non-membership period. It is not clear under the current law as to how the net income for the non-membership period is allocated to the beneficiaries and trustee which is discussed below.

Broadly, the consolidation provisions provide that for a non-membership period in an income year, the net income of the trust for that non-membership period is to be determined as if the start and end of the non-membership were the start and end of the income year.[128] Income and expense items being, where appropriate, allocated to the non-membership period and the period (membership period) that the trust was a subsidiary member of the consolidated group, or apportioned among those periods in the event that direct allocation was not appropriate.[129] However, these consolidation provisions do not make reference to 'trust income' or the present entitlement of beneficiaries to it in the non-membership period: these integers are required to be ascertained to determine a beneficiary's or trustee's tax liability under Division 6. The proportion of trust income that a beneficiary is presently

125 *ITAA 97* (n 7) s 701-1(2).
126 Ibid s 701-1(3).
127 Ibid s 701-1(1). This is the 'single entity rule' ('SER') which, pursuant to a statutory fiction, treats a subsidiary member of a consolidated group as part of the head entity rather than a separate entity for certain purposes including for the purpose of determining the head company's liability for income tax for the income year in which the subsidiary member is a member of the consolidated group. See also *ITAA 97* s 701-1(2).
128 Ibid s 701-30(3)(a) as applicable to trusts by operation of s 701-65.
129 Ibid s 701-30(3)(c) as applicable to trusts by operation of s 701-65.

entitled to in the non-membership period determines their share of the net income upon which the beneficiary is subject to tax. Where a part of the net income of the trust is not subject to tax in the hands of the beneficiaries, the trustee is subject to tax.[130] It would have been expected that the legislation would have expressly dealt with the issues of 'trust income' and 'present entitlement' to that trust income in a non-membership period rather than just deal with the determination of net income in that period.

It is also unclear as to whether the net income of the trust as determined under the consolidation provisions mentioned above in a non-membership period is relevant for a trustee of the trust that is outside the consolidated group, that is, does Part 3-90 of the *ITAA 97* have application to determine the net income of the trust in respect of which the trustee is subject to tax where the trustee is outside the consolidated group. This is an unresolved issue.

Further uncertainty in relation to the part year issue arises under Subdivision 716-A of the *ITAA 97*. Subdivision 716-A applies, inter alia, where an entity that is a beneficiary of a trust joins or leaves a consolidated group part way through an income year and would, but for consolidation, have included its share of the net income of the trust in its assessable income.[131]

Where Subdivision 716-A applies, the assessable income of a beneficiary for the beneficiary's non-membership period is worked out as its share[132] of the trust's assessable income and deductions that are attributable to the beneficiary's non-membership period.[133] The assessable income of the head company includes the beneficiary's share of the trust's assessable income and deductions that are attributable to any period when the beneficiary was a member of the group but the trust was not.[134] The provisions apportion assessable income and deductions rather than net income so that the amount recognised by the beneficiary for its non-membership period and by the head company for the beneficiary's membership period properly reflects the income and deductions position of the trust for that

130 *ITAA 36* (n 40) s 99A(4).
131 *ITAA 97* (n 7) s 716-75(c).
132 A beneficiary's share of the assessable income (and deductions) of the trust is the percentage interest of the trust income to which the beneficiary is presently entitled: *ITAA 97* s 716-90(2).
133 *ITAA 97* s 716-85.
134 Ibid s 716-80.

particular period in the income year.[135] If the apportionment were made on the basis of the trust's net income, the income would effectively be spread evenly over the whole income year which may not accurately reflect the beneficiary's appropriate entitlement for a particular period within the income year.[136]

On 8 May 2007, the Minister for Revenue and the Assistant Treasurer announced measures to improve the income tax law affecting consolidated groups and MEC groups.[137] One of the measures was that the 'consolidation and trust provisions would be modified to interact appropriately where a trust is a member of a consolidated group or MEC group for part of the income year, with effect from the commencement of the 2007-08 income year. The amendments will ensure that the beneficiaries of a trust that joins or leaves a group part way through the trust's income year will be taxed on an appropriate share of the income of the trust.'[138]

The part year issue had been the subject of discussion at a meeting of the National Tax Liaison Group ('NTLG')[139] held on 15 March 2006.[140] The issue was also the subject of a detailed Discussion Paper prepared by the ATO (although expressed not to necessarily represent its views) in relation to the consideration of the part time issue by the Consolidation Sub-Committee of the NTLG at its meeting on 28 June 2007.[141]

The part year issue was outlined by Kokkinos[142] and Rider.[143] Both authors raised the same concerns as described above in relation to the interaction of the consolidation provisions and

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135 The apportionment of the trust's assessable income and deductions for a period in an income year is based on those amounts of assessable income and deductions that are reasonably attributable to the period and a percentage (worked out on a daily basis) of such amounts that are not reasonably attributable to a particular period in the income year: *ITAA 97* (n 7) ss 716-80, 716-85.

136 See Explanatory Memorandum, New Business Tax System (Consolidation and Other Measures) Bill (No 1) 2002 (Cth) 122, [4.28]-[4.31].

137 The Hon Peter Dutton, Minister for Revenue and the Assistant Treasurer, The Department of the Treasury (Cth), 'Improving the Income Tax Law for Consolidated Groups' ('Media Release 8 May 2007').

138 Ibid Attachment.

139 The NTLG is one of the Stewardship groups operated by the ATO as a means of improving taxpayer experience and administration of Australia's taxation, superannuation and registry systems. The NTLG discusses systemic or strategic matters regarding, inter alia, the administration of tax policy, implementation of new measures and associated law design process, interpretation or application of the law and its evolution or development, the administration of the tax and superannuation laws and compliance with those laws. See the composition of the NTLG and the various matters which it discusses at <https://www.ato.gov.au/about-ato/consultation/consultation-groups/stewardship-groups/national-tax-liaison-group>.

140 See the minutes of meeting at <https://www.ato.gov.au/law/view/document?docid=rtf/ntlg20060315>.

141 See the minutes of meeting at <https://www.ato.gov.au/law/view/document?docid=rtf/ntlg20070628>.

142 Alexis Kokkinos, 'SMEs – The Forgotten Souls' (2007) 11(1) *The Tax Specialist* 13, 31–32.

143 Cameron Rider, 'Cutting Consolidation to the Core' (2007) 11(1) *The Tax Specialist* 43, 50–51.

the taxation of trusts provisions where a trust (or a beneficiary) is a member of a consolidated group for only part of a year.

Following a review of unenacted tax measures of the previous Government, on 13 May 2008, the Treasurer and Assistant Treasurer[144] announced, inter alia, that the income tax law would be amended such that beneficiaries of a trust that join or leave a consolidated group part way through an income year were to be taxed on an appropriate share of the trust's net income. The amendment was to apply from the 2007-08 income year. The proposed amendment was not introduced into Parliament.

The part year issue was also considered by the Board as part of its post-implementation Review into certain aspects of the consolidation regime.[145] The Discussion Paper[146] referred to the 'anomalous outcomes that may arise when taxing the net income of a trust that joins or leaves a consolidated group part way through a year.'[147] The Discussion Paper made the following points:

1. The issues that arise as a result of interactions between the trust and consolidation provisions mainly arise because of the way trusts are taxed. Issues also arise because beneficiaries of a trust can join a consolidated group at a different time to the trust, or the trust may never join.[148]

2. Where a trust is a member of a consolidated group for part of an income year, it is unclear how beneficiaries work out the share of trust income to which they are presently entitled. For the purpose of calculating the trust's net income for the non-membership period, the consolidation rules treat the trust's non-membership period as if it were an income year. However, these rules do not modify how the income of a trust (which is different to the trust's net income) is calculated or change the time a beneficiary is presently entitled to the income of the trust.[149]

3. If the income of the trust is not calculated over the same period as the trust's net income, beneficiaries may be assessed on a greater or lesser amount than is

144 The Hon Wayne Swan, Treasurer, and The Hon Chris Bowen, Assistant Treasurer, The Department of The Treasury (Cth), 'The Way Forward on Tax Measures Announced, but Not Enacted, by the Previous Government' (Media Release 13 May 2008), Attachment.
145 See above n 90 and accompanying text.
146 See above (n 91).
147 Ibid 32 [4.7].
148 Ibid [4.12].
149 Ibid 33 [4.2].

appropriate. In addition, if a beneficiary has not been assessed on an amount received from the trustee, CGT consequences may arise.[150]

4. Beneficiaries that are not members of a consolidated group during an income year may be presently entitled to a share of a trust's income either before it joins a consolidated group or after it leaves a group. If a beneficiary is not a member of the consolidated group, it is unclear how their share of net income is calculated.[151]

5. Concerns have been raised that the consolidation core rules that require the net income of a trust to be calculated for each period that a trust is not a member of a consolidated group only apply to the trust. That is, they do not apply for the purposes of working out the tax outcome of a beneficiary.[152] If this is the outcome, a beneficiary will be assessed on their share of the trust's net income as if the trust had never been a member of a group. That is, the net income of the trust will be calculated for the whole year instead of being apportioned between the membership period and the non-membership period.[153] As a consequence, the trust's net income will need to be reconstructed to include any intra-group transactions that were ignored for consolidation purposes. In addition, the amount the beneficiary is assessed on under the trust provisions will be different to the amount calculated under the consolidation provisions.[154]

6. Similar issues also arise when a beneficiary is a member of a consolidated group for part of an income year and the rules that apportion the trust's assessable income and deductions for an income year between the beneficiary and the head company apply. If the trust is a member of another consolidated group, it is unclear whether the single entity rule is taken into account when applying the apportionment rules. That is, can the beneficiary take into account the fact that the trust does not have assessable income or deductions because the trust is taken to be part of the head company?[155]

7. It is also unclear how the apportionment rules interact with the consolidation core rules. The consolidation core rules require the trust's net income to be calculated as if the non-membership period were an income year — that is, on a derived basis. The apportionment rules require amounts to be reasonably attributed to relevant periods. Consequently, beneficiaries could be assessed on amounts that would not be included in the trust's net income that is calculated for the trust's non-membership period.[156]

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150 Ibid [4.3].
151 Ibid 34 [4.6].
152 Ibid [4.7].
153 Ibid [4.8].
154 Ibid [4.9].
155 Ibid [4.10].
156 Ibid 34-35 [4.11].

The Board in its Position Paper,[157] after receiving submissions[158] to its Discussion Paper and further consideration of the matters associated with the part year issue, adopted the following positions.

1. The net income and trust law income should be worked out appropriately for each non-membership period as should the trust's exempt income and non-assessable non-exempt income be allocated appropriately between the periods.[159]

2. The net income and trust law income should be apportioned between the membership and non-membership periods using similar principles to those in Subdivision 716-A of the *ITAA 97* which are used to allocate the income and deductions of a trust between the head company and a beneficiary. That is, the trust's net income for the non-membership period should be calculated by reference to the income and expenses that are reasonably attributed to the period and a reasonable proportion of such amounts that are not attributable to any particular period within the income year. In addition, to the extent income and expenses are apportioned in calculating the trust's net income for the non-membership period, similar adjustments may be appropriate when calculating the trust law income.[160]

Ultimately, the Board in its Report[161] to Government recommended that when determining the 'net income' of a trust that is a member of a consolidated group for part of an income year, the amount should be determined by reference to the income and expenses that are reasonably attributable to the period and a reasonable proportion of such amounts that are not attributable to any particular period. Also, to the extent the income and expenses are apportioned in calculating the trust's net income for the non-membership period, similar adjustments are appropriate when calculating the trust law income.[162]

The Board recommended that the issue should be addressed in the anticipated Government's re-write of the tax law provisions relating to trusts.[163] The Government agreed in principle to the Board's recommendation.[164] In December 2013 the Assistant Treasurer of the newly

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157 See above (n 100).

158 The submissions can be accessed at <https://taxboard.gov.au/consultation/post-implementation-review-into-certain-aspects-of-the-consolidation-regime#submissions>.

159 Position Paper (n 100) [4.9].

160 Ibid [4.10]-[4.12].

161 See above (n 9).

162 Report (n 9) 55–56.

163 Ibid 56, Recommendation 5.1.

164 Assistant Treasurer's May 2013 Press Release (n 109).

elected Coalition Government announced[165] that the issue dealing with 'the tax outcome for the beneficiaries of a trust that joins or leaves a consolidated group part way through the income year' would be considered as part of a broader review of consolidation issues to be undertaken by the Treasury in 2015 including addressing outstanding recommendations from the Board's review of the consolidation regime. The Treasury conducted consultation between 28 April 2015 and 19 May 2015 in respect of certain measures relating to amendment to strengthen the integrity of the tax consolidation rules[166] and ultimately released exposure draft legislation[167] and exposure draft explanatory materials.[168] The exposure draft legislation did not contain amendments relating to trusts in tax consolidation or any of the interaction matters referred to above.

That re-write of the tax law provisions never proceeded and there has been no legislative amendment to date as recommended by the Board.

2.5 Partnerships within Consolidation

The literature is relatively sparse on the inclusion of a partnership in a tax consolidated group or MEC group and consists of conference papers. The literature, which was written within 15 months of the commencement of the tax consolidation regime on 1 July 2002, is largely descriptive with no detailed analysis of issues that arise.[169]

O'Shannessy noted[170] that the eligibility requirements for a partnership to be a subsidiary member of a consolidatable group or MEC group are contained in s 703-15(2))b), Item 2 of

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165 Assistant Treasurer, The Department of The Treasury (Cth), 'Integrity Restored to Australia's Taxation System' (Media Release 14 December 2013) Attachment Item 88.

166 Australian Government, The Department of The Treasury, *Restoring Integrity to the Consolidation Regime* (Web Page) <https://treasury.gov.au/consultation/restoring-integrity-to-the-consolidation-regime>.

167 <https://treasury.gov.au/sites/default/files/2019-03/C2015-022_150414_restoring-integrity-consolidation-regime-exposure-draft.pdf>

168 <https://treasury.gov.au/sites/default/files/2019-03/C2015-022_150414_restoring-integrity-consolidation-regime-exposure-draft-EM.pdf>

169 See Adrian O'Shannessy, 'Treatment of Trusts and Partnerships Under the Consolidation Regime', (Conference Paper, Taxation Institute of Australia, Consolidation Intensive, 18 July 2003); Mark Poole, 'Types of Consolidatable Groups and Membership (Seminar Paper, Taxation Institute of Australia, 30 October 2002); Richard Hendriks, 'Partnerships and Trusts' (Conference Paper, Taxation Institute of Australia, 3-4 February 2003).

170 O'Shannessy (n 169) 1-5.

the ITAA and 'partnership' is defined in s 995-1(1) of the *ITAA 97*.[171] That definition provides that a partnership means:

> (a) an association of persons (other than a company or a * limited partnership) carrying on business as partners or in receipt of * ordinary income or * statutory income jointly; or
>
> (b) a limited partnership.

The expression 'limited partnership' is defined, broadly, as a partnership in which at least one of the partners has limited liability.[172] O'Shannessy indicated that a partnership under the definition includes a 'tax partnership', that is, persons 'in receipt of ordinary income or statutory income jointly' and that a 'corporate limited partnership'[173] does not fall within the partnership definition as it is treated as a company for tax purposes.[174] However, a corporate limited partnership can be the head company of a consolidated group, subject to the satisfaction of the relevant head company eligibility requirements,[175] as it is treated as a company.[176]

O'Shannessy, Poole and Hendriks referred to the wholly owned requirement.[177] The ownership requirement[178] for partnerships necessitates that all partners (other than nominees)[179] of a partnership are required to be subsidiary members of the consolidated group otherwise the wholly-owned requirement will not be satisfied.[180]

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171 The eligibility requirements for a partnership to qualify as a subsidiary member of a 'potential MEC group' are contained in the table to *ITAA 97* (n 7) s 719-10(1)(b). A MEC group comes into existence when a choice is made to consolidate a potential MEC group pursuant to ITAA 97 s 719-5(1)(a).

172 *ITAA 97* s 995-1(1), definition of 'limited partnership'.

173 Broadly, a 'corporate limited partnership' is a limited partnership that is treated as a company for tax purposes under Division 5A of Part III of the *ITAA 36* (n 40). The meaning and effect of Division 5A was considered in *Federal Commissioner of Taxation v Resource Capital Fund IV LP* (2019) 266 FCR 1, 4-11 (Besanko, Middleton, Davies, Steward and Thawley JJ).

174 O'Shannessy (n 169) 2. The *Tax Laws Amendment (Transfer of Provisions) Act 2010* (Cth), Schedule 2, item 45, amended the definition of 'partnership' in s 995-1(1) of the *ITAA 97* by adding Note 2 which indicates that a reference to a partnership does not include a reference to a corporate limited partnership pursuant to *ITAA 36* s 94K.

175 See the head company requirements in *ITAA 97* s 703-15(2)(a), item 1 in the table. Note 2 to the definition of company in *ITAA 1997* s 995-1(1) includes a corporate limited partnership pursuant to *ITAA 36* s 94J.

176 O'Shannessy (n 169) 2.

177 O'Shannessy (n 169) 3-4 ; Poole (n 169) 9-12; Hendriks (n 169) 3-4.

178 *ITAA 97* s 703-15(2)(b), column 4, item 2 of the table.

179 Nominees holding membership interest in a partnership cannot be subsidiary members but can be an interposed entity between members: *ITAA 97* s 703-45.

180 In respect of a partnership, a member is a 'partner in the partnership' (*ITAA 97* s 960-130(1), item 2) and their interest in, or in relation to, the partnership by virtue of being a member is a 'membership interest' in the partnership (*ITAA 97* s 960-135). As a matter of law, the interest, being an equitable interest, of a partner in a partnership consists of a right to a proportion of the surplus after the realisation of the assets and payment of the debts and liabilities of the

Both O'Shannessy and Hendriks noted[181] that although a 'partner' of a partnership is not defined for the purposes of the *ITAA 36* or *ITAA 97*, a partner should be taken for the purposes of the consolidation provisions to refer to persons who are partners under the general law and also to persons who are in receipt of income jointly and therefore a tax partnership. Both categories of persons are partners for the purposes of the taxation of partnerships provisions in the *ITAA 36*.[182] Their conclusions were noted as being confirmed by comments of Beaumont J in *Federal Commissioner of Taxation v McDonald.*[183] Both O'Shannessy and Hendriks concluded that tax partnerships (that is situations where persons were in receipt of income jointly (such as co-owners of property) could be members of join a consolidated group (subject to satisfaction of the wholly owned requirement).[184]

Poole noted[185] that there is no residence requirement for a partnership to be a subsidiary member of a consolidated group. Poole referred to the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No 1) 2002 (Cth) ('2002 Consolidation Bill No 1 EM') which indicated that since a partnership is a resident partnership for most income tax purposes where at least one of the partners is a resident, no residency test requirement is needed.[186] The 2002 Consolidation Bill No 1 EM further explained that 'in a consolidation context this means that a partnership whose partners are subsidiary members (having

partnership: *Commissioner of Taxation v Everett* (1980) 143 CLR 440, 446-7 (Barwick CJ, Stephen, Mason and Wilson JJ); *Commissioner of State Taxation (SA) v Cyril Henschke Pty Ltd* (2010) 242 CLR 508, 517 [24]-[25] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ); *Commissioner of State Revenue (WA) v Rojoda Pty Ltd* (2020) 268 CLR 281, 302 [33] (Bell, Keane, Nettle and Edelman JJ) ('*Rojoda*').

181 O'Shannessy (n 169) 4; Hendriks (n 169) 4.

182 The taxation of partners of partnerships (excluding taxation relating to capital gains) is provided for in *ITAA 36* (n 40) div 5, pt III. Although a partnership is liable to furnish a return of the income of the partnership, it is not liable to tax: *ITAA 36* s 91. For the purposes of the taxation of capital gains in relation to partnerships, broadly, the partners individually make a capital gain or loss from a 'CGT event' happening in relation to a partnership or one of its CGT assets: *ITAA 97* s 106-5(1). However, s 106-5(1) only applies to general law partnerships and not tax law partnerships: see *Hedges v Federal Commissioner of Taxation* (2023) 117 ATR 57, 67 [25] (Logan, Goodman and Hespe JJ) ('*Hedges*'). The capital gains tax provisions are drafted on the basis that each partner has an interest (equal to their proportionate interest in the partnership) in each asset of the partnership: see *Hedges* 64-67, [12]-[26]. For an analysis of the erroneous assumption on which the capital gains tax provisions in relation to partnerships are drafted and also adopted by the Commissioner of Taxation in Taxation Ruling IT 2540, see Dominik Breznik, 'Application of Capital Gains Tax to Partnership Assets: Challenges and Reform' (2023) 25(1) *Journal of Australian Taxation* 49. Breznik's view, supported by an analysis of relevant case law including the decision of the High Court in *Rojoda* (n 180), is that the only interest a partner has, either before or after the dissolution of the partnership, is a right to an account and distribution of the proceeds of the sale of an asset (at 59-60). A partner's interest in a partnership is not an interest in any specific asset, other than a right to that partner's share of the proceeds of the sale of an asset upon termination of the partnership (at 59). A partner's equitable interest is not accurately expressed as a 'beneficial interest' in the partnership assets (at 60).

183 (1987) 18 ATR 957, 966-9.

184 O'Shannessy (n 169) 4; Hendriks (n 169) 4.

185 Poole (n 169) 9.

186 Ibid.

satisfied the Australian residence requirements themselves) will be a resident partnership for most income tax purposes. It is therefore unnecessary to impose a further residence test on partnerships.'[187] Although it can readily be accepted that a partnership, the membership interests in which are wholly owned by Australian resident entities pursuant to the wholly owned requirement, should not have a residence requirement for eligibility as a member of a consolidated group, the reasons set out in the 2002 Consolidation Bill No 1 EM for having no residence requirement are curious. This is because the Australian income tax law does not contain a concept of residence of a partnership, that is, the *ITAA 36* and the *ITAA 97* make no reference to the residence of a partnership.[188]

An issue raised by the Board in its Review,[189] was whether a 'foreign hybrid' under Division 830 of the *ITAA 1997* which treats certain foreign entities as partnerships for Australian tax purposes should be permitted to be a member of an Australian tax consolidated group.[190]

Division 830 was introduced into the *ITAA 1997* by the *Taxation Laws Amendment Act (No 1) 2004* (Cth) with effect from 30 June 2004. The explanatory memorandum[191] that accompanied the amending Bill indicated[192] that the amendments provided certainty and removed unintended consequences for taxpayers that resulted from the current treatment of investments in foreign hybrids under the CFC regime[193] and, to a lesser extent, under the

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187 2002 Consolidation EM (n 21) [3.63].

188 The residence and source rules relevant to the taxation of the net income of a partnership are set out in *ITAA 36* (n 40) Division 5, Part III. Broadly, the assessable income of an Australian resident partner includes their share of the net income of the partnership (*ITAA 36* s 92(1)(a)) and the assessable income of a non-resident partner is their share of the net income of the partnership that is attributable to sources in Australia (*ITAA 36* s 92(1)(b)). Broadly, the net income of a partnership is the assessable income of the partnership, calculated as if the partnership were a taxpayer who was a resident, less all allowable deductions (*ITAA 36* s 90, (definition of 'net income')). For capital gains in relation to partnerships (see above (n 182)), broadly, an Australian resident partner will take into account those capital gains in determining their net capital gain for an income year which is included in their assessable income pursuant to *ITAA 97* (n 7) s 102-5(1). For non-resident partners, capital gains made in relation to the partnership are disregarded unless the relevant CGT event happens in relation to an asset that is 'taxable Australian property': *ITAA 97* s 855-10(1). The category of assets that constitute 'taxable Australian property' are set out in *ITAA 97* s 855-15.

189 See above (n 90).

190 Discussion Paper (n 91) 38-40.

191 Explanatory Memorandum, Taxation Laws Amendment Bill (No 7) 2003 (Cth) ('Foreign Hybrid EM').

192 Ibid [9.7].

193 The 'CFC regime' is the set of rules (contained in Part X of the *ITAA* 36) which, broadly, result in certain tainted income of controlled foreign companies being attributed to Australian resident attributable taxpayers and included in their assessable income on a current basis.

FIF regime.[194] Under Division 830 a 'foreign hybrid' is defined as a 'foreign hybrid limited partnership' ('FHLP') or a 'foreign hybrid company' ('FHC').[195]

Broadly, a FHLP is defined[196] as a limited partnership (not being an Australian resident or a resident of a foreign tax country for the purposes of its income tax law) formed in a foreign country where foreign income tax is imposed on the partners and not the limited partnership in respect of its income or profits. A further requirement[197] under the FHLP definition is that the limited partnership is a controlled foreign company ('CFC') under Australia's CFC regime[198] at the end of a 'statutory accounting period'[199] that ends in an income year and that at the end of the statutory accounting period there is an 'attributable taxpayer'[200] in relation to the limited partnership that has an 'attribution percentage'[201] greater than nil.

Fulton noted[202] that the Commissioner of Taxation has taken the view that United States of America ('USA') formed limited partnerships,[203] a Delaware, USA limited partnership,[204] a United Kingdom limited partnership[205] and a German Kommanditgesellschaft[206] are FHLPs.

Broadly, a FHC is defined[207] as a company (not being an Australian resident or a resident of a foreign country for the purposes of its income tax law) that meets the 'partnership treatment

194 The former FIF regime (contained in former Part XI of the *ITAA 36* (n 40)) was repealed by the *Tax Laws Amendment (Foreign Source Income Deferral) Act (No 1) 2010* (Cth) effective from the 2010–11 income year and later years of income. Broadly, the foreign investment fund ('FIF') measures (introduced by the *Income Tax Assessment Amendment (Foreign Investment) Act 1992* (Cth)) applied from 1 January 1993 to certain interests held by Australian resident taxpayers in a foreign company or foreign trust. Broadly, unless a relevant exemption applied, a taxpayer was required to determine (using a method set out in the FIF measures) the amount of their 'foreign investment fund income' in relation to their interests in FIFs for each year of income and include it in their assessable income.

195 *ITAA 97* (n 7) s 830-5.

196 Ibid s 830-10.

197 Ibid s 830-10(1)(e).

198 See above (n 193).

199 A statutory accounting period is each period of 12 months that ends on 30 June unless an election has been made to change the commencement date for a 12 month period: *ITAA 36* s 319.

200 *ITAA 36* s 361(1).

201 Ibid s 362(1).

202 John Fulton, 'Australia's "Cat-in-the-Box" Entity Classification Provisions' (2025) 28(3) *The Tax Specialist* 101, 102.

203 Australian Taxation Office Interpretative Decisions 2010/93 and 2010/94.

204 Australian Taxation Office Interpretative Decision 2008/80.

205 Australian Taxation Office Interpretative Decision 2006/334.

206 Australian Taxation Office Interpretative Decision 2007/47.

207 *ITAA 97* s 830-15.

requirements'.[208] A further requirement[209] under the FHC definition is that the company is a CFC under Australia's CFC regime[210] at the end of a statutory accounting period that ends in an income year and at the end of the statutory accounting period there is an attributable taxpayer in relation to the company that has an attribution percentage greater than nil.

Fulton[211] noted that the introduction of Division 830 addressed certain tax issues arising for Australian investors in CFCs and the former FIFs by reclassifying as "partnerships" for Australian tax purposes certain foreign fiscally transparent entities that otherwise would be treated as companies under general concepts (such as FHCs) or as companies under Division 5A of Part III of the *ITAA 36* for limited partnerships (such as FHLPs).[212]

The Board in its Discussion Paper indicated that prior to the introduction of Division 830 non-resident entities that are now subject to Division 830, that is foreign hybrids, could not have become members of a consolidated group since they were non-resident companies for Australian income tax purposes.[213] However, after the introduction of Division 830 they are treated as partnerships for all purposes of the income tax law including the consolidation membership rules and, as there is no residence requirement for partnerships, they are eligible to become members of a consolidated group.[214]

The Board in its Discussion Paper sought stakeholder comments on whether foreign hybrids should be permitted to become members of consolidated groups, querying whether it was consistent with the Government's policy intent to limit the type of entities that can become members of a consolidated group.[215] The Board in its Position Paper,[216] after considering

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208 The 'partnership requirements' are set out in *ITAA 97* (n 7) ss 830-15 (2) and (3), either of which can be satisfied. *ITAA 97* s 830-15(2) will be satisfied where the company was formed in the USA and under USA income tax law the company is a limited liability company that is either treated as a partnership or as an entity that is disregarded as an entity separate from its owner. *ITAA 97* s 830-15(3) will be satisfied where the company is formed in a foreign country whose foreign income tax law treats it as a partnership and the company satisfies the requirements of regulations that are in force for the purposes of this requirement. The only regulation that has been made in relation to *ITAA 97* s 830-15(3) is the regulation requiring the company to be a limited liability partnership for the purposes of the *Limited Liability Partnership Act 2000* (UK): *Income Tax Assessment (1997 Act) Regulations 2021* (Cth) reg 830-15.01.

209 *ITAA 97* s 830-15(1)(d).

210 See above (n 193).

211 See above (n 202) 101.

212 Ibid 102. See also David Watkins and Alyson Rodi, 'Foreign Entities – Characterisation and Treatment for Australian Tax Purposes' (Conference Paper, Taxation Institute of Australia, 18 September 2008) 8–9, [1.2].

213 Discussion Paper (n 91) 39.

214 Ibid.

215 Discussion Paper (n 91) 40, [4.36]-[4.37].

216 See above (n 100).

stakeholder feedback, considered that foreign hybrids should be eligible to become members of a consolidated group and that the issue should be reviewed in the future if evidence suggests that integrity risks arise as a result of this outcome.[217] The Board's position was reflected in its Report to Government.[218]

O'Shannessy outlined the way in which the consolidation provisions dealt with a partnership becoming a subsidiary member of a consolidated group and the provisions where a partner but not the partnership joined a tax consolidated group.[219]

The explanatory memorandum[220] to the Bill that introduced Division 713-E into the *ITAA 1997* indicated that it contained special tax cost setting rules ('Div 713-E rules') for assets that relate to a partnership where a partner (but not the partnership) joins a consolidated group and where a partnership joins a consolidated group.

Broadly, where an entity that is a partner in a partnership becomes a member of a consolidated group, the Div 713-E rules modify the general cost setting provisions[221] such that they operate as if the 'partnership cost setting interests'[222] of the partner in the partnership were the only assets of the partner in the partnership.[223] The Div 713-E rules also modify the

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217 Position Paper (n 100) 46 [4.31]-[4.35].

218 Report (n 9) 60 [5.26]-[5.27].

219 See above (n 169) 12-16. Subdivision 713-E of the *ITAA 97* (n 7) was introduced into the *ITAA 97* by the *Taxation Laws Amendment Act (No 6) 2003* (Cth), applicable from 1 July 2002, and only contained provisions dealing with the tax cost setting rules for partners and partnerships upon joining a consolidated group. Subsequently, Subdivision 713-E was amended by the *Taxation Laws Amendment (2004 Measures No 2) Act 2004* (Cth), applicable from 1 July 2002, to include provisions that provided for the tax consequences to the head company upon a partnership or a partner leaving a consolidated group.

220 Explanatory Memorandum, Taxation Laws Amendment Bill (No 6) 2003 (Cth) ('2003 No 6 EM').

221 The provisions are in: *ITAA 97* s701-10, *ITAA* 97 sub-div 705-A and any other provision of the *ITAA 97* that gives Subdivision 705-A a modified effect: *ITAA 97* s 713-205(3).

222 A 'partnership cost setting interest' in a partnership is the asset that is comprised of (a) an interest in an asset of the partnership or (b) an interest in the partnership that is not covered by (a), but does not include an asset that is a membership interest in the partnership: *ITAA 97* s 713-210. The 2003 No 6 EM (n 220) explains that the concept of 'partnership cost setting interest' draws upon the recognition for CGT purposes of CGT assets in *ITAA 1936* (n 40) ss 108–5(2)(c) and 108-5(2)(d). However, the assets referred to in the definition of 'partnership cost setting interest' are not limited to CGT assets and can therefore comprise assets consisting of anything of economic value (as applicable under the general cost setting rules). Also, consistent with the CGT rules, a partner, such as the head company, can have more than one cost setting interest in an asset of the partnership. This may arise because of the incremental acquisition of partnership interests by the one entity or through the operation of the single entity principle (for example, where more than one of the subsidiary members is a partner in the partnership): [3.60-[3.61]

223 *ITAA 97* s 713-205(1).

way in which tax cost setting amounts are worked out for the partnership cost setting interests of the joining partner.[224]

The Div 713-E rules also modify the general tax cost setting process for partnership assets when a partnership joins a consolidated group.[225] Broadly, the cost setting amount of each asset of the partnership is determined based on the aggregate of the amounts for all the partnership cost setting interests in the partnership at the joining time (called the 'partnership cost pool').[226]

2.6 Conclusion

This Chapter has analysed the literature, academic and other, that relates to some areas of the research the subject of this thesis. The four areas covered above were: tax policy reasons for Australia's inclusion of trusts and partnerships in the Australian tax consolidation regime ('tax policy issue'), entity classification issues for trusts ('trust classification issue'), net income and trust income apportionment issues in relation to trusts joining or leaving a consolidated group during an income year (the 'part year issue') and some issues in respect of partnerships in tax consolidated groups ('partnership issue') . The extent of the literature in these four areas can be described as thin. There is some, albeit thin, consideration of the tax policy issue, the trust classification issue and the part time issue in academic literature. The trust classification issue, the part year issue and the partnership issue (in relation to whether foreign hybrids as partnerships should be eligible to be members of consolidated groups) were the subject of consideration by a government tax review body (ie, the Board of Taxation). The conclusion can reasonably be made that there is a paucity of academic literature in the proposed research area.

It is submitted that the paucity of academic literature that has considered some issues associated with trusts and partnerships as members of Australian tax consolidation groups, and the absence of literature that analyses in detail the position of trusts and partnerships in

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224 See *ITAA 1997* (n 7) s 713-225 for the modifications. Pursuant to the single entity rule in *ITAA 1997* s 701-1, upon a partnership joining a consolidated group, the assets of the partnership are taken to be the assets of the head company and the partnership is not recognised as a separate entity.

225 *ITAA 97* ss 713-235 and 713-240.

226 *ITAA 97* s 713-240.

tax consolidation, evidences that there is a research gap which the research undertaken in this thesis can fill.

This thesis provides critical analysis in Chapters 6 to 9 to fill the research gap. The analysis is structured as set out in Chapter 1.

Chapter 3 - The Enterprise Doctrine: Influencer for Group Taxation?

3.1 Introduction

Chapter 1 at 1.2 introduced and briefly discussed the enterprise doctrine (or enterprise theory). Broadly, the enterprise doctrine relates to the feature of modern day business whereby business is carried on by an enterprise or corporate group that is organised in the form of domestic and international entities under the common control of a parent entity rather than separate entities.[227]

This chapter, at 3.2, outlines and examines the origins and content of the enterprise doctrine and its implications.

At 3.3, the response to the enterprise doctrine by corporate law, predominantly in Australia and the United States, and under the accounting standards is examined and analysed.

At 3.4, the application of the enterprise doctrine is examined and analysed in relation to group taxation regimes.

At 3.5. the application of the enterprise doctrine is examined and analysed in relation to Australia's tax consolidation regime.

3.2 Enterprise Doctrine – Its Origins and Content

As early as the 1940s in the United States there was a recognition that the single entity corporation, conceived as an artificial person whose existence was under corporations law, was often carrying on business not alone but as part of a group that was a combined economic enterprise. This phenomenon was noted and explained by Berle[228] as follows:

> As the scale of business enterprises enlarged, the process of sub-division began; hence subsidiary corporations wholly-owned or partly-owned; or holding companies combined into a series of corporations constituting a combined economic enterprise; and so forth. More often than not, a single large-scale business is conducted, not by a single corporation, but by a constellation of corporations controlled by a central holding company, the various sectors being separately incorporated, either because they were once independent and have been acquired, or because the central concern, entering new fields, created new corporations to

[227] See above nn 1-2 and accompanying text.

[228] Adolf A Berle, ' The Theory of Enterprise Entity' (1947) 47(3) *Columbia Law Review* 343.

develop them, or for tax reasons. In some instances, departments of the business are separately incorporated and operated as separate legal units (citations omitted).

Berle proposed a thesis, which he named the 'theory of enterprise entity', as follows: first, the entity commonly known as a 'corporate entity' takes its being from the reality of the underlying enterprise, formed or in formation; secondly, the state's approval of the corporate form sets up a prima facie case that the assets, liabilities and operations of the corporation are those of the enterprise; and thirdly, where, however, the corporate entity is defective, or otherwise challenged, its existence, extent and consequences may be determined by the actual existence and extent and operations of the underlying enterprise, which by these very qualities acquires an entity of its own, recognized by law.[229]

Berle examined his theory in relation to three fields of corporations law[230] and concluded that the underlying principle was that whenever the 'corporate entity' is challenged, the court looks at the enterprise.[231]

Blumberg stated that the 'traditional corporations law presupposing as its subject matter the individual corporation and looking upon it as the basic legal unit entity no longer adequately serves all the needs of modern jurisprudence'.[232] Blumberg noted that the US corporation law was being supplemented by a doctrine of enterprise law that had as its focus the business enterprise as a whole and not its fragmented components.[233]

Blumberg also noted that at the outset, a corporation by reason of its creation under royal or state charter was an independent juridical entity with its own rights and duties, separate and distinct from its shareholders.[234] By the late 1880s when corporations were permitted to own the shares of other corporations, the door was opened to holding companies, parent,

[229] Ibid 344.

[230] The first field was that of the 'de facto' corporation where the courts in varying circumstances had treated a corporation as existing even though it had not been incorporated under the relevant corporations law (see above (n 228) 345-7). The second field was where the courts disregarded a corporation duly incorporated and the recognition of a new entity which was more aligned with the actual business enterprise being carried on (see above (n 228) 348-350). The third field was where the courts had found shareholder liability over and above their contribution to capital with the case of *Anderson v Abbott*, 321 US 349 (1944) cited as an example of the court imposing shareholder liability in respect of a corporation that the US Supreme Court held had been formed by shareholders desiring to own and control several banks as part of an overall enterprise of the shareholders (see above (n 228) 350-2).

[231] See above (n 228) 354.

[232] Blumberg (n 1) 605.

[233] Ibid.

[234] Ibid 606.

and subsidiary corporations with major businesses reorganised as corporate groups.[235] Blumberg noted that this permissiveness led to tremendous growth in the size, scope, and complexity of American enterprise.[236]

Kluver has commented that the modern large business enterprise consists of a group of subsidiary corporations owned by a common parent.[237] Kluver referred[238] to an empirical study by Ramsay and Stapledon[239] that revealed that 89% of the 415 sample companies[240] had a least one controlled entity[241] and that, on average, each listed company had 28 controlled entities although the average was skewed by some listed companies that had a very large number of controlled entities (for example, News Corporation Ltd had 778 and BHP had 379).[242] The study also found that 90% (10,612 out of a total of 11,779) of controlled entities were wholly owned and that a further 1009 (8.6%) controlled entities were controlled by a listed company holding (either directly or indirectly) at least 50% but less than 100% of the shares or units.[243]

Ramsay and Stapledon noted that there were several reasons why a company may establish one or more subsidiaries so that its business is conducted through a corporate group rather than a single company. First, the company can reduce exposure of its assets by establishing a subsidiary with the principle of limited liability ensuring (subject to exceptions when the 'corporate veil' is lifted or pierced) that the assets of the holding company will be protected from any liability incurred by the subsidiary.[244] Secondly, the operation of a business through a corporate group rather than a single company can result in lower taxation through, for

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235 Ibid 607.

236 Ibid 607-8.

237 John Kluver, 'Entity vs Enterprise Liability: Issues for Australia' (2005) 37(3) *Connecticut Law Review* 765 ('Entity vs Enterprise Liability') 765.

238 Ibid 765-6.

239 Ian M Ramsay and GP Stapledon, 'Corporate Groups in Australia' (2001) 29 *Australian Business Law Review* 7 ('Corporate Groups in Australia').

240 The study covered 415 of the Top 500 companies (measured by market capitalization) listed on the Australian Stock Exchange ('ASX') as at 28 November 1997: Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 7.

241 Ramsay and Stapledon noted that at the time the data for the study was obtained (from 1997 annual reports), an ASX listed company was required to include certain information about each "controlled entity" under the relevant corporations law provisions and regulations. At the time (2001) the results were presented, the corporations law and regulations had been amended to refer to "subsidiary" rather than "controlled entity" but the broad control concept had been retained in Accounting Standard AASB 1034: Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 22 .

242 Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 8-9.

243 Ibid 9.

244 Ibid 13.

example, the use of tax havens.[245] Thirdly, in some countries there can be financial reporting considerations resulting from the fact that the financial statements of subsidiaries do not have to be consolidated with those of the holding company.[246] Fourthly, a convenient way of structuring the acquisition of an existing business in partnership with others is to acquire the existing business through a new company (with the existing business owners acquiring an interest in the new company) or by taking an interest in an existing company rather than purchasing assets. Fifthly, a company may want outside investment in part only of its business which can be achieved by incorporating that part of the business as a subsidiary and allowing outsiders to acquire a minority shareholding in the subsidiary.[247] It allows the company to raise additional capital without forfeiting control. Finally, the establishment of subsidiaries may allow greater flexibility in debt financing.[248]

Hadden indicated that for large public companies, the initial impetus for the growth in corporate groups in Britain and the United States appears to have been the desire to create larger structures for cooperation between established companies which developed into unified economic entities, whether from external pressure or anti-trust legislation or from

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245 Ibid. The tax minimisation reason is probably less of an issue currently than it was previously. This is primarily due to the work of the Organisation for Economic Co-operation and Development ('OECD') which in February 2013 released its report, *Addressing Base Erosion and Profit Shifting*, that concluded that a significant source of domestic tax base erosion occurred through profit shifting, constituting a serious risk to tax revenues, tax sovereignty and tax fairness for both OECD member and non-member countries. In July 2013 the OECD released an action plan, *Action Plan on Base Erosion and Profit Shifting*, which called for fundamental changes to the current mechanisms and the adoption of consensus based approaches designed to prevent and counter base erosion and profit shifting ('BEPS'). One of the actions was the development of a single multilateral instrument ('MLI') or treaty between all countries that wished to participate, which would modify bilateral double tax treaties between countries in accordance with the recommended tax treaty measures that were developed as part of the BEPS Project: see Peter Stinson, 'Impact of the Multilateral Instrument on the Interpretation of Australia's Income Tax Treaties' (2020) 49(4) *Australian Tax Review* 281 which discusses the background and effect of the MLI and Australia's response to it, and the impact of the MLI on the interpretation of Australia's tax treaties. The following are some of the legislative measures introduced in Australia subsequent to the BEPS project that have reduced the ability of multinationals and certain others to base erode and shift profits: multinational anti-avoidance law (or 'MAAL') that targets the use of artificial and contrived arrangements to avoid the attribution of profits to a permanent establishment in Australia (*ITAA 36* (n 40) s 177DA); hybrid mismatch rules that target the avoidance of tax, or the obtaining of tax benefits, through hybrid mismatch arrangements (*ITAA 97* div 832); diverted profits tax (or 'DPT') that targets the shifting or diverting of profits from Australia to offshore through arrangements with third parties (*ITAA 36* ss 177H-177R). Australia has passed legislation that implements Pillar Two of the OECD/G20 Two-Pillar Solution which is designed to ensure that large multinational enterprises pay a minimum level of tax of 15% on the income arising in each jurisdiction in which they operate: see, generally, for details of Australia's implementation of Pillar Two of the OECD/G20 Two-Pillar Solution and general background: Australian Taxation Office, *When and How the Pillar Two Rules Apply* (Web Page) <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/multinationals/global-and-domestic-minimum-tax/when-and-how-the-pillar-two-rules-apply>.

246 Ibid.

247 Ibid.

248 Ibid.

internal managerial forces.[249] Expansion was achieved by establishing new sales and production subsidiaries in new locations of operation, often in other countries and by acquiring other existing companies or groups in the same sphere of business activity with the result that there was created increasingly complex national and multinational groups of companies with a large number of subsidiaries that were typically wholly owned and wholly controlled by the group holding company.[250]

Hadden also noted that a feature of corporate groups in the United Kingdom and the United States was that they were mostly wholly owned but that in Australia and Canada their structure was more complex with interlocking webs of majority and minority holdings which made it difficult to assess profitability and solvency of the group and individual companies and to identify those formally responsible for their operations.[251]

The Final Report ('CASAC Report')[252] on corporate groups by the Companies and Securities Advisory Committee ('CASAC') identified some of the economic and commercial benefits in conducting an enterprise through a corporate group structure including: reducing commercial risk, or maximising potential financial return, by diversifying an enterprise's activities into various types of businesses, each owned by a separate group company; preserving intangible property of existing companies by acquiring the companies themselves to expand an enterprise or increase market power; attracting capital without forfeiting overall control by, for example, incorporating part of the business as a separate subsidiary and allowing outside investors to acquire a minority shareholding in it; lowering the risk of legal liability by confining high liability risks, including environmental and consumer liability to particular companies thereby isolating remaining group assets from potential liability; and providing better security for debt or project financing such as where a lender requires a borrower to have project assets in a special purpose company that the lender takes a charge over.[253]

The above analysis has indicated that the enterprise doctrine, hallmarked by the rise of large corporate groups carrying on business as an economic enterprise rather than as a group of separate legal entities, has caused the corporate law to adapt in recognition of an approach

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249 Tom Hadden, 'The Regulation of Corporate Groups in Australia' (1992) 15(1) *University of New South Wales Law Journal* 61.

250 Ibid 63.

251 Ibid 63-4.

252 Companies and Securities Advisory Committee, *Corporate Groups* (Final Report, May 2000) ('CASAC Report').

253 Ibid 3.

that mostly focuses on separate legal entities, rather groups or enterprises undertaking business, that is no longer appropriate.

3.3 Corporate Law and Accounting Responses to the Enterprise Doctrine

3.3.1 Corporate Law Response

Corporate law in both Australia and the United States, having its historical roots in limited liability of a company which is treated as a separate and distinct entity, has had to adapt to accommodate, in some areas, the 'unitary character of large business enterprises'[254] rather than continue its sole focus on a group consisting of separate legal entities.[255]

Blumberg noted that 'the traditional concept that each corporation has its separate legal identity inevitably undermines the effectiveness of legislative attempts to regulate the domestic activities of corporate groups.'[256] Further, '[o]nly through the substitution of enterprise principles focussing on the economic realities of a business undertaking rather

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254 Strasser and Blumberg (n 1) 2.

255 There have been many articles and books written, from a United States corporate law perspective, in relation to the need for corporate law to adapt and embrace an enterprise analysis or doctrine rather than the single entity approach: see, for example, Blumberg (n 1); Peter Muchlinski, 'Limited Liability and Multinational Enterprises: A Case for Reform?' (2010) 34 *Cambridge Journal of Economics* 915; Kurt A Strasser, 'Piercing the Veil in Corporate Groups' (2005) 37(3) *Connecticut Law Review* 637 ('Piercing the Veil'). Strasser and Blumberg (n 1); Phillip Blumberg et al, *Blumberg on Corporate Groups* (Aspen Publishers, 2nd ed, 2005); Cindy A Schipani, 'The Changing Face of Parent and Subsidiary Corporations: Enterprise Theory and Federal Regulation' (2005) 37(3) *Connecticut Law Review* 691; Robert B Thompson, 'Piercing the Veil: Is the Common Law the Problem?' (2005) 37(3) *Connecticut Law Review* 619; Nicholas Georgakopoulos, 'Avoid Automatic Piercing: A Comment on Blumberg and Strasser' (2011) 1(1) *Accounting, Economics, and Law*: *A Convivium* Article 12; Phillip I Blumberg, 'National Law and Transnational Groups and Transactions: Survey of the American Experience' (1995) 5 *Australian Journal of Corporate Law* 295 ('National Law and Transnational Groups'). From an Australian company law perspective and the need for the Australian corporate law to adapt to an enterprise approach, see, for example, Hadden, (n 249); Lynden Griggs, 'A Note on the Application of Enterprise Theory to the Problem of Phoenix Companies' (1998) 2 *Macarthur Law Review* 53; Ian M Ramsay, 'Allocating Liability in Corporate Groups: An Australian Perspective' (1999) 13(2) *Connecticut Journal of International Law* 329 ('Allocating Liability in Corporate Groups'); John Kluver, 'European and Australian Proposals for Corporate Group Law: A Comparative Analysis' (2000) *European Business Organization Law Review* 1(2) 287; Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239); Jenny Dickfos, 'Directors' Duties Under an Enterprise Approach' (Seminar Paper, Insolvency Seminar, University of Adelaide, 25 September 2009); Kluver, 'Entity vs Enterprise Liability' (n 237); Helen Anderson, 'Veil Piercing and Corporate Groups — An Australian Perspective' [2010] *New Zealand Law Review* 1; Jason Harris and Anil Hargovan, 'Corporate Groups: The Intersection between Corporate and Tax Law: *Commissioner of Taxation v BHP Billiton Finance Ltd*' (2010) 32(4) *Sydney Law Review* 723; Anil Hargovan and Jason Harris, 'Together Alone: Corporate Group Structures and their Legal Status Revisited' (2011) 39 *Australian Business Law Review* 85; Helen Anderson, 'Challenging the Limited Liability of Parent Companies: A Reform Agenda for Piercing the Corporate Veil' (2012) 22(2) *Australian Accounting Review* 115; Freya Smith, 'Asset Protection in Multinational Enterprises – Where to Now?' (2014) 22(4) *The Multinational Business Review* 351; John H Farrar, 'Doctrinal Incoherence and Complex Variables in Piercing the Corporate Veil Cases' (2014) 29 *Australian Journal of Corporate Law* 23; Robert P Austin and Ian M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis Butterworths, 17th ed, 2018) [4.270]-[4.340]. For an analysis of corporate groups in the United Kingdom including circumstances of veil piercing see Daniel D Prentice, 'Some Aspects of the Law Relating to Corporate Groups in the United Kingdom' (1999) 13(2) *Connecticut Journal of International Law* 305; Agustin Ricardo Spotorno, 'Piercing the Corporate Veil in the UK: The Never-Ending Mess' (2018) 39(4) *Business Law Review* 102.

256 Blumberg, 'National Law and Transnational Groups' (n 255) 296.

than on the legal forms through which it is conducted for the traditional doctrine has made possible the successful application of American law to multinational corporations and their activities'....[257]

Blumberg noted that the adoption of enterprise principles that imposed legal obligations on the parent corporation or affiliated corporations for acts of a subsidiary participating in the collective conduct of a common integrated enterprise was essential for the full implementation of regulatory programs.[258] He also noted that the American law of corporate groups based on principles of enterprise law was emerging from their major jurisprudential sources: statutory law of specific application to corporate groups and their components, including administrative gloss; statutory law of general application covering designated economic activities without any reference to corporate groups and their components, construed by the courts to have enterprise dimensions; and judicial decisions in controversies arising under common law or involving judicial jurisdiction or procedure.[259]

Strasser noted that piercing the veil is the United States corporate law's most widely used doctrine to decide when a shareholder or shareholders will be held liable for obligations of a corporation.[260] Strasser noted that a parent company was in quite a different economic role and performs a quite different management role to individual shareholders in a public company – the parent company creates, operates and dissolves subsidiaries primarily as a part of a business strategy in pursuit of the larger enterprise, which the parent and all of the subsidiaries are pursuing together.[261]

Thompson has noted that since within corporate groups the assets of the entire group are not available for the liabilities incurred by one of the other corporations in the group (instead only the assets held by the parent corporation or subsidiary were available for liabilities incurred by that parent corporation or subsidiary), the corporate law, under the veil piercing doctrine, allows a shifting of some of the economic risk of the group entities to the parent

257 Ibid.
258 Ibid.
259 Ibid 296-7.
260 Strasser, 'Piercing the Veil' (n 255) 637.
261 Ibid 638.

corporation. This is the same as the veil piercing in the case of a single corporation where risk is shifted to the individual shareholders.[262]

Strasser indicated that in traditional veil piercing cases the United States courts, broadly, consider three factors. First, whether the subsidiary has a separate existence , either formally or as a matter of business reality. In considering this factor, the courts often look to excessive control over the subsidiary's day-to-day operations and decision-making, as well as the extent to which the parent disregards the subsidiary's separateness.[263] Secondly, 'wrongful conduct' is required with some courts willing to treat the simple commission of a tort, breach of contract or insolvency as sufficiently wrongful conduct.[264] Thirdly, the wrongful conduct should have caused the plaintiff's loss.[265] Strasser indicated that the veil piercing doctrine has been consistently criticised with the core charge being that the doctrine is expressed at such a high level of abstraction that decisions in individual cases are highly discretionary with courts applying no real principles and offering little guidance for future cases.[266]

Ramsay indicated that Australian corporate law in relation to corporate groups adheres mostly to the 'separate entity principles' rather than any 'enterprise principles'.[267] Although Ramsay indicated that there were a variety of approaches adopted in Australia for the regulation of corporate groups, there had been no systematic reform, but rather a piecemeal approach had been adopted.[268] The CASAC Report also noted that the corporations law of Australia had traditionally applied the separate entity approach and did not permit the controllers of a corporate group to treat the group as a single enterprise for the purpose of their entrepreneurial activities.[269]

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262 Thompson (n 255) 621.
263 Strasser, 'Piercing the Veil' (n 255) 640.
264 Ibid 640-1.
265 Ibid 641.
266 Ibid.
267 Ramsay, 'Allocating Liability in Corporate Groups' (n 255) 330.
268 Ibid 343.
269 CASAC Report (n 252) 26 [1.72].

Ramsay[270] and Ramsay and Stapledon[271] outlined the following approaches that had been adopted: lifting of the corporate veil by courts;[272] tightening of financial reporting rules;[273] statutory limits on share cross-holdings;[274] extension by courts of the definition of 'shadow director' to include companies;[275] use of the oppression remedy to remedy abuses in corporate groups;[276] acknowledgment by the courts and Parliament of the need for a degree of flexibility in the content of directors' duties in a group context;[277] recognition by the courts of the possibility of a parent company being vicariously liable for wrongs committed by its

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270 Ibid 343-4.

271 Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 14

272 Ramsay and Stapledon indicated that the agency ground (that is, the shareholder principal is liable for certain liabilities incurred by the agent company) is commonly used in Australia for justifying lifting or piercing the corporate veil and is more likely to be made out where the controller of a company is a parent company and the controlled company is a wholly owned subsidiary: Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 15. Austin and Ramsay (n 255) have noted the following circumstances in which the corporate veil may be lifted: where a company structure is used to perpetuate a fraud or where a company structure is used with the sole, or dominant, purpose of enabling another person to avoid a legal obligation (at [4.250.12]); and where under-resourced companies may be found to be agents of their controllers or to be shams or devices (at [4.250.15]).

273 Ramsay and Stapledon, 'Corporate Groups in Australia', (n 239) 14 have indicated that the tightening of financial reporting rules relates to the adoption in 1991 of accounting standard AASB 1024 which made the preparation of consolidated statements mandatory for all parent companies that controlled (as defined in AASB 1024) other entities: see below nn 301-9 and accompanying text.

274 A company is prohibited from taking security over its own shares and shares in a company that controls it: *Corporations Act 2001* (Cth) s 259B (*'Corporations Act'*)). Section 259C invalidates the issue or transfer of shares of a company to an entity it controls unless an exception applies or ASIC has exempted the company from the operation of the section. If a company obtains control, or increases its control, of an entity that holds shares in the company, then within 12 months either the entity must cease to hold shares in the company or the company must cease to control the entity (subject to exceptions): s 259D. See Ramsay and Stapledon (n 239) 16.

275 The definition of 'director' in s 9AC(1) of the *Corporations Act* (n 274) includes a person who is not validly appointed as a director if the directors of the company are accustomed to act in accordance with the person's instructions or wishes. Such a person is known as a 'shadow director' and the person may be a company. It is noted in this regard that the *Acts Interpretation Act 1901* (Cth) s 2C(1) provides that a reference to 'persons' in a Commonwealth Act includes a 'body corporate' and there is no relevant contrary intention in the *Corporations Act* that displaces this interpretation. Therefore, there is a risk that if directors of a subsidiary act in accordance with the instructions or wishes of a parent company, the parent company may be a shadow director with all the duties and obligations of directors under the *Corporations Act*: see Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 16-17; Austin and Ramsay (n 255) 1242 [20.200]. In *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR Hodgson J of the New South Wales Supreme Court accepted that a holding company is not a director of its subsidiaries merely because it has control of how the board of its subsidiaries are constituted, however, in the circumstances before him he held that three nominee directors of a controlled company (Giant Resources Ltd ('Giant')) of Pioneer International Limited ('Pioneer'), who were also directors of Pioneer, did not give any separate consideration in their capacity as directors of Giant in making strategic decisions concerning the affairs of Giant but merely accepted decisions which had effectively been made by Pioneer and, accordingly, Hodgson J concluded that Pioneer was a (shadow) director of Giant.

276 The oppression remedy in the *Corporations Act* (n 274) pt 2F.1 may be available to affected persons where directors of a company take actions which are not in the best interests of that company but are for the benefit of related companies, or, perhaps, where a shareholder in a group company claims they are being oppressed because of what is happening in another group company even though the shareholder is not a member of that company: see Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 18-19. See also, generally, Austin and Ramsay (n 255) 734-771.

277 Ramsay and Stapledon noted that although each company in a corporate group must be treated as having its own interests, the courts have acknowledged that to some extent directors, when performing their functions, may properly consider the interests of other companies within the corporate group: Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 17-18. The corporations law expressly provides that a director of a corporation that is a wholly owned subsidiary of another corporation is taken to act in good faith in the best interests of the subsidiary if the constitution of the subsidiary expressly authorises the director to act in the best interests of its holding company and the director acts in the best interests of the holding company and the subsidiary is not insolvent at the time the director acts or does not become insolvent because of the director's act: *Corporations Act* (n 274) s 87.

nominee directors on a subsidiary company's board;[278] and specific laws dealing with insolvency in corporate groups.[279]

Dickfos[280] has noted that the 'enterprise approach' recognises the corporate group as a single unit which is at odds with the separate legal entity approach of corporate law that fails to see the significance of companies operating in unison for a greater economic goal and choosing instead to concentrate on particular issues that face each company based on the separate legal entity doctrine.[281] Dickfos concluded that there was a conflict between the economic reality of group company behaviour in Australia and the legal treatment of those companies with the majority of laws regulating corporate groups reflecting an entity approach.[282]

Austin and Ramsay have noted that the *Corporations Act 2001* (Cth) ('*Corporations Act')* 'shows no general intention that the separate legal identity of companies in a group be disregarded or that their rights and duties should be merged'.[283] They, however, point to certain areas where the *Corporations Act* directs that two or more companies be regarded together for particular policies.[284]

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278 Ramsay and Stapledon noted that in the New Zealand case of *Dairy Containers Limited v NZI Bank Limited* [1995] 2 NZLR 30 Thomas J said that in principle it should be possible for a parent company to be held vicariously liable for the wrongful acts (or omissions) of one of its employees serving as a (nominee) director on the board of a subsidiary. Although the issue has not been decided in Australia, there are strong policy reasons in favour of allowing the doctrine of vicarious liability to apply to these circumstances: Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 17. See also Austin and Ramsay (n 255) 626.

279 Broadly, pursuant to the *Corporations Act* (n 274) s 588V, a liquidator of a subsidiary can bring proceedings against the holding company of a group if at the time of the subsidiary incurring a debt there were reasonable grounds for suspecting insolvency and either the holding company and one or more of its directors was aware of reasonable grounds for suspecting insolvency, or having regard to the holding company's control over the subsidiary's affairs, and to any other relevant circumstances, it is reasonable to expect that a holding company in the holding company's circumstances (or one or more of its directors) would be aware that there were reasonable grounds for suspecting insolvency: see Ramsay and Stapledon, 'Corporate Groups in Australia' (n 239) 20; Austin and Ramsay (n 255) 1242 [20.200].

280 Dickfos (n 255).

281 Ibid 3.

282 Ibid.

283 Austin and Ramsay (n 255) [4.320].

284 These areas are: the prohibition in *Corporations Act* (n 274) s 259B on a company taking security over its own shares also relates to shares in a company that controls it; s 259C that invalidates a company's acquisition of shares in a company that controls it; the regulation under s 260A of a company's giving of financial assistance to persons acquiring its shares relates also to shares in a holding company; through Australian Accounting Standard AASB 10 (which is required to be complied with by s 296(1)) that requires that management should periodically report to the members on the financial position of the company in relation to groups by requiring accounts of entities controlled by one company to be presented to members of the controlling company; and Chapter 2E that seeks to prevent public companies or entities related to them improperly giving financial benefits to interests associated with their directors: Austin and Ramsay (n 256) [4.320]. See also in this regard CASAC Report (n 252) 26-8 [1.72]-[1.74].

The CASAC Report[285] recommended a regime under which the directors of the ultimate holding company of a wholly-owned group could choose to consolidate all or some of the group so that those consolidated would be treated as one legal structure and would be regulated by single enterprise principles. Broadly, the holding company and each group company would be collectively liable for all the contractual debts (but not torts) of all group companies, directors of group companies could act in the overall group interest without having to have regard to the interests of particular group companies, group companies could merge merely at the discretion of the directors of the holding company and would have power to provide appropriate relief from accounting and any other residual separate entity requirements.[286]

Priskich noted that although the recommended regime for consolidated group companies in the CASAC Report was 'founded on sound principles' … 'the 'Achilles' heel of the proposal is its failure to provide sufficient incentives for companies in a corporate group to choose the consolidation solution'.[287] The recommended regime has not been legislated to date.[288]

Spotorno[289] has noted that In the United Kingdom, rooted in the famous case of *Salomon v Salomon & Co Ltd*,[290] once incorporated, a limited liability company has a separate legal personality different from its shareholders and directors, with rights and liabilities of its own. However, there are circumstances under which the courts and legislature may provide exceptions to both the principles of separate corporate personality and limited liability and which form the doctrine of veil piercing.[291]

Spotorno observed that it is undisputed that from case law and academic articles the doctrine of veil piercing in the United Kingdom is contradictory, confusing and unprincipled.[292]

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285 See above (n 252).

286 Ibid 31-3 [1.82]- [1.91].

287 Vicky Priskich, "CASAC's Proposals for Reform of the Law Relating to Corporate Groups' (2001) 19(6) *Companies and Securities Law Journal* 360, 362-3.

288 Warren has noted that the suggestions for 'large-scale legislative reform in this area' such as the recommendation in the CASAC Report 'have fallen by the wayside' and reside in the 'too hard: basket': Marilyn Warren, 'Corporate Structures, The Veil and the Role of Courts' (2016) 40(2) *Melbourne University Law Review* 657, 673.

289 Spotorno (n 255) 102.

290 [1897] AC 22.

291 Ibid.

292 Ibid 103.

Spotorno noted that although the courts have sought to circumscribe the doctrine to narrow and neat limits, contradictory case law shows the efforts to be in vain. Spotorno referred to cases that had disregarded legal personality since the company was a 'device', on the grounds of 'single economic unit' and a 'denial of justice', and 'to achieve justice'.[293] In addition, many informal terms such as cloak, stratagem, mask, creature, device, alter ego, façade, or sham were used to refer to cases in which a company was used by its controller for an impropriety.

Prentice also indicated that although the courts had been willing to pierce the corporate veil and recognise the phenomenon of corporate groups, it was seldom done and there had been no judicial recognition of a doctrine that recognises corporate groups as constituting a single economic entity.[294] Moreover, Prentice maintained that jurisprudence in the area of veil piercing was far from principled with the cases 'going in different directions and unhelpful metaphors abound'.[295]

Spotorno noted that it had been anticipated that the Supreme Court of the United Kingdom in *Petrodel Resources Ltd v Prest* (*Prest*)[296] would provide clarity as to the extent of the veil piercing doctrine in the United Kingdom.[297] However, as Spotorno noted, a weakness of the decision was the failure to adopt a coherent approach as to whether there was a principle underpinning the veil piercing doctrine. Lightman and Hargreaves commented that the Supreme Court in *Prest* appeared to be unanimous that the long-established principle that a company has a personality and property separate from its shareholders remained valid, that there is a 'doctrine' of piercing of the corporate veil, and that the circumstances in which the corporate veil can be pierced are very limited.[298] However, it was also noted that there was no unanimity as to the extent and application of the veil piercing doctrine.[299]

293 Ibid 104.
294 Prentice (n 255) 305.
295 Ibid 320.
296 [2013] 3 WLR 1.
297 Spotorno (n 255) 104-6 [4.2].
298 Daniel Lightman and Emma Hargreaves, '*Petrodel Resource Ltd v Prest*: Where Are We Now?' (2013) 19(9) *Trusts & Trustees* 877, 878.
299 Ibid 878-80.

3.3.2 Accounting Response

Walker and Mack[300] noted that in 1987 the Institute of Chartered Accountants ('ICAA') and the Australian Society of Accountants[301] jointly published an exposure draft relating to consolidation reporting that argued that partial consolidations or other forms of presentation failed to provide a 'true and fair view', and that full consolidated statements should be made compulsory.[302] This led to the issue in 1990 of Australian Accounting Standard AAS 24, *Consolidated Financial Reports*, ('AAS 24') by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants ('ASCPA') and the ICAA.[303] Walker and Mack noted that AAS 24 was soon reissued in slightly amended form by the Australian Accounting Standards Board ('AASB') as AASB 1024, *Consolidated Accounts* (1991).[304] AASB 1024 made the preparation of consolidated statements mandatory for all entities which were subject to those standards and applied to all companies 'which were parent entities of an economic entity deemed a reporting entity'.[305]

Walker and Mack commented on the importance of AASB 1024 in the history of consolidated reporting:

> The issue of AASB 1024 also marked the end of the approach (pioneered by Australian stock exchanges in the 1920s and formally adopted in the Victorian Companies Act of 1938 and in legislation subsequently enacted in other states) of presenting 'group accounts' in different forms: either as a single set of consolidated statements, the presentation of separate financial statements of subsidiaries, the presentation of a consolidated statement encompassing subsidiaries (without the parent company), or through some combination of separate statements and consolidated statements. Further, the issue of AASB 1024 ensured that Australian parent companies with subsidiaries were required to present a consolidated statement encompassing all controlled entities—including unincorporated entities such as trusts.[306]

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300 RG Walker and Janet Mack, 'The Influence of Regulation on the Publication of Consolidated Statements' (1998) 34(1) *Abacus* 48.

301 The Australian Society of Accountants changed its name to the Australian Society of Certified Practising Accountants in 1990.

302 Ibid 58.

303 Ibid. See also Julie Cotter, 'Relevance of Parent Entity Financial Reports' (Discussion Paper, Australian Accounting Standards Board, 2003) 3-4 [1.1.2].

304 Ibid 59. Accessible at.

305 Ibid. It was also noted that the standard had the force of law as it was made pursuant to *Corporations Act 1989* (Cth) s 283(1).

306 Ibid.

AASB 1024 indicated that the objective underlying the preparation of accounts for an economic entity (being a group of entities comprising the parent entity and each of the subsidiaries it, directly or indirectly, controls) is to provide relevant and reliable financial information about the related entities as a single reporting entity to reflect that these entities operate as a single economic unit.[307] For a number of entities to be able to operate together as a single economic unit, they need to be under common direction and this occurs when entities are related by being under the common control of one entity.[308]

Currently, Part 2M.3 of the *Corporations Act* and the *Corporations Regulations 2001* (Cth) set out the financial reporting requirements for certain entities including public companies and large proprietary companies.[309] Included are requirements in relation to the maintenance, preparation, auditing, distribution and lodgement of financial statements and related reports. A financial report and a directors' report must be prepared for each financial year by, inter alios, all public companies and all large proprietary companies.[310]

The financial report for a financial year consists of the financial statements,[311] notes to the financial statements,[312] for a public company - the consolidated entity disclosure statement,[313] and the directors' declaration that the financial statements and notes comply with the accounting standards and give a true and fair view, and that there are reasonable grounds to believe that the entity is solvent.[314] The financial report must comply with the 'accounting standards'[315] and any further requirements in the regulations.[316]

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307 AASB 1024 [7] (x).

308 Ibid. Control for the purposes of AASB 1024 was defined as 'the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity (at [9])

309 Broadly, pursuant to the *Corporations Act* (n 274) s 45A(3) and the *Corporations Regulations 2001* (Cth) reg 1.0.02B, a 'large proprietary company' is a proprietary company under the *Corporations Act* that satisfies at least two of the following requirements: the consolidated revenue for the financial year of the company and any entities it controls is at least $50 million; the value of the consolidated gross assets at the end the financial year and any entities it controls is at least $25 million; and the company and any entities it controls have at least 50 employees at the end of the financial year. Broadly, a proprietary company is a company that is registered as a proprietary company under the *Corporations Act* s 45A(1) and that has no more than 50 shareholders (s 113). A public company is a company that is not a proprietary company (s 9, definition of 'public company').

310 *Corporations Act* s 292(1). A small proprietary company may also be required to prepare a financial report and a directors' report in certain circumstances: s 292(2).

311 Ibid s 295(1)(a) and s 295(2).

312 Ibid s 295(1)(b) and s 295(3).

313 Ibid s 295(1)(ba) and s 295(3A).

314 Ibid s 295(1)(c) and s 295(4).

315 Ibid s 296(1).

316 Ibid s 296(2). The regulations are contained in *Corporations Regulations 2001* (Cth).

The financial statements are those required by the 'accounting standards' to be prepared including, if the accounting standards require a company to prepare financial statements in relation to a consolidated entity, those financial statements in relation to the consolidated entity.[317] The financial statements and notes for a financial year must give a true and fair view of the performance of the company and, if consolidated financial statements are required, the financial position and performance of the consolidated entity.

The Australian Accounting Standards Board has the power to make accounting standards by legislative instrument for the purposes of the *Corporations Act* .[318] All legislative instruments, pursuant to the *Legislation Act 2003* (Cth) ('*Legislation Act'*), are required to be registered on the Federal Register of Legislation[319] established under the *Legislation Act.*

Included in the legislative instruments registered on the Federal Register of Legislation is Accounting Standard AASB 10 *Consolidated Financial Statements* ('AASB 10').[320]

AASB 10 states that its objective is 'to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities'.[321] In achieving that objective, AASB 10:[322]

(a) requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements;

(b) defines the principle of *control*, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;

(d) sets out the accounting requirements for the preparation of consolidated financial statements; and

(e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

317 Ibid s 295(2).
318 Ibid s 334.
319 The Federal Register of Legislation may be accessed at <https://www.legislation.gov.au/>.
320 AASB 10 was made by the AASB on 24 July 2015 and has been amended from time to time: see AASB 10, Compilation details 55-6. The current compiled version of AASB applies to annual periods beginning on or after 1 January 2022 but before 1 January 2025. AASB 10 replaced AASB 127 which had replaced AASB 1024.
321 AASB 10 [1].
322 Ibid [2].

There are some exceptions to the requirement to prepare consolidated financial statements for some entities[323] including an 'investment entity'. [324]

The 'consolidated financial statements' are the financial statements of a parent (that is, the entity that controls one or more entities) and its subsidiaries (the entities that are controlled by another entity) in which the assets, liabilities, equity, income, expenses and cash flow of the parent and its subsidiaries are presented as those of a single economic entity.[325]

Under AASB 10 an entity ('investor') will be a parent of an entity ('investee') if it 'controls' the investee, control being determined on the basis that all of the following elements are satisfied: the investor has 'power over the investee, the investor has 'exposure, or rights, to variable returns from the involvement with the investee, and the investor has the ability to use its power over the investee to affect the amount of the investor's returns.[326]

In relation to the three elements of control set out above, AASB 10 provides the following explanation:

(a) An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns.[327]

(b) Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings.[328]

(c) An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance.[329]

(d) An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the

323 Ibid [4].
324 Ibid [31]. Broadly, an investment entity is an entity that: obtains funds from one or more investors for the purpose of providing them with investment management services; commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and measures and evaluates the performance of substantially all of its investments on a fair value basis (at [27]).
325 Ibid Appendix A.
326 Ibid [6]-[7].
327 Ibid [10].
328 Ibid [11].
329 Ibid [15].

ability to use its power to affect the investor's returns from its involvement with the investee.[330]

The CASAC Report noted that the requirement for a company to prepare consolidated group accounts for itself and any controlled entity is an example of an area where the corporations law (through the accounting standards) overrides the strict application of the separate entity approach.[331]

Accordingly, it can be concluded that the requirements of Part 2M.3 of the *Corporations Act* in relation to the obligation, pursuant to AASB 10,[332] to prepare consolidated financial statements of an economic entity (that is, a parent and all of its controlled subsidiaries) is a recognition of the enterprise doctrine which, in essence, treats a parent and its subsidiaries as a single business enterprise under the control of the parent with economic integration within the group.

3.4 Group Taxation Regimes and the Enterprise Doctrine

Ting has indicated that the rise of corporate groups and the emergence of the enterprise doctrine has led to the introduction of tax consolidation regimes in many countries.[333] The design of each country's consolidation regime differs with varying eligibility requirements and effects.[334] Ting further noted that the introduction of a consolidation regime is often a major taxation reform in a country, fundamentally changing the taxation of corporate groups.[335]

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330 Ibid [17].

331 CASAC Report (n 252) 26 [1.73]. See also Austin and Ramsay (n 255) [4.320]. The requirement for wholly-owned subsidiaries to observe certain financial reporting obligations may be relied on in certain circumstances. The Australian Securities and Investments Commission ('ASIC') made an order, the *ASIC Corporations (Wholly-owned Companies) Instrument 2016/7*85, pursuant to s 341(1) of the *Corporations Act* (n 274), which took effect on 29 September 2016 (which succeeded class order (CO 98/1418)) that, broadly, relieves wholly-owned entities of a holding entity from certain financial reporting obligations if they have entered into a deed of cross guarantee with the holding entity and other wholly-owned entities under which their debts are guaranteed and satisfied other conditions: see Austin and Ramsay (n 255) [20.250]; *Canon Australia Pty Ltd, in the matter of Canon Australia Pty Ltd* [2023] FCA 281 [3]-[4] (Stewart J); *Re Flight Centre Technology Pty Ltd* and Others (2022) 160 ACSR 651, 657 [18] (Black J).

332 AASB 10 is given the force of law by the *Corporations Act* ss 296, 304.

333 Ting (n 1) 5-7. Ting examines and compares in detail the tax consolidation regimes in Australia, France, Italy, Japan, the Netherlands, New Zealand, Spain and the United States. See also Ting, 'Policy and Membership Requirements' (n 14) 311.

334 Ting (n 1) 5-7. See also the Branch Reports in International Fiscal Association, Cahiers de Droit Fiscal International Volume 106A: *Group Approach and Separate Entity Approach in Domestic and International Tax Law* (2022). The Branch Reports in Volume 106A outline, inter alia, the extent to which, if any, each of 39 countries has a group tax regime.

335 Ibid 6. The Australian income tax consolidated groups regime originated from a proposal contained in the Howard Government's business tax reform proposals contained in the *ANTS White Paper* (n 443) of 1998: see below nn 442-9 and accompanying text. The Ralph Review further developed and consulted on the tax consolidation regime proposal contained in the *ANTS White Paper*: see Chapter 5, 5.3 and 5.7 below.

Hey and Schnitger have commented[336] on the rationale of group tax regimes as follows:

> The core rationale of any group tax regime is the reflection of the economic unit and the ability-to-pay of the group which does not depend on the number of legally independent subunits. While economic double taxation of distributions between related entities is avoided in many jurisdictions also outside tax groups, the main purpose of all group tax regimes is the immediate offsetting of losses. The immediate offsetting of intra-group profits and losses is even more relevant if the use of losses is restricted.

Masui has noted that central to the taxation of corporate groups is the objective of, first, off-setting the profits and losses of members of the group ('profit and loss offsetting objective') and, secondly, deferring the recognition of gains arising from asset transfers between group members ('tax-free intra-group asset transfer objective').[337]

Ting has noted that the two key dimensions under which the enterprise doctrine may be applied to the taxation of corporate groups are the taxable unit and the tax base.[338] Under the enterprise doctrine the taxable unit can be a group of companies under the common control of a parent company.[339] Whether or not the taxable unit under the enterprise doctrine includes resident and non-resident entities is a matter of tax system design for a particular country.[340]

Once the taxable unit is defined under the enterprise doctrine, it is necessary to determine the tax base of that taxable unit. Ting noted that under the enterprise doctrine, the tax base of a taxable unit can take into account the taxable income and losses of all its group members which are calculated according to the tax law of the country.[341] Such a tax base design meets the profit and loss offsetting objective mentioned above.

Ting further noted that where a tax base was defined to exclude intra-group transactions, it would meet the tax-free intra-group asset transfer objective mentioned above and represent a stronger application of the enterprise doctrine.[342]

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336 Johanna Hey and Arne Schnitger, General Report in International Fiscal Association, Cahiers de Droit Fiscal International Volume 106A: *Group Approach and Separate Entity Approach in Domestic and International Tax Law* (2022) 13, 30.

337 Yoshihiro Masui, General Report in International Fiscal Association, Cahiers de Droit Fiscal International Volume 89b *Group Taxation* (2004) 21, 31.

338 Ting (n 1) 27.

339 The separate entity approach would regard each entity as a taxable unit.

340 Ting (n 1) 27-8.

341 Ibid 28, 32-4. Ting also noted that where the taxable unit of a particular country is defined to include non-resident entities, the tax base may be based on the taxable income and losses of all resident and non-resident group entities computed under the laws of that country (at 34-38).

342 Ibid 32.

Masui reported ('IFA 2004 Report') that in relation to the profit and loss offsetting objective and the tax-free intra-group asset transfer objective, of the 30 branch reports reporting on group taxation in 2004, 11 countries[343] had a taxation regime that included both objectives, 9 countries[344] included only one of the objectives and 10 countries[345] did not include either objective as they did not have a group taxation regime.[346]

Hey and Schnitger reported ('IFA 2022 Report') that since the IFA 2004 Report the Republic of Korea (2010) Belgium (2019) and Hungary (2019) had introduced group tax regimes and Mexico had abolished its group tax regime.[347] Moreover, there were still many countries[348] that did not provide for group taxation regimes.[349] Hey and Schnitger indicated that the main reason that countries did not provide any group taxation measures was their negative effect on tax revenue.[350] Also, there were 'systematic reservations by countries with a strong separate entity approach which find it more difficult to regard groups as economic units'.[351]

Hey and Schnitger indicated[352] that group taxation systems vary widely in their conceptual design and distinguished four different approaches. First, a full consolidation regime,[353] under which there is a determination of the consolidated income of the group. Secondly, profit and loss attribution and the elimination of inter-company results.[354] Thirdly, profit and loss attribution,[355] under which aggregate income of the group is determined. Fourthly, either a group contribution approach with profit transfer to loss-making entities with payments required,[356] or a group relief approach with loss transfer to profit-making companies[357] with the separate entity principle applying under both approaches.

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343 Australia, France, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Sweden, the United Kingdom and the United States.

344 Austria, Denmark, Finland, Germany, India, Luxembourg, Mexico, Portugal and Singapore.

345 Argentina, Belgium, Canada, Czech Republic, Hungary, Korea, Peru, South Africa, Switzerland and Uruguay.

346 Masui (n 337) 33.

347 Hey and Schnitger (n 336) 31.

348 Argentina, Canada, Chile, Colombia, Czech Republic, Hong Kong, India, Mauritius, Peru, South Africa, Switzerland, Turkey, Ukraine, and Uruguay.

349 Hey and Schnitger (n 336) 31.

350 Ibid.

351 Ibid.

352 Ibid 31-2.

353 These were the consolidation regimes of Australia, Netherlands, New Zealand and the United States.

354 These were the consolidation regimes of France and Spain.

355 These were the consolidation regimes of Austria, Denmark, Germany, Hungary, Italy, Japan, Republic of Korea (partial elimination of inter-company results), Luxembourg, Poland and Portugal.

356 These were the consolidation regimes of Belgium (payment to the extent of tax saving required), Finland, New Zealand Norway and Sweden.

357 These were the consolidation regimes of Singapore and the United Kingdom (partial elimination of inter-company results).

Hey and Schnitger indicated that in ascending order the approaches 'reflect the economic unit of the group' with the full consolidation design being the 'most adequate reflection' (that is, reflective of a strong enterprise doctrine) and the fourth category adhering to the separate entity principle.[358]

Ting has noted[359] that Hey and Schnitger's second category, often called 'pooling', is the most common application of the single entity concept with the parent company and its subsidiaries in a consolidated group largely treated as separate entities for income tax purposes with the taxable income or loss of each group member being computed on an individual basis. Subsequently, the separate entity results are aggregated at the group level, often adjusted for intragroup transactions, to arrive at consolidated taxable income or loss.[360] The 'pooling' approach is generally regarded as reasonably straightforward and simple to apply.

Hey and Schnitger also noted that full consolidation group tax regimes, which effectively treat the group as one single taxpayer can be found in Australia, the Netherlands and New Zealand. In New Zealand, all taxable incomes of group members are aggregated to compute the group's taxable income or loss which policy design is consistent with the enterprise doctrine.[361] In the Netherlands, the profits of a fiscal unity are determined as if the group of entities is one single taxpayer and, thus, all transactions (transfers of assets, reorganisations) are considered "internal" transactions. However, due to anti-avoidance considerations, it is necessary to attribute loss and interest carry-forwards to separate group entities if they have arisen before entering the group.[362]

3.5 Australia's Tax Consolidation Regime and the Enterprise Doctrine

As discussed above, the ANTS White Paper had proposed a tax consolidation regime in its proposals for business tax reform which was an area of consideration by the Ralph Review[363] in its examination and consultation with business in respect of the reform of business taxation including re-designed company tax arrangements.

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358 Hey and Schnitger (n 336) 32.
359 Ting, 'Key Design Issues' (n 27) 421.
360 Ibid 432. See also Hey and Schnitger (n 336) 32.
361 Ting (n 1) 82.
362 Hey and Schnitger (n 336) 32.
363 See below n 467 and accompanying text.

In the Ralph Review's *A Platform for Consultation* discussion paper,[364] reasons were outlined, consistent with the ANTS White Paper, why a tax consolidation regime that focused on a wholly owned group as the tax entity, rather than a tax system that taxes each entity in a group as a separate entity, would improve significantly the taxation of entity groups.[365] Included in the reasons for taxing a wholly owned group as single consolidated entity were:

1. Simplification of the tax system and a reduction in compliance costs would result if intra-group transactions and intra-group interests were ignored as compliance obligations associated with intra-group transactions would not be necessary nor would it be necessary to consider complex provisions relating to such transactions and interests.[366]

2. Removal of taxation impediments to group restructuring since intra-group asset transfers, buy-backs of shares in group companies and group company liquidation would have no tax consequences for the consolidated group.[367]

3. Promotion of greater equity by the elimination of double tax that may arises in respect of a single economic gain and by preventing loss duplication, loss cascading and value shifting that can arise from intra-group dealings.[368]

4. Promotion of economic growth by providing a taxation framework that allowed Australian businesses to adopt organisational structures based more on commercial rather than tax considerations.[369]

It can be observed that *A Platform for Consultation* viewed the proposed tax consolidation regime as the introduction of a tax system based on the taxation of a wholly owned group as a taxable entity rather than the taxation of a group of companies by taxing each separate group member. Such an approach is consistent with the enterprise doctrine discussed in 3.2. Moreover, such an approach was regarded as providing benefits and the elimination of problems associated with an approach that taxed group members as separate entities.

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364 See below n 480 and accompanying text.

365 *A Platform for Consultation* (n 480) 533 [25.1].

366 Ibid 536 [25.8]-[25.9].

367 Ibid 536-7 [25.11]-[25.12].

368 Ibid 537-8 [25.16]-[25.17]. Double taxation can arise where gains are taxed in commercial transactions and again on the disposal of equity; loss cascading can arise where multiple tax losses occur in a chain of companies but there is only one economic loss. Loss duplication can arise where a tax loss occurs in carrying on a business or on the disposal of an asset and again on the disposal of equity: at 533 [25.3]. See also, Ting, 'Key Design Issues' (n 27) 446-7; Cooper (n 27) 276-90.

369 Ibid 534 [25.7].

A Platform for Consultation noted that since under consolidation the identity of individual group entities and intra-group ownership interests were to be disregarded it was necessary to reconstruct the cost base of the equity (such as the shares in a company or units in a unit trust) in an entity of the group upon its leaving the consolidated group. A reconstruction was required to be undertaken to determine a capital gain or loss on the transfer of that equity.[370]

A Platform for Consultation set out two alternative models for the reconstruction of equity cost bases noting that both models linked the cost base for equity in an entity sold by a consolidated group to the cost of the assets in the entity but the models differed as to how this was achieved.[371] First, an 'entity-based' model which, broadly, reconstructs a cost base for equity equal to the price the group paid for the entity plus the net increase of the aggregate cost base of the assets of the entity whilst in consolidation.[372] Secondly, an 'asset-based' model, which, broadly, disregards an entity's separate existence whilst in consolidation and upon an entity's entry into consolidation, the sum of the cost bases for the assets of the entity is reset equal to the consolidated group's cost base for the equity of the entity. Under the asset-based model, when an entity leaves the group, a cost base for its equity is reconstructed which is equal to the sum of the cost bases of its assets.[373]

In the Ralph Review's report to Government, *A Tax System Redesigned*,[374] the asset-based model was recommended rather than the entity-based model which was seen as requiring special rules for intra-group asset transfers which would add complexity to the law and increased costs for compliance and administration.[375] A major advantage of the asset-based model was that there were no tax compliance requirements for intra-group transfers due to the alignment of tax values at formation or acquisition.[376] Moreover, the proposed treatment had a broad degree of consistency with the accounting treatment at the group level in that intra-group transactions were disregarded and gains and losses realised during consolidation were not duplicated upon the disposal of membership interests.[377]

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370 Ibid 570-1 [27.1]-[27.2].
371 Ibid 572 [27.6].
372 Ibid 572-4 [27.7]-[27.11].
373 Ibid 574-7 [27.12]-[27.20].
374 *A Tax System Redesigned* (n 508).
375 Ibid 527 [15.5]
376 Ibid 528.
377 Ibid.

Ting noted that the choice of the asset-based model was influenced by the experience in the United States that had adopted an entity-based model but queried whether the costs and complexity argument put forward as a major reason for not favouring the entity-based model would also be present with the asset-based model.[378] Ting viewed the tax cost setting rules ('TCS rules')[379] required under the asset-based model that govern the tax cost setting of assets upon an entity joining a consolidated group and the tax cost setting for membership interests in an entity held by the consolidated group upon exit from the group as equally complex and costly in terms of compliance and administration.[380] Ting's view can readily be accepted as subsequent experience has demonstrated that the TCS rules continued to evolve after the enactment of the consolidation regime in 2002 and are complex and costly from an administrative and compliance perspective.[381]

The explanatory memorandum to the Bill[382] ('2002 Consolidation EM') that first enacted the tax consolidated regime in Australia noted the following features of the regime:[383]

1. A consolidated group consists of an Australian resident head company and all of its Australian resident wholly-owned subsidiaries. The subsidiary members may be companies, trusts or partnerships.
2. Rules allow certain resident wholly-owned subsidiaries of a foreign company to form a consolidated group known as a MEC group. Without this measure, wholly-owned resident subsidiaries of a foreign resident company would not be able to form a consolidated group in the absence of a single Australian resident head company unless they were restructured. The aim of this measure is to ensure that existing company groups that currently have access to grouping provisions (e.g. loss transfer and CGT rollover) will be able to form a consolidated group despite not having a single resident head company.

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378 Ting, 'A Road of No Return' (n 27) 170 .

379 The tax cost setting rules for assets when an entity becomes a member of a consolidated group are set out in Division 705 of *ITAA 97* (n 7). The tax cost setting rules for a group's cost of its membership interests in an entity when it leaves the group are set out in Division 711 of *ITAA 97*.

380 Ting, 'Key Design Issues' (n 27) 448.

381 The Board of Taxation in their report 'Post-Implementation Review into Certain Aspects of the Consolidation Regime (see above (n 9)) commented that despite the consolidation regime as a whole having delivered substantial efficiency and integrity improvements to the Australian tax system as compared to the former income tax grouping rules that had previously applied, there was substantial complexity in the operation of the regime, particularly when entities enter a consolidated group. This factor, the Board of Taxation noted, creates difficulty for groups and their advisers and places significant resource requirements on the Government to maintain and administer the regime (at 15, [2.24]-[2.25]). The Board of Taxation also noted that although the complexity of the tax cost setting rules is generally manageable, it is difficult when their complexity is combined with the uncertainty that can arise in their detailed application including interactions with other areas of the tax law (at 18-19, [2.39]-[2.46]).

382 2002 Consolidation EM (n 21).

383 Ibid 9-10 [1.13], 12-15 [1.16]-[1.37].

3. Pursuant to the 'single entity rule', a consolidated group is taxed as a single entity for all income tax purposes with subsidiary members of the group being treated as parts of the head company rather than as separate income tax identities.
4. All intra-group transactions are ignored.
5. Gains and losses realised within a consolidated group are recognised only once.
6. Loss integrity and value shifting rules do not apply to transactions between the members of a consolidated group
7. Generally, the head company of a consolidated group will be liable for the income tax debts of the group.
8. Generally, loss transfer and capital gains tax rollover relief rules no longer apply to wholly-owned groups.
9. The cost setting rules set the cost for income tax purposes of assets of entities when they become subsidiary members of a consolidated group and of membership interests in those entities when they cease to be subsidiary members of the group. These rules recognise that the head company's cost of becoming the holder of all of the assets is an amount which reflects the cost to the group of acquiring the entity. When an entity leaves a group, the alignment of the head company's costs for membership interests in each entity and its assets is preserved by recognising the cost of those interests as an amount equal to the cost of the entity's assets at that time reduced by the amount of its liabilities.
10. When an entity becomes a member of a consolidated group, its unused carry forward losses are tested to determine whether they can be transferred to the group. Broadly, a loss can only be transferred to the head company of a consolidated group if the loss could have been used outside the group by the entity seeking to transfer it. The utilisation of losses transferred to a consolidated group is subject to an annual limit that is determined by reference to the fraction of the group's income and gains considered to have been generated by the entity that transferred the losses. This is referred to as the available fraction method.
11. The choice to consolidate a group is optional but once it is made it is irrevocable.

The 2002 Consolidation EM explained that the single entity rule ('SER')[384] would 'operate in respect of a consolidated group as if the subsidiaries are absorbed into the head company, which is the relevant taxpayer'.[385] The 2002 Consolidation EM noted that the consequences of the SER were:

1. There is a common tax accounting period for all members, consolidated accounts for franking, losses and foreign credits and a single income tax return would by lodged (by the head entity) for the group with no separate lodgement requirements for subsidiary members.[386]

384 *ITAA 97* (n 7) s 701-1(3). See also above (n 18) and accompanying text.
385 2002 Consolidation EM (n 21) 20 [2.16].
386 Ibid 20 [2.17].

2. Transactions between members of a consolidated group would be ignored for income tax purposes and therefore intra-group asset transfers have no tax consequences.[387]
3. The assets and liabilities of subsidiary members are treated for income tax purposes as if they were owned by the head entity.[388]
4. In general, the head company is liable for the income tax-related liabilities of the consolidated group that are referable to the period of consolidation and special rules apply to allow the recovery of income tax-related liabilities directly from other members of the group where the head company has failed to pay that group liability on time.[389]
5. During consolidation, by reason of the 'absorption of the subsidiaries into the head company' under the SER, the taxable income of the group is that of the head company determined on the basis that assessable income and allowable deductions of the group are those of the head company.[390]

Ting has noted[391] that the SER is 'enhanced' by the 'entry history rule'[392] and the 'exit history rule'.[393] As noted by Ting, the entry history rule has the consequence that the tax history and attributes of a joining member are deemed to be those of the head company as the subsidiary does not exist for tax purposes whilst it is in the consolidated group.[394] The 'exit history rule' applies where a subsidiary member leaves a consolidated group and has the effect that the leaving entity takes with it the history in relation to the assets, liabilities and businesses that cease to be a part of the head company as a consequence of the leaving.[395]

Ting has noted that tax consolidation regimes to varying extents apply the enterprise doctrine to treat a corporate group as a single entity and that the Australian tax consolidation regime 'represents the strongest application of the enterprise doctrine' as compared to other countries' systems of taxing consolidated groups.[396]

387 Ibid 21 [2.18]-[2.19].
388 Ibid 21 [2.20].
389 Ibid 21 [2.21].
390 Ibid 21-2 [2.22].
391 Ting, 'A Road of No Return' (n 27) 167 .
392 The entry history rule is contained in *ITAA 97* (n 7) s 701-5.
393 The exit history rule is contained in *ITAA 97* s 701-40.
394 Ting, 'A Road of No Return' (n 27) 167. See also, 2002 Consolidation EM (n 21) 24 [2.31]-[2.33].
395 2002 Consolidation EM (n 21) 25 [2.38]-[2.47].
396 Ting, 'A Road of No Return' (n 27) 162-4.

Ting and Stinson noted that the SER 'represents a strong application of the enterprise doctrine' as it requires that all subsidiary members of a group are 'parts of the head company of the group, rather than separate entities'. [397]

In summary, therefore, the Australian tax consolidation regime, consistent with the enterprise doctrine that regards a group of companies as a single economic unit and not a group of separate entities, treats a group of wholly owned entities (comprising companies, trust and partnerships) of a single Australian resident company, the 'head company', as parts of the head company with the result that those group members have no separate existence for tax purposes whilst they remain members of the head company's tax consolidated group. Moreover, intra-group transactions and dealings and membership interests held by group members in other group members are ignored during consolidation, and all assets and liabilities of the group are taken to be those of the head company with the head company determining the taxable income and meeting tax liability for the group.

Accordingly, it can be concluded that Australia's tax consolidation regime as described and analysed above results in the taxation of a business enterprise, represented by the consolidated group, as a single economic entity which reflects the enterprise doctrine.

3.6 Conclusion

This chapter at 3.2 introduced the enterprise doctrine noting its origins and history and indicated that modern large business enterprises comprise a group of companies, with the parent company owning or controlling subsidiaries, which carry on business as a group rather than as a collection of separate individual legal entities.

At 3.3 the response of the corporate law to the enterprise doctrine in the United States, Australia, and to a lesser extent the United Kingdom, was analysed noting that although the corporate law had its origins in the separate entity doctrine it had embraced a group approach or focus in some areas such as where the courts (most commonly in the United States) have allowed so-called 'veil piercing' or 'lifting the veil' to disregard the separate entity doctrine, the permissibility of directors to take into account the interests of the group in certain

[397] Antony Ting and Peter Stinson, Australian Branch Report in 'A: Group Approach and Separate Entity Approach in Domestic and International Tax Law', International Fiscal Association, Cahiers de Droit Fiscal International Volume 106A (2022) 107, 113.

circumstances, the recognition in Australia of ‘shadow directors’ that may include a company whereby directors of a company are acting in accordance with, say, the direction of the parent company, and the ability of the liquidator of a subsidiary to bring proceedings against the holding company where there were reasonable grounds for suspecting insolvency at the time a debt was incurred by the subsidiary.

The requirements of the accounting standards, which have the force of law pursuant to the corporations law, to prepare accounts for an economic entity, that is the group of entities comprising the parent company and each of the subsidiaries it controls, was also analysed at 3.3.

At 3.4 the varying approaches of taxation law to the taxation of corporate groups were analysed, noting that some approaches recognised groups as taxable entities separate from the individual entities of the group thereby reflecting the enterprise doctrine. However, the design features of group taxation regimes by countries varied with some reflecting a stronger reflection of the enterprise doctrine than others.

At 3.5 the Australian tax consolidation regime was analysed and the conclusion was made that it represents a strong enterprise doctrine.

Chapter 4 - Research Questions and Methodology

4.1 Introduction

This chapter at 4.2 outlines the research questions which are addressed by this thesis.

At 4.3 the research methodology and approach to be used in answering the research questions is explained.

4.2 Research Questions

As discussed in chapter 1, the tax policy decision to include trusts and partnerships in Australia's tax consolidation regime is unique amongst the tax consolidation regimes around the globe.

The literature review in chapter 2 concluded that there is a paucity of academic literature in respect of the inclusion of trusts and partnerships in Australian tax consolidated groups. The academic literature that has considered Australia's tax consolidation regime has considered the regime more generally or has focused on other features of the regime.

Taking into account the above, the research will address the following research questions.

1. Does the Australian tax legislation adequately and effectively provide for the inclusion of trusts and partnerships in tax consolidated groups?

2. What legislative reforms are required to better achieve the policy intent of the inclusion of trusts and partnerships in the Australian tax consolidation regime?

3. Does the inclusion of trusts and partnerships in Australia's tax consolidation regime promote a stronger enterprise doctrine and represent good tax policy?

In answering research question 1, a detailed critical analysis is undertaken of the legislative provisions that relate to the inclusion of trusts and partnerships in consolidated groups to determine their purpose, meaning and efficacy. The methodology is discussed in 4.3.2.1

In answering research question 2, where appropriate, recommendations for legislative reform will be made to better achieve the policy intent to include trusts and partnerships in tax consolidated groups. The methodology is discussed in 4.3.2.2.

In answering research question 3, analysis is undertaken to determine whether Australia's tax policy decision to include trusts and partnerships in tax consolidated groups represents a stronger enterprise doctrine as compared to a regime without such an inclusion and whether such inclusion represents good tax policy. The methodology is discussed in 4.3.2.3.

Chapter 4.3.1 below outlines what comprises legal research and the methodologies by which it is undertaken.

4.3 Research Approach and Methodology

Research questions 1 and 2 identified in 4.2 primarily involve legal research, that is, research of the law. Outlined below is a summary of what comprises legal research and the methodologies by which it is undertaken.

4.3.1 Legal Research and its methodologies

4.3.1.1 Introduction and Doctrinal Research

Chynoweth has remarked that 'there is a dearth of theoretical literature on the nature of legal scholarship and a consequent lack of awareness about what legal scholars actually do.'[398] However, in the last two decades there have been a number of academic articles written, both in Australia and overseas, about the nature of legal research and its methodologies.[399]

Hutchison and Duncan noted that by the 1980s law had been 'well established as an academic discipline'[400] and cite the early work of the Pearce Committee[401] which categorised legal research as encompassing 'doctrinal research', 'reform-oriented research' and 'theoretical research'.

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398 Paul Chynoweth, 'Legal research' in Andrew Knight and Les Ruddock (eds), *Advanced Research Methods in the Built Environment*, (Wiley-Blackwell, 2008) 28.

399 See, for example, Terry Hutchinson, 'Developing Legal Research Skills: Expanding the Paradigm' (2008) 32(3) *Melbourne University Law Review* 1065; Mark Van Hoecke, 'Methodology of Comparative Legal Research' (2015) *Law and Method* 1; Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17(1) *Deakin Law Review* 83; Kylie Burns and Terry Hutchinson, 'The Impact of "Empirical Facts" on Legal scholarship and Legal Research Training' (2009) 43(2) *The Law Teacher* 153; Dawn Watkins and Mandy Burton (eds), *Research Methods in Law* (Routledge, 2013); Mark Van Hoecke (ed), *Methodologies of Legal Research* (Hart Publishing, 2011); Jaap Hage, 'Comparative Law as Method and the Method of Comparative Law' in Dirk Heirbaut and Maurice Adams (eds), *The Method and Culture of Comparative Law* (Bloomsbury Publishing, 2014) 37; Jaakko Husa, 'Research Design of Comparative Law — Methodology or Heuristics?' in Dirk Heirbaut and Maurice Adams (eds), *The Method and Culture of Comparative Law* (Bloomsbury Publishing, 2014) 53; Alice Pirlot, 'Tax Law Scholarship: Introspection and Typology' (2025) 2 *British Tax Review* 277.

400 Hutchinson and Duncan (n 399) 101.

401 Dennis Pearce, Enid Campbell and Don Harding, *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Commission* (AGPS, 1987) ('Pearce Report').

The Pearce Report defined doctrinal research as 'research which provides a systematic exposition of the rules governing a particular legal category, analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments'. Reform-oriented research was defined as 'research which intensively evaluates the adequacy of existing rules and which recommends changes to any rules found wanting'. Lastly, 'theoretical research' was defined as 'research which fosters a more complete understanding of the conceptual bases of legal principles and the combined effects of a range of rules and procedures that touch on a particular activity'. [402]

In 2005, the Council of Australian Law Deans ('CALD') released a statement ('CALD Statement') on the nature of legal research.[403] The CALD Statement recognised that the categories of legal research contained in the Pearce Committee report were now perhaps 'too narrow' and 'may be usefully described as occurring in varying combinations of the following categories': doctrinal, theoretical, critical/reformist, fundamental/contextual, empirical, historical, comparative, institutional, process-oriented and interdisciplinary.[404]

The CALD Statement made the point that doctrinal research 'involves rigorous analysis and creative synthesis, the making of connections between seemingly disparate doctrinal strands, and the challenge of extracting general principles from an inchoate mass of primary materials.'[405]

Hutchinson is of the view that doctrinal research is a discrete research methodology.[406] Initially, similar to other research projects, a critical analysis of the existing literature to inform the researcher 'what is known and not known about the topic' should be made.[407] In doctrinal research the primary data is the sources of the law, that is, the statutory law or the case law, which is identified and then interpreted and analysed.[408]

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402 Ibid, vol 3, 17.

403 CALD's statement was a part of its submission to the Department of Education, Science and Training in relation to the Research Quality Framework, May and 2005. The CALD statement may be accessed at <http://www.cald.asn.au/assets/lists/Resources/cald%20statement%20on%20the%20nature%20of%20legal%20research%20-%202005[1].pdf>.

404 CALD Statement (n 403) 2.

405 Ibid 3.

406 Terry Hutchinson, 'Doctrinal Research' in Watkins, Dawn and Mandy Burton (eds), *Research Methods in Law* (Routledge, 2013) 9-10, 13-17.

407 Ibid 18. See also Alan Bryman and Emma Bell, *Business Research Methods* (Oxford University Press, 4th ed, 2015) 100; Hutchinson and Duncan (n 399) 113.

408 Hutchinson (n 406) 18.

Hutchinson and Duncan make the point that doctrinal research is centred on the reading and analysis of the relevant primary sources which is far more than simply a description of the law.[409] Doctrinal research requires 'a high level of analysis and critique' which is essentially a qualitative approach.[410]

Central to legal research relating to statute law is statutory interpretation or construction, the process of ascertaining the meaning[411] of the words contained in statutes and other legislative instruments. Statutory rules[412] and common law principles have evolved that govern the process of statutory meaning or construction.[413] As discussed above, the modern approach to statutory interpretation in Australia begins with the words of the statute having regard to their context and purpose.[414] The context includes the legislative history and relevant and permissible extrinsic materials although understanding the context has utility if, and so far as, it assists in fixing the meaning of the statutory text.[415] Legislative history and extrinsic materials cannot displace the meaning of the statutory text nor is their examination an end in itself.[416]

Often the legal meaning will accord with the literal or grammatical meaning of the word or words but not always. Another meaning may, taking into account the context, purpose of the legislation and consequences of the grammatical meaning, be reasonably open which requires the words to be construed in a way that does not correspond to their literal or grammatical meaning.[417] Also, where the text read in context permits of more than one potential meaning, the choice of those meanings may eventually turn on an evaluation of the

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409 Hutchinson and Duncan (n 399) 113.

410 Ibid 116.

411 The meaning of the words of a statute, ascertained through the process of statutory interpretation, is often referred to as their 'legal meaning': *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 384 [78] (McHugh, Gummow, Kirby and Hayne JJ); *Taylor v The Owners – Strata Plan No 11564* (2014) 253 CLR 531, 557-8 (Gageler and Keane JJ).

412 The *Acts Interpretation Act 1901* (Cth) contains provisions which apply in the interpretation of Commonwealth legislation subject to a contrary intention manifested in the particular legislation being interpreted.

413 See, generally, Dennis Pearce, *Statutory Interpretation in Australia* (LexisNexis, 10th ed, 2024) and Perry Herzfeld and Thomas Prince, *Statutory Interpretation Principles* (Thomson Reuters, 2nd ed, 2021).

414 See, for example, the decisions of the High Court of Australia in *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384; *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355; *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27; *Lacey v Attorney-General (Qld)* (2011) 242 CLR 573 and *SAS Trustee Corporation v Miles* (2018) 265 CLR 137. See also James Spigelman, 'The Intolerable Wrestle: Developments in Statutory Interpretation' (2010) 84 *Australian Law Journal* 822 and Chloe Burnett, 'Interpretation in the French High Court' (2017) 44 *Australian Bar Review* 95.

415 *Commissioner of Taxation v Consolidated Media Holdings Limited* (2012) 250 CLR 503, 519 [39].

416 Ibid.

417 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 384 [78] (McHugh, Gummow, Kirby and Hayne JJ).

relative coherence of each with the scheme of the statute and its identified objects or policies.[418]

It has been observed that statutory construction is an application of the concept of the hermeneutic circle: the understanding of the parts (the statutory words or provision) is dependent upon understanding the larger whole (the relevant statute and its context and purpose), but the larger whole can only be understood on the basis of the parts, so that arriving at an understanding of any particular part involves movement to and fro between the parts and the whole.[419]

4.3.1.2 Other non-doctrinal legal research

The Pearce Report divided non-doctrinal legal research into 'reform-oriented research' (designed to accomplish change in the law) and 'theoretical research' (designed to foster a greater understanding of the conceptual bases of legal principles).[420]

McKerchar has remarked that such non-doctrinal research employs the methodologies commonly used in other disciplines.[421]

McKerchar makes the point that taxation is not a discipline but a social phenomenon that can be studied through various disciplinary lenses. Thus, taxation can attract researchers from the disciplines of law, accounting, economics, political science, psychology and philosophy.[422] McKerchar's 'overarching message' is that there are many approaches to research and no one methodology is better than another: each has its strengths and weaknesses.[423] However, some approaches are more suitable than others in answering the research questions and 'researchers will have personal preferences for different approaches depending on their ontology and epistemology, whether implicit or explicit'.[424]

McKerchar's message is that research design should not be limited by the traditional research paradigms of positivism and interpretivism, being 'by and large determined by how a

418 *Taylor v Owners – Strata Plan No. 11564* (2014) 253 CLR 531, 557 [66] (Gageler and Keane JJ).

419 *Thomas v State of New South Wales* [2008] NSWCA 316, [22] (Campbell JA). See also Joseph Campbell and Richard Campbell, 'Why Statutory Interpretation is Done as it is Done' (2014) 39 *Australian Bar Review* 1.

420 See above (n 401) and accompanying text.

421 Margaret McKerchar, 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation', (2008) 6(1) *eJournal of Tax Research* 5, 19.

422 Ibid 5.

423 Ibid 21.

424 Ibid.

researcher views the world (ontology) and believes that knowledge is created (epistemology).[425] Although each researcher will have a paradigm preference, McKerchar urges that it is important to keep an open mind to the work of researchers in both tax and other disciplines and that a researcher should be flexible enough to be able to work within the most appropriate paradigm depending on the research being undertaken.[426]

Pirlot identified five types of objectives that tax law scholars pursue in their research: explaining the law, assessing the consistence and uniformity in the use of concepts, evaluating the law and making policy recommendations, answering questions about the legal compatibility of tax legislation, and using or developing theories that shed light on tax-related topics.[427] The first three objectives are utilised in varying degrees in this thesis.

4.3.2 Research Methodology for Research Questions

The research methodology for each research question is set out below.

4.3.2.1 Research Question 1

Research question 1 is: Does the Australian tax legislation adequately and effectively provide for the inclusion of trusts and partnerships in tax consolidated groups?

Research in respect of research question 1 is primarily undertaken using a doctrinal research methodology.

As discussed in 4.3.1.1 in relation to legal research methodology, doctrinal research involves a critical analysis of the legislative provisions that relate to the inclusion of trusts and partnerships in tax consolidated groups, taking into account their purpose, meaning and context, to assess the adequacy and effectiveness of the legislative provisions. As indicated above, Hutchinson and Duncan take the view that doctrinal research requires 'a high level of analysis and critique' which is essentially a qualitative approach.[428]

The aim of this doctrinal research is to determine whether the policy to include trusts and partnerships in tax consolidated groups has been appropriately and adequately achieved through the legislative provisions.

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425 Ibid 6.
426 Ibid 7.
427 See above n (399) 289-94.
428 Hutchinson and Duncan (n 399) 116.

The data sources will include government and government sponsored reviews and papers pertaining to the design and implementation of the Australian tax consolidation regime; explanatory memoranda to parliamentary bills introducing the tax consolidation legislation; the consolidation legislation as enacted; and relevant court cases that have considered aspects of the consolidation legislation and its interpretation. It will also be necessary to consider any academic (scholarly) literature, Australian Taxation Office guidance and rulings and other literature that has considered the relevant legislative provisions.

4.3.2.1 Research Question 2

Research question 2 is: What legislative reforms are required to better achieve the policy intent of the inclusion of trusts and partnerships in the Australian tax consolidation regime?

Although research question 2, in part, requires a doctrinal research approach, it is also necessary to use a 'reform-oriented research' approach which intensively evaluates the adequacy of existing rules and which recommends changes to any rules found wanting'.[429]

The research takes into account the results of the doctrinal research in relation to research question 1, that is, the adequacy of the legislative provisions relating to trusts and partnerships in tax consolidated groups in achieving their purpose and recommends reforms to the tax consolidation legislation that relates to the inclusion of trusts and partnerships in tax consolidated groups.

4.3.2.3 Research Question 3

Research question 3 is: Does the inclusion of trusts and partnerships within consolidated groups in Australia's tax consolidation regime promote a stronger enterprise doctrine and represent good tax policy?

Research question 3, in part, relates to whether the Australia's tax policy to include trusts and partnerships in Australian tax consolidated groups represents a 'good' tax policy.

There are long-standing, well-established and generally accepted principles or guidelines that are regarded as features of a well-designed or good tax system. These are simplicity,

[429] Pearce Report (n 401) vol 3, 17.

efficiency, fairness, and neutrality.[430] From time to time other design principles are stated, such as 'flexibility', 'growth', 'convenience of payment', 'economy in collection', 'transparent' and 'competitiveness'.[431] However, as observed by Alley and Bentley, the principles often overlap and some are more specific or detailed than others that are broad and general concepts.[432] Alley and Bentley conclude by recommending that the set of design principles for a good tax system should encompass principles of equity and fairness, certainty and simplicity, efficiency, neutrality and effectiveness.[433]

Broadly, in considering the above-mentioned design criteria, simplicity refers to whether the relevant tax rules are clear and easy to understand rather than complex and uncertain.[434] Fairness (or equity) relates to whether persons in the same situation are treated equally ('horizontal equity') and whether those in different situations are treated differently ('vertical equity').[435] Neutrality means that a tax system should not affect the business decisions of a taxpayer, that is, tax should not be a factor in making a choice in respect of implementing a business structure.[436] Efficiency relates to minimization of compliance and administration costs and the collection of taxes should be straightforward.[437]

Ting,[438] in assessing whether the design of Australia's tax consolidation regime represented good tax policy, used the criteria of simplicity, fairness, neutrality, and competitiveness.[439]

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430 See, for example, Ting, *The Taxation of Corporate Groups*, above n 14, 19-26; Clinton Alley and Duncan Bentley, 'A Remodelling of Adam Smith's Tax Design Principles' (2005) 20 *Australian Tax Forum* 579; Richard M Bird and J Scott Wilkie, 'Designing tax policy: constraints and objectives in an open economy' (2013) 11 (3) *ejournal of Tax Research* 284; James Simon, Adrian Sawyer and Ian Wallschutzky, 'Tax simplification: A review of Initiatives in Australia, New Zealand and the United Kingdom', (2015) 13(1) *eJournal of Tax Research* 280; Jeremy Sherwood, Chris Evans and Binh Tran-Nam, 'The Office of Tax Simplification: The Way Forward' (2017) 2 *British Tax Review* 249; Taxation Review Committee ('Asprey Report'), Full Report (1975) 3.5-3.27.

431 Alley and Bentley (n 430) 585-588.

432 Ibid 588, 621.

433 Ibid 621-623.

434 Binh Tran-Nam and Chris Evans, 'Tax Policy Simplification: An Evaluation of the Proposal for a Standard Deduction for Work Related Expense' (2011) 26 *Australian Tax Forum* 719; Graeme S Cooper, 'Themes and Issues in Tax Simplification', (1993) 10 *Australian Tax Forum*, 417 ('Themes and Issues'); Graeme S Cooper, 'Legislating Principles As a Remedy For Tax Complexity' (2010) 4 *British Tax Review* 334 ('Legislating Principles'); James Simon, Adrian Sawyer and Ian Wallschutzky, 'Tax Simplification: A Review of Initiatives in Australia, New Zealand and the United Kingdom', (2015) 13(1) *eJournal of Tax Research* 280; Jeremy Sherwood, Chris Evans and Binh Tran-Nam, 'The Office of Tax Simplification: The Way Forward' (2017) 2 *British Tax Review* 249.

435 Asprey Report (n 430) 3.7.

436 Ting (n 1) 25-26.

437 Alley and Bentley (n 430) 622.

438 Ting (n 1).

439 Ibid 22-26. Ting viewed 'competitiveness' as the object of a tax system to enhance the competitiveness of a country's businesses and to promote economic growth: at 21.

In considering, for the purposes of research question 3, whether Australia's tax policy decision to include trusts and partnerships in the tax consolidation regime represents good tax policy, that assessment is to be made by applying the accepted tax system design criteria mentioned above.

In considering whether the inclusion of trusts and partnerships in Australian tax consolidated groups promotes a stronger enterprise doctrine,[440] statistics have been obtained from the ATO as to the number of trusts and partnerships that are members of Australian tax consolidated groups including MEC groups.[441] However, the ATO has no statistics available that indicate the value of assets that trusts and partnerships 'contribute' to a tax consolidated group. Presumably, this is because the head company of a tax consolidated group is only required to lodge an income tax return that discloses, inter alia, the group's total assets with no separate disclosure for group members' individual assets.

4.4 Conclusion

This chapter set out at 4.2 the three research questions which this thesis addresses.

The nature of legal research, the research approach primarily adopted in considering research question 1 and research question 2, was outlined in 4.3.1 and the methodologies by which it is undertaken.

The research methodology for each of the research questions was set out and explained in 4.3.2.

[440] See Ting (n 1) 3-5 and accompanying text.

[441] See above nn 13 and 23-5 and accompanying text.

Chapter 5 - Business Tax Reform, the Rise and Fall of Entity Taxation and the Birth of the Tax Consolidation Regime

5.1 Introduction

Although the major aim of this thesis is analysing trusts and partnerships within consolidated groups and MEC groups, it is useful to consider the history of so-called 'entity taxation' in Australia which had at its core the taxation of trusts (subject to limited exceptions) like companies. The initial tax consolidation proposals included trusts within the class of eligible entities that could comprise a tax consolidated group since they were to be taxed as if they were a company under the proposed 'consistent entity regime' or entity taxation regime. Partnerships (other than limited partnerships) were not to be included in the entity taxation regime.

Ultimately, the proposed entity taxation regime was abandoned and, at the time the first tax consolidation Bill[442] was introduced into Parliament on 16 May 2002 , trusts and partnerships were eligible, subject to various requirements, to be subsidiary members of a tax consolidated group.

This chapter at 5.2, 5.3 and 5.4 outlines the history of business tax reform in Australia including the Ralph Review proposals for an entity taxation regime, which included most trusts and were to be taxed like companies.

At 5.5 the September 1999 Report released by the Ralph Review is outlined, including the proposal to tax trusts like companies and a consolidation regime for groups of companies and trusts.

At 5.6 the October 2000 draft entity taxation legislation is outlined which included a revised proposal to only tax non-fixed trusts as companies with fixed trusts to retain their current tax treatment.

The 2000 draft tax consolidation legislation is outlined at 5.7 which included all wholly owned resident trusts as eligible to be subsidiary members of a consolidated group but not partnerships.

[442] The New Business Tax System (Consolidation) Bill (No 1) 2002 (Cth).

The Government's decision to abandon the entity regime is outlined at 5.8. The February 2002 draft tax consolidation legislation and explanatory material is outlined at 5.9 including the decision to allow fixed and non-fixed trust and partnerships to be eligible to be members of tax consolidated groups.

At 5.10 the introduction of the first Bill that implemented the tax consolidation regime is noted.

5.2 Beginning of Business Tax Reform

On 13 August 1998 Mr Peter Costello, Treasurer of the Commonwealth of Australia, announced[443] a new tax system for Australia and released the Government's tax reform plan, *Tax reform: not a new tax, a new tax system* ('ANTS White Paper').[444] The reforms outlined in the ANTS White Paper were largely based on the work completed by a Task Force,[445] the formation of which was announced by the Prime Minister John Howard on 13 August 1997.[446]

The ANTS White Paper indicated that the taxation of business entities required reform due to inconsistent entity treatment, inappropriate taxation of company groups and inconsistent treatment of distributions.[447]

In respect of the differential treatment of entities producing unfair outcomes, the ANTS White Paper noted:[448]

> Under current law, vastly different treatment is accorded investment income channelled through different entities. The treatment is different both between the various entities and at the individual investor (eg shareholder) level.
>
> Companies, fixed trusts, and discretionary trusts all offer investors the prospect of limited liability - shielding them from full personal liability for making good the entities' financial liabilities. And yet there is very different treatment across these entities of distributions out of profits freed from taxation by tax preferences ('tax-preferred' income). Such distributions by *companies* (ie unfranked dividends) are taxed in the hands of individual resident shareholders. In the case of *fixed trusts* these distributions are generally taxed with a delay

443 Treasurer, 'A New Tax System for All Australians' (Press Release, 13 August 1998); <https://devmin.tspace.gov.au/ministers/peter-costello-1996/media-releases/new-tax-system-all-australians>

444 Australia, *Tax Reform: Not A New Tax, A New Tax System* (White Paper, Australian Government Publishing Service August 1998) ('*ANTS White Paper*').

445 The formal Task Force was headed by Ken Henry of Treasury and comprised representatives of the Australian Taxation Office, the Department of the Prime Minister and Cabinet, the Treasurer's Office and the Cabinet Policy Unit: see Peter Tilley, '2000: A new tax system', (Working Paper 14/2021, Tax and Transfer Policy Institute, Australian National University, July 2021) 6.

446 Prime Minister, 'Taxation Reform' (Press Release, 13 August 1997).

447 *ANTS White Paper* (n 444) 109.

448 Ibid.

> when the interests in the trust are sold. With *discretionary trusts* the distributions are not taxed at all. The beneficiaries of discretionary trusts enjoy 'the best of both worlds', benefiting from both limited liability and the flow-through of tax preferences.
>
> Sole traders and partners in partnerships are able to access tax-preferred income but they bear liability for losses of their businesses (unless in limited partnerships); that is, they do not have limited liability arising from the entity.

In addressing the 'flawed' tax treatment of business entities, the ANTS White Paper proposed a strategy to consult on a framework for taxing trusts like companies and on the extension of the framework to other business entities.[449]

The ANTS White Paper noted that it did not make sense for the same investment to receive different tax treatment simply because it was an asset of a trust rather than that of a company and that consultation would take place in order to achieve consistent taxation of discretionary and fixed trusts like companies under a clear, fair and simple regime of redesigned company taxation.[450]

Freudenberg[451] questioned the accuracy of the claim, as part of the justification for entity taxation, made in the ANTS White Paper that fixed trusts and discretionary trusts offer investors the prospect of limited liability. Freudenberg referred[452] to the decision in *JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd*[453] (*Broomhead*) as authority for the proposition that sui juris beneficiaries of trusts may be personally liable to indemnify the trustee for liabilities properly incurred by the trustee in the execution of the trust.

Although Freudenberg's point is a legitimate one and tends to weaken the justification made in the ANTS White Paper for the proposed entity regime based on the limited liability of trusts, the issue of the personal liability of beneficiaries to indemnify trustees for a trust's liabilities is complex. The New South Wales Court of Appeal in *Balkin v Peck*[454] referred to the decision of McGarvie J in *Broomhead*, noting that His Honour had based his conclusion as to the right of a trustee to be indemnified by beneficiaries for properly incurred liabilities by the trustee

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449 Ibid 112.

450 Ibid 113.

451 Brett Freudenberg, 'Entity Taxation: The Inconsistency between Stated Policy and Actual Application' (2005) 1(2) *Journal of the Australian Tax Teachers Association* 458. The rationale of limited liability of beneficiaries of a discretionary trust as a justification for including discretionary trusts in entity taxation has been questioned by Glover: John Glover, 'Taxing Trusts: Entity v Conduit – An Assessment' (1999) 2(4) *The Tax Specialist* 194, 200.

452 Ibid 463.

453 [1985] VR 891.

454 (1998) 43 NSWLR 706.

on the principle, derived from the Privy Council decision in *Hardoon v Belilios*,[455] that a 'beneficiary who gets the benefit of the trust should bear its burdens unless he can show some good reasons why the trustee should bear the burdens himself'.[456]

D'Angelo[457] noted that although a trustee's right of indemnity out of the trust property, in respect of liabilities properly incurred by the trustee in administering the trust is well established,[458] 'less well known is that a trustee may have rights of indemnification against the beneficiaries personally, although there is surprising uncertainty around the question'.[459] D'Angelo examined the circumstances in which the personal indemnity arises[460] and whether creditors may subrogate to it in the way they may subrogate to the indemnity against trust property.[461] It is not necessary to further consider the issues examined by D'Angelo in relation to the personal indemnity here[462], however, it can be reasonably concluded that the justification for entity taxation contained in the ANTS White Paper based on the limited liability of beneficiaries of trusts is somewhat overstated.

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455 [1901] AC 118

456 (1998) 43 NSWLR 706, 712 (Mason P, Priestley JA and Sheppard AJA agreeing). See also *Causley v Countryside (No 3) Pty Ltd* [1996] NSWCA 97; *Chief Commissioner of State Revenue v CCM Holdings Trust Pty Ltd; Chief Commissioner of State Revenue v CCT Motorway Company Nominees Pty Ltd* [2014] NSWCA 42, [62]-[63] (Gleeson JA). Ford has noted the *Hardoon v Belilios* rule should also apply 'where there is more than one beneficiary and all of them are sui juris and entitled to the same interest as absolute owners between them: HAJ Ford, 'Trading Trusts and Creditors Rights' (1981) *Melbourne University Law Review* 1, 7. The New South Wales Law Reform Commission considered the liability of beneficiaries and the rule in *Hardoon v Belilios*) in New South Wales Law Reform Commission, *Laws Relating to Beneficiaries of Trusts* (Report No 144, May 2018) 3-13. The Commission's recommendation was that the rule should be abolished as it works greater hardship on beneficiaries that it confers benefit on trustee or creditors and its abolition would relieve that hardship without material injustice to trustees or creditors (at 13, [2.37]). For completeness, the rule in *Hardoon v Belilios* was repealed by s 100A of the Trustee Act 1925 (NSW): see Campbell, JC, 'The New Section 100A Trustee Act 1925 (NSW): When a Beneficiary is Personally Liable to Indemnify a Trustee' (2020) 14(2) *Journal of Equity* 103. See also Anthony F Bathurst, 'Commercial Trusts and the Liability of Beneficiaries: 'Are Commercial Trusts a Satisfactory Vehicle to be Used in Modern Day Commerce?' (Harold Ford Memorial Lecture, Melbourne Law School, 5 October 2021) that considers the liability of beneficiaries in relation to commercial trusts.

457 Nuncio D'Angelo, 'Shares and units: The parity myth and the truth about limited liability' (2011) 29(8) Company and Securities Law Journal 477.

458 *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 245; *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524, 542-3 [29]-[31] (Kiefel CJ, Keane and Edelman JJ); 561 [83] (Bell, Gageler and Nettle JJ), 577-8 [130]–[131] (Gordon J).

459 D'Angelo (n 457) 496.

460 Ibid 497-500.

461 Ibid 500-501. See also Diccon Loxton and Nuncio D'Angelo, 'Trustees Limitation of Liability: Myths, Mysteries and a Model Clause' (2013) 41(3) *Australian Business Law Review* 142 where there is a detailed consideration of the limitation of the personal liability of a trustee.

462 The right of a trustee to a personal indemnity from beneficiaries has been considered by Hughes: RA Hughes, 'The Right of a Trustee to a Personal Indemnity from Beneficiaries' (1990) 64(9) *Australian Law Journal* 567.

Freudenberg[463] also notes that the observation in the ANTS White Paper that tax preferred income that flows through fixed trusts is taxed on a delayed basis[464] is not entirely accurate as there are certain types of tax preferred amounts that can flow to beneficiaries of fixed trusts without any taxation, delayed or otherwise.[465]

The ANTS White Paper indicated that certain trusts would be excluded from the proposed entity tax regime. The general principle for exclusion was where a trust had been created and settled only as a legal requirement or subject to a legal test or sanction. Accordingly, on this basis, trusts excluded would include constructive trusts and trusts arising in a range of circumstances where the sole beneficiary was subject to a legal disability or was legally incapacitated.[466]

The ANTS White Paper also proposed consultation on allowing groups of companies, trusts and co-operatives to consolidate their taxation position.[467] The stated basis for the proposed tax consolidation regime was the growing complexities in the law facing company groups and associated high compliance costs as well as the ability of group companies to gain unintended tax advantages from the then existing grouping concessions and from dealing among themselves.[468] It was further noted that it was essential to deal with these issues as trusts were to be brought within the company tax framework.[469]

5.3 Ralph Review – *A Strong Foundation* Discussion Paper

On 14 August 1998, the Treasurer announced[470] that, as indicated in the ANTS White Paper, there would be consultation with business on business tax reform. Consultation was to occur in relation to a redesigned company tax regime including taxing trusts like companies and also

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463 Freudenberg (n 451).

464 Beneficiaries holding interests in fixed trusts are subject to CGT event E4 contained in s 104-70 of the *ITAA 97* (n 7) under which, broadly, a beneficiary makes a capital gain in respect of their interest if the aggregate of non-assessable amounts distributed to the beneficiary exceeds the beneficiary's cost base for that interest.

465 Freudenberg (n 451) 463.

466 *ANTS White Paper* (n 444) 119.

467 Ibid 123.

468 The *ANTS White Paper* noted that group companies were able to create artificial losses by cascading losses through the company chain and by shifting assets between subsidiaries at values higher or lower than their market values: *ANTS White Paper* (n 444) 110.

469 Ibid 123.

470 Treasurer, 'Business Income Tax Consultation' (Press Release, 14 August 1998). <https://web.archive.org/web/20160311214034/http://www.rbt.treasury.gov.au/publications/paper1/HTML/App.htm#AppB>.

extending the approach to other entities. There was also to be consultation with business on a more consistent approach to the taxation of business investments.

The Treasurer's 14 August 1998 announcement ('14 August 1998 Statement') indicated that the Government had appointed Mr John Ralph to conduct the consultation with business, assisted by a Tax Reform Task Force located in Treasury and had asked him to complete his review ('Ralph Review') and report to the Government by 31 March 1999. The 14 August 1998 Statement contained the terms of reference for the Ralph Review and in relation to the reform of business entities there was to be an examination of:

> the re-designed company tax arrangements proposed to apply to companies, trusts, cooperatives, limited partnerships and life insurers – including a move towards consolidated group taxation and the achievement of a consistent treatment of distributions of profit and contributed capital.

On 27 October 1998 the Treasurer announced[471] that the reporting time to Government for the Ralph Review had been extended to 30 June 1999 and that certain business leaders[472] had been appointed to the Review.

On 23 November 1998 Mr John Ralph, the Chairman of the Review of Business Taxation, released[473] the first of the Review's consultative documents, a discussion paper entitled *A Strong Foundation*.[474] As set out in *A Strong Foundation*, its object was 'to consult on the framework and process limitations of the business tax system with a view to recommending fundamental improvement'[475] rather than at that stage addressing specific policy issues relating to the taxation of entities and investments.[476]

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471 Treasurer, 'Review of Business Taxation' (Press Release, 27 October 1998); <https://web.archive.org/web/20160311214034/http://www.rbt.treasury.gov.au/publications/paper1/HTML/App.htm#AppB>.

472 Mr Rick Allert (Chairman of Southcorp Ltd) and Mr Bob Joss (Chief Executive Officer of Westpac Banking Corporation).

473 Review of Business Taxation, 'Review Of Business Taxation Releases First Discussion Paper' (Press Release, 23 November 1998); <16 Mar 2018 - Review of Business Taxation - Trove (nla.gov.au)>.

474 Australian Government, *A Strong Foundation – Discussion Paper: Establishing Objectives, Principles and Processes* (Australian Government, November 1998). <https://web.archive.org/web/20160304180255/http://www.rbt.treasury.gov.au/publications/paper1/index.htm>.

475 Ibid Overview, xiv, [21].

476 These were to be addressed in a second discussion paper: see below (n 480).

A Strong Foundation proposed three national taxation objectives that would provide high level guidance for the design and operation of the business tax system: optimising economic growth, ensuring equity, and facilitating simplification.[477] *A Strong Foundation* also proposed that in achieving the national taxation objectives it was necessary to adopt a range of supporting principles in relation to legislative design, policy design and administrative design.[478] The national objectives and supporting principles were intended to constitute a coherent framework for the development and maintenance of the business tax system.

5.4 Ralph Review – *A Platform for Consultation* Discussion Paper

On 22 February 1999 the members of the Ralph Review released[479] the Ralph Review's second discussion paper, *A Platform for Consultation*[480] which, pursuant to the Ralph Review's terms of reference, considered a range of issues and problems of the then current taxation treatment of investments and entities and canvassed a range of options for business tax reform.

The Overview to *A Platform for Consultation* noted that A *Strong Foundation's* investment neutrality principle required the consistent taxation of entities. Accordingly, the consistent taxation of public and private companies, discretionary and fixed trusts, limited partnerships, co-operatives and life insurers would address the issue of the same investments attracting different tax treatment simply because they are put through a different entity.[481] Also, *A Platform for Consultation* noted that *A Strong Foundation's'* national taxation objective of 'facilitating simplification'[482] would be achieved through consistent taxation treatment of entities.[483]

A Platform for Consultation proposed that the calculation of taxable income for entities covered by the new entity tax system, including trusts, would generally be determined in a

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477 *A Strong Foundation* (n 474) Overview, xvii, [34]; 62-64 .

478 Ibid Chapter 6.

479 Review of Business Taxation, 'A Platform for Consultation, Discussion Paper 2 Building on a Strong Foundation' (Press Release, 22 February 1999); <https://webarchive.nla.gov.au/awa/20180316084138/http://rbt.treasury.gov.au/>.

480 Commonwealth of Australia, *A Platform For Consultation, Discussion Paper 2 Building on a Strong Foundation* (Australian Government, February 1999).

481 Ibid 53 [198]; 345 [15.1]-[15.3].

482 *A Strong Foundation* (n 474) 64. Simplification related to simplifying both tax legislation and tax administration.

483 *A Platform for Consultation* (n 480) 471 [21.1].

manner consistent with that for companies.[484] Also, as a general principle, entities subject to the new entity tax system should have consistent access to tax concessions.[485]

In relation to trusts, *A Platform for Consultation* proposed that the new entity tax system would apply to all resident trusts unless they were specifically excluded. Moreover, the term 'trust' would have its ordinary meaning such that arrangements that came within the equitable concept of a trust relationship would be taxed as entities unless specifically excluded.[486]

In relation to partnerships, *A Platform for Consultation* proposed either the extension of the CGT fractional interest approach to the depreciation provisions, or, alternatively, apply an entity treatment to partnerships for depreciation and CGT purposes.[487] Under an entity approach for both depreciation and capital gains, the partnership would be regarded as the owner of all assets similar to that for depreciation purposes – the partners' ownership interest would be in the partnership as a whole.[488]

On 22 February 1999, the date of release of *A Platform for Consultation*, the Treasurer announced that cash management trusts would be subject to flow-through taxation such that income earned and distributed by cash management trusts would not be taxed in the hands of the trustee but in the hands of the individual investor. Also, flow-through treatment would, in principle, apply to other collective investment vehicles that were widely held unit trusts that distribute virtually all of their income annually, such as bond trusts, common funds, managed funds and property trusts.[489]

A Platform for Consultation proposed that those trusts excluded from the new entity tax system could be taxed under a modified Division 6[490] that reflected the nature of such trusts,

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484 Ibid 471 [21.4].
485 Ibid 473 [21.16].
486 Ibid 481 [22.1].
487 Ibid 328-40.
488 Ibid 336-7 [14.25]-[14.33].
489 Treasurer, 'The Review of Business Taxation: Cash Management Trusts' (Press Release, 22 February 1999); <https://petercostello.com.au/the-review-of-business-taxation-cash-management-trusts/> ('22 February 1999 Press Release').
490 Division 6 of Part III of the *ITAA 36* (n 40).

including the limited potential for such trusts to be used for commercial activities and for interests to be sold.[491]

A Platform for Consultation, consistent with the ANTS White Paper, indicated that the general principle for trusts to be excluded from the new entity tax system was that they had to be 'created or settled only as a legal requirement or subject to a legal test or sanction'.[492] This principle was aimed at trusts where the beneficiary (and the settlor or parent or guardian) would not usually have any real say in the use of a trust structure. This principle distinguished these trusts from trusts created at a settlor's direction.[493] Included within the excluded trust category were trusts: arising upon the property of a bankrupt person becoming vested in the Official Trustee, as a result of a court ordering a trust to be established to preserve the assets, or provide an income stream, or both, to a person suffering a legal disability, complying superannuation funds, and deceased estates provided that administration was complete within two years of the date of death.[494] Also excluded were constructive trusts and trusts under which property is held by a trustee pursuant to a bare trust (that is, no active duties to be performed by the trustee other than to hold the relevant property) with beneficiaries being absolutely entitled to that property.[495]

Chapter 22 of *A Platform for Consultation* identified several policy issues relating to trusts within the new entity tax system and canvassed options in relation to them. The issues cited included trusts that had multiple purposes, some of which meant that the trust was excluded from the new entity tax system and others that were consistent with the trust being within the new entity tax system.[496] Other issues included the effect of a resettlement of a trust for the purposes of the new entity tax system[497] and, since the nature of discretionary and hybrid trusts differ from fixed trusts and companies, full alignment of the tax treatment for these entities was not possible. For example, the continuity of ownership test applicable to fixed trusts was not appropriate for a discretionary trust as their objects do not have an interest in

491 *A Platform for Consultation* (n 480) 481- 2 [22.4] - [22.5].
492 Ibid 481 [22.2].
493 Ibid.
494 Ibid 503-4.
495 Ibid 481 [22.3].
496 Ibid 488 [22.31]-[22.32].
497 Ibid 490-93 [22.46]-[22.57].

trust property.[498] Another issue raised was the determination of cost base for beneficiaries of their interests in trusts especially in relation to discretionary objects of a discretionary trust which do not have an interest in trust property, rather a right of due administration.[499]

Chapter 26 of *A Platform for Consultation* contained a framework for the Government's proposed regime for taxing groups as a single entity as indicated in the ANTS White Paper.[500] There were six framework design principles set out (and discussed briefly) for the development of the proposed consolidation taxation regime. First, consolidation was to be optional, but if a group decided to consolidate, all its wholly owned Australian resident group entities (being companies and trusts) must consolidate.[501] Secondly, consolidated groups were to be treated as a single entity with the lodgement of a single income tax return and all intra-group transactions would be ignored.[502] Thirdly, the current grouping provisions were to be repealed as the availability of a consolidated taxation regime removed the need to retain the grouping provisions.[503] Fourthly, individual entity losses and franking account balances would be brought into the consolidated group with appropriate safeguard measures.[504] Fifthly, carry-forward losses and franking balances were to remain with the consolidated group upon the exit of an entity from the group.[505] Sixthly, provisions were to be established for determining the cost base of equity in an entity upon its exit from the consolidated group.[506]

Following the release of *A Platform for Consultation* on 22 February 1999, several public seminars were conducted by the Ralph Review in all capital cities of Australia in March 1999. In response to a call for submissions on *A Platform for Consultation*, the Ralph Review received 300 submissions by 16 April 1999.[507]

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498 Ibid 488 [22.33]-[22.34].
499 Ibid 495-98 [22.68]-[22.79].
500 See above (n 444) 110, 123.
501 *A Platform for Consultation* (n 480) 545-51.
502 Ibid 552-7.
503 Ibid 557-8.
504 Ibid 558-64.
505 Ibid 564-7.
506 Ibid 567 chapter27.
507 The submissions may be accessed at the archived website of the Ralph Review: <https://webarchive.nla.gov.au/awa/20180316084138/http://rbt.treasury.gov.au/>. See also: Review of Business Taxation, 'Over 280 Submissions Received' (Press Release 5/99, 2 June 1999).

5.5 Ralph review – *A Tax System Redesigned* Report and Draft Legislation

On 21 September 1999 the Treasurer announced **(**'21 September 1999 Press Release') the release of the Ralph Review's report *A Tax System Redesigned*[508] and announced certain taxation reforms based on the review undertaken by the Ralph Review.[509] Attachment K to the 21 September 1999 Press Release indicated that the Government would implement, with improvements, the reforms to achieve a unified entity regime announced in the ANTS White Paper as follows:

1. taxing trusts, life insurers, co-operatives and limited partnerships like companies.
2. simplifying the imputation system (with abolition of the intercorporate dividend rebate but without introduction of a deferred company tax).
3. refunding excess imputation credits to resident individuals and superannuation funds to improve equity between taxpayers.
4. providing a system of consolidation for groups of companies and trusts, while addressing value shifting; and
5. achieving a consistent treatment of entity distributions.

The 21 September 1999 Press Release indicated that, consistent with the Treasurer's announcement on 22 February 1999,[510] collective investment vehicles would be taxed on a flow-through basis as well as those types of trusts which were to be excluded from the unified entity regime. The unified entity regime was to commence on 1 July 2001.

A Tax System Redesigned, broadly consistent with the approach proposed in *A Platform for Consultation,* recommended that certain trusts should be excluded from entity taxation[511] and that a modified version of Division 6 should govern their taxation including incorporating some features of the recommended tax treatment of collective investment vehicles.[512] Also, *A Platform for Consultation* recommended that trusts for absolutely entitled beneficiates,[513] trusts arising from certain stakeholder arrangements,[514] purchaser trusts[515] and certain constructive trusts,[516] should be excluded from entity taxation.

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508 Australian Government, *A Tax System Redesigned* (Australian Government, July 1999).
509 Treasurer, 'The New Business Tax System' (Press Release, 21 September 1999); <https://ministers.treasury.gov.au/ministers/peter-costello-1996/media-releases/new-business-tax-system>.
510 22 February 1999 Press Release (n 489).
511 *A Tax System Redesigned* (n 508) 546-7, [16.10], 557-8.
512 Ibid 546-7.
513 Ibid 547-8 [16.11].
514 Ibid 549 [16.13].
515 Ibid 549 [16.14].
516 Ibid 550 [16.15].

The 21 September 1999 Press Release also announced the release of draft legislation ("Ralph Draft Legislation") and explanatory notes[517] which it said illustrated 'the type of legislative product achievable from more integrated design processes and a more principle-based legislative framework'. *A Tax System Redesigned* indicated[518] that the Ralph Draft Legislation and explanatory notes represented a snapshot of the legislative material necessary to give effect to the Ralph Review's recommendations. Included in the Ralph Draft Legislation and explanatory notes was the 'consistent entity regime' applying to companies, limited partnerships and most trusts as well as details of separate flow-through taxation for collective investment vehicles.

The Ralph Draft Legislation provided special rules for the taxation of 'tax entities' and the taxation of dealings between those entities and their members (such as distributions, contributions of capital and rearrangements of membership interests).[519] The definition of tax entity included a company, a trust, a person in the person's capacity as an executor administering a deceased estate, a limited partnership, and an arrangement entered into, or that arose, outside Australia and did not give rise to a trust but would have given rise to a trust if it had been entered into or had arisen in Australia.[520]

The general rule was that the consistent entity regime was to apply to all tax entities except to the extent that the legislative provisions provided otherwise.[521] Excluded from the consistent entity regime were complying superannuation funds, complying approved deposit funds and pooled superannuation trusts.[522] Also excluded were deceased estates until the first to occur of the completion of the administration, or two years since the date of death.[523] The Ralph Draft Legislation noted that rules were being developed to identify the other kinds of trust that would be excluded from the consistent entity treatment regime.[524]

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517 Australian Government, *A Tax System Redesigned: Draft Legislation* (Australian Government, July 1999) ('Ralph Draft Legislation').
518 *A Tax System Redesigned* (n 508) 4.
519 Ralph Draft Legislation (n 517) s 150-1.
520 Ibid s 960-105.
521 Ibid s 151-5.
522 Ibid s 151-10(1).
523 Ibid s 151-10(2).
524 Ibid s 151-10(1).

A 'collective investment vehicle' was not to be liable to tax on its taxable income if it fully distributed 98% or more of its taxable income before the end of the year of income.[525] Broadly, a collective investment vehicle was defined as an entity that was a fixed trust that was a unit trust, the central management and control of which was in Australia and had at least one trustee that was an Australian resident.[526] In addition, the unit trust must be widely-held (as defined[527]), or every member was either a pooled investment entity, a government body not subject to tax, or a foreign resident, or the trust was a registered managed investment scheme and at least 75% of the membership interests were held by pooled investment entities.[528] It was also necessary that the membership interests in the unit trust were equivalent[529] and the unit trust's activities were limited to 'investment activities'.[530] Broadly, investment activities were defined as activities which consisted wholly of either, or wholly of both of, investing in land or an interest in land, for the purpose, or primarily for the purpose, of receiving rent; or investing or trading in any of all of: secured or unsecured loans, bonds, debentures, stock or other securities, shares in a company, units in a unit trust, futures and forward contracts, interest rate and currency swap contracts, forward exchange rate and forward interest rate contracts, life insurance policies, a right or option in respect of the aforementioned, and any similar financial instruments.[531]

In relation to partnerships, *A Tax System Redesigned*, broadly, adopted the 'fractional interest approach' and 'entity approach'[532] proposed in *A Platform for Consultation*.[533] Under the fractional interest approach, partners would separately account for their shares of partnership receipts and payments and assets and liabilities. Only a partner selling their interest in the partnership or partnership asset would need to account for the disposal with continuing partners being unaffected. A purchaser of an interest in a partnership would claim

525 Ibid s 157-10.
526 Ibid s 157-95(1)(a)-(c).
527 Ibid s 960-110
528 Ibid s 157-95((1)(d).
529 Ibid s157-95(1)(e) and (3).
530 Ibid s157-95(1)(f) and (4).
531 Ibid s 157-95(4).
532 The entity approach was referred to as the 'joint approach' in *A Tax System Redesigned* to avoid confusion with the proposed entity taxation regime.
533 See above nn 487-8 and accompanying text.

depreciation deductions based on their purchase price for interests in the depreciable assets of the partnership.[534]

Under the entity approach (renamed as the 'joint approach'), a partnership would calculate its taxable income or loss as if it were a single taxpayer and, in particular would account for all gains and losses on the disposal of partnership assets rather than just non-CGT gains and losses on assets.[535]

5.6 2000 Draft Entity Taxation Legislation

On 11 October 2000, following extensive consultation, the Treasurer announced the release of exposure draft legislation[536] ('2000 Draft Entity Taxation Legislation') and explanatory material[537] to tax certain trusts like companies and commented:[538]

> [t]he proposed legislation for taxing trusts like companies achieves the objective of greater consistency in the taxation of entities while minimising compliance and restructuring costs. Under this approach, non-fixed trusts will be taxed like companies. Broadly, companies, fixed trusts, limited partnerships and co-operatives will retain their current tax treatment. This approach removes the requirement for the introduction of a collective investment vehicle regime.

The 2000 Draft Entity Taxation Legislation provided for tax treatment of 'non-fixed trusts' and distributions made by non-fixed trusts that was comparable to the tax treatment of companies and dividends paid by companies.[539] A 'non-fixed trust' was defined as a trust that was not a 'fixed trust'[540] which in turn was defined as a trust in respect of which entities have 'fixed entitlements' to all of the income and capital of the trust.[541] An entity had a 'fixed entitlement' to a share of the income or capital of a trust if that entity had a 'fixed entitlement'

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534 *A Tax System Redesigned* (n 508) 553.

535 Ibid 554-5.

536 Exposure Draft New Business Tax System (Entity Taxation) Bill 2000. <https://webarchive.nla.gov.au/awa/20010626232454/http://homer.treasury.gov.au/publications/TaxationPublications/TheNewBusinessTaxSystem/NewBusinessTaxationSystem(EntityTaxation)Bill2000/contents.htm>. ('2000 Draft Entity Taxation Legislation').

537 Exposure Draft New Business Tax System (Entity Taxation) Bill Explanatory Statement. <https://webarchive.nla.gov.au/awa/20020627161356/http://www.treasury.gov.au/publications/TaxationPublications/TheNewBusinessTaxSystem/NewBusinessTaxationSystem(EntityTaxation)Bill2000/Bill/bill.htm>.

538 Treasurer, 'Taxing Trusts Like Companies and Simplified Imputation Rules – Exposure Draft Legislation' (Press Release, 11 October 2000); <https://petercostello.com.au/taxing-trusts-like-companies-and-simplified-imputation-rules-exposure-draft-legislation/>.

539 2000 Draft Entity Taxation Legislation (n 536), s 153-20.

540 Ibid s 995-1(1), definition of 'non-fixed trust'.

541 Ibid s 995-1(1), definition of 'fixed trust'.

to that share within the meaning of Division 272 in Schedule 2F to the *ITAA 36*.[542] Broadly, a fixed entitlement within Division 272 was a 'vested and indefeasible interest'[543] in a share of income of a trust or of capital of the trust.[544]

Accordingly, upon the release of the 2000 Draft Entity Taxation Legislation on 11 October 2000, the Government's proposed entity regime which at the outset, as set out in the ANTS White Paper of 13 August 1998,[545] was to include all trusts (except those trusts that were expressly excluded) had become by 11 October 2000 a regime that would only include 'non-fixed trusts' with the retention of the then current tax treatment of companies, fixed trusts, limited partnerships and co-operatives.

5.7 2000 Draft Tax Consolidation Legislation

On 8 December 2000, following extensive consultation, the Treasurer announced[546] the release of exposure draft legislation[547] ('2000 Draft Tax Consolidation Legislation') and explanatory material[548] to allow wholly owned groups of companies and trusts to opt to be treated as a single consolidated entity for tax purposes.

Under the 2000 Draft Tax Consolidation Legislation, a consolidatable group was to consist of a single head entity and all of the '100% Australian subsidiaries' of that head entity, known as subsidiary members.[549] The head entity was an entity that was a 'common Australian

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542 Ibid s 995-1(1), definition of 'fixed entitlement'.

543 An interest in income or capital is said to be 'vested' where the holder has an immediate fixed right of present or future enjoyment and an interest is 'indefeasible' where it is not subject to any condition: see *Dwight v Commissioner of Taxation* (1992) 37 FCR 178, 192 (Hill J); *Walsh Bay Developments Pty Ltd v Commissioner of Taxation* (1995) 130 ALR 415, 427-8 (Beaumont and Sackville JJ);*Trustees of the Estate Mortgage Fighting Fund Trust v Commissioner of Taxation* (2000) 102 FCR 15, 36 [55] (Hill J).

544 *ITAA 36* (n 40) s 272-5, Schedule 2F.

545 *ANTS White Paper* (n 444).

546 Treasurer, 'Consolidated Taxation of Wholly Owned Groups – Exposure Draft Legislation' (Press Release, 8 December 2000); <https://petercostello.com.au/consolidated-taxation-of-wholly-owned-groups-exposure-draft-legislation/>.

547 Exposure Draft New Business Tax System (Consolidation) Bill 2000; <https://webarchive.nla.gov.au/awa/20171125152910/https://www.legislation.gov.au/Details/C2004B00844/Html/Text.>

548 Exposure Draft New Business Tax System (Consolidation) Bill Explanatory Statement. <https://webarchive.nla.gov.au/awa/20060910193833/http://www.icaa.com.au/upload/download/343d750a.pdf.>

549 2000 Draft Tax Consolidation Legislation, s 168-65, s 168-80. It is noted that, pursuant to s 168-60 of the 2000 Draft Tax Consolidation Legislation, a consolidated group first comes into existence when a choice made by the head entity of a consolidatable group that the group be consolidated starts to have effect under s 168-95 of the 2000 Draft Tax Consolidation Legislation.

corporate tax entity' and not a '100% Australian subsidiary' of another common Australian corporate tax entity at that time.[550]

A 'common Australian corporate tax entity' was, broadly, defined as an entity that was an 'Australian corporate tax entity' that was subject to the company tax rate and was not an excluded entity.[551] An 'Australian corporate tax entity' was defined by reference to the 2000 Draft Entity Taxation Legislation to mean an entity that was a 'corporate tax entity' and an Australian resident. [552] A 'corporate tax entity' was defined in the 2000 Draft Entity Taxation Legislation to mean a company, a corporate limited partnership, a corporate unit trust, a public trading trust and a trust covered by the non-fixed trust rules.[553] The 'non-fixed trust rules' were the provisions relating to non-fixed trusts (which were defined as trusts that were not 'fixed trusts'[554]) in Divisions 153 to 159 of the 2000 Draft Entity Taxation Legislation.[555]

The concept of a '100% Australian subsidiary' referred to common Australian corporate tax entities and to trusts that were not common Australian corporate tax entities that satisfied certain Australian residence tests and were wholly owned by an Australian corporate tax entity ('holding entity') or wholly owned by the holding entity's wholly owned subsidiaries, or wholly owned by both the holding entity and its wholly owned subsidiaries.[556]

In summary, therefore, it was proposed in the 2000 Draft Tax Consolidation Legislation that certain wholly owned Australian resident trusts that were not common Australian corporate tax entities (which concept included corporate unit trusts, public trading trusts and also non-fixed trusts that were subject to the non-fixed trust rules and to be taxed similarly to companies under the 2000 Draft Entity Taxation Legislation) could be subsidiary members of a consolidatable group. Accordingly, Australian resident fixed trusts that met the wholly owned requirement were eligible to be subsidiary members of a consolidatable group. Also, if a trust was a 'common Australian corporate tax entity' as discussed above, and not a 100%

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550 Ibid s 168-75.

551 Ibid s 168-78. Excluded entities included, broadly, corporate tax entities subject to the mutuality principle (s 168-78(2)), cooperative companies (s 168-78(3)), certain credit unions (s 168-78(4) and (5)), PDFs (s 168-78(6) and certain non-profit companies (s 168-75(7)).

552 2000 Draft Entity Taxation Legislation, s 960-116, definition of 'Australian corporate tax entity'.

553 Ibid s 960-115, definition of 'Corporate tax entity'.

554 Ibid s 995-1(1), definition of 'non-fixed trust'.

555 Ibid s 995-1(1), definition of 'non-fixed trust rules'.

556 2000 Draft Tax Consolidation Legislation, s 168-85.

Australian subsidiary of another corporate tax entity, the trust was eligible to be a head entity.[557]

Under the 2000 Draft Tax Consolidation Legislation a partnership (other than a 'corporate limited partnership'[558] which was included within the types of entity that was a 'corporate tax entity')[559] was not eligible to be a head entity of a consolidatable group as it was not a 'common Australian corporate tax entity' within s 168-78(1) of the 2000 Draft Tax Consolidation Legislation.[560] Also, a partnership (other than 'corporate limited partnerships' which, as discussed above, were 'corporate tax entities') could not qualify as a subsidiary member of a consolidated group or a consolidatable group under s 168-80 of the 2000 Draft Tax Consolidation Legislation since it was not an entity that satisfied the requirements of the definition of '100% Australian subsidiary' in s 168-65 of the 2000 Draft Tax Consolidation Legislation.

5.8 Abandonment of Entity Taxation Proposal

On 27 February 2001, The Treasurer announced ('February 2001 Press Release') that following the release of the 2000 Draft Entity Taxation Legislation the Government had received many submissions raising technical problems, particularly in relation to distinguishing the source of different distributions, and valuation and compliance issues, which made the 2000 Draft Entity Taxation Legislation 'not workable'.[561] The Treasurer indicated that following advice taken from the Board of Taxation,[562] which recommended that the 2000 Draft Entity Taxation Legislation should not proceed, the Government had decided to withdraw the draft legislation. Instead, The Treasurer said there would commence a new round of consultations (including with the Board of Taxation) on principles which could

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557 Ibid s 168-75.

558 A corporate limited partnership was a limited partnership (which at that time was defined in s 94B of the *ITAA 36* (n 40) as 'a partnership where the liability of at least one of the partners was limited') that satisfied the terms of s 94D of Division 5A of the *ITAA 36*. The object of Division 5A was for certain limited partnerships to be treated as a company for tax purposes: s 94A.

559 2000 Draft Entity Taxation Legislation, s 960-115, definition of 'corporate tax entity', para (b).

560 Section 168-78(1)(a) required an entity to be an 'Australian corporate tax entity' which was defined in s 960-116 (to be inserted by the 2000 Draft Entity Taxation Legislation) as a 'corporate tax entity' (defined in s 960-115) that was an Australian resident. A partnership did not qualify as a 'corporate tax entity' within s 960-115 as it was not an entity that came within the list of entity types set out in the definition.

561 Treasurer, 'Entity Taxation' (Press Release, 27 February 2001); <https://petercostello.com.au/entity-taxation-a/> ('27 February 2001 Press Release').

562 See The Board of Taxation, *Taxation of Discretionary Trusts, A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer*, November 2002, 3, [2]-[4] ('Taxation of Discretionary Trusts Report').

protect legitimate small business and farming arrangements whilst addressing any tax abuse in the trust area.[563]

The Board of Taxation, after the February 2001 Press Release, commenced its review focusing on tax abuse in relation to discretionary trusts and delivered its Report ('Taxation of Discretionary Trusts Report') to the Government in November 2002.[564] The Government released the Taxation of Discretionary Trusts Report on 12 December 2002.[565]

In the Taxation of Discretionary Trusts Report, the Board of Taxation considered that there were 'no compelling arguments for broad based reform to more closely align the tax treatment of discretionary trusts and companies and that the Government should retain the current flow-through treatment of distributions of non-assessable amounts by discretionary trusts'.[566]

The Board of Taxation's conclusion above was based, partly, on its view that discretionary trusts were not close substitutes for companies. Although trusts and companies have some similarities (such as asset protection for beneficiaries and shareholders due to limited liability of trusts[567] and companies), the Board of Taxation was of the view that they had important differences – first, discretionary trusts have much more limited access to equity finance than do companies and, secondly, in the case of small businesses, limited liability is not a particularly important factor in the choice of business entity. In this latter respect, the Board of Taxation was of the view that estate planning and the intergenerational transfer of assets were the prime drivers of choice in deciding whether a discretionary trust should be the desired business entity.[568]

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563 February 2001 Press Release (n 395).

564 Taxation of Discretionary Trusts Report (n 562).

565 Treasurer, 'Taxation of Discretionary Trusts' (Press Release, 12 December 2002); <https://petercostello.com.au/taxation-of-discretionary-trusts/> ('12 December 2002 Press Release').

566 Taxation of Discretionary Trusts Report (n 562) 1, Recommendation 1, 11-13.

567 As discussed above, nn 452-62 and accompanying text, there is potential liability of beneficiaries to the trustee or to third party creditors of a trust although it is a complex area of law. However, there is little or no risk of liability in relation to objects of discretionary trusts as they have no beneficial or equitable interest in the trust property: *Kennon v Spry* (2008) 238 CLR 366 (*Kennon*), 386-7 (French CJ); 407-408 (Gummow and Hayne JJ). See also *MSP Nominees Pty Ltd v Commissioner of Stamps (SA)* (1999) 198 CLR 449, 509 [34] (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ); *David & Ros Carr Holdings Pty Ltd v Ritossa* [2025] NSW CA 108 [41] (Leeming JA). Objects of a discretionary trust have the equitable right to compel the trustee to consider whether or not to make a distribution to them and an equitable right to the proper administration of the trust: *Kennon* 393 (French CJ); 407-408 (Gummow and Hayne JJ).

568 Taxation of Discretionary Trusts Report (n 562) 11, [47]-[50].

The Board of Taxation's conclusion was also based on its view that efficiency and equity of the tax system would not necessarily be improved by aligning the treatment of discretionary trusts and companies. Moreover, any proposal to tax discretionary trusts like companies could impose significant transitional costs on the economy and on those individuals who had structured their affairs under existing rules.[569]

A further matter noted by the Board of Taxation was that a key difference between the taxation of companies and trusts (or partnerships and individuals) is that amounts that are tax-preferred income are not taxed on distribution to beneficiaries whereas such amounts are assessable dividends for company shareholders. If this tax-preferred income were to become taxable on distribution, income earned through a trust would be taxed differently to income earned by an individual directly which would be a departure from the 'integration'[570] objective which leads to potential equity and efficiency concerns. The Board of Taxation therefore considered that to the extent that flow-through taxation had the potential to further integration, it had the potential to deliver superior outcomes in terms of equity and efficiency.

The Board of Taxation also considered that the potential equity and efficiency gains associated with integration of trust taxation and individual taxation should not be abandoned due to concerns about tax abuse – as a general rule, tax abuse should be addressed at source through better enforcement action to limit tax abuse opportunities.[571] Moreover, the Board of Taxation considered that in light of the implementation of trust integrity measures over several years,[572] concern about the use of trusts for tax planning did not of itself warrant fundamental change to the tax treatment of discretionary trusts.[573]

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569 Ibid 12, [52]-[55].

570 The Board of Taxation had previously explained that an element of the conduit approach to taxing entities is that tax paid on income through an entity should receive the same tax treatment as income earned directly by an individual – this is referred to as 'integration' – which had been regarded as a 'theoretical ideal' in prior Australian tax system reviews: see Taxation of Discretionary Trusts Report (n 562), 8, [30]-33].

571 Taxation of Discretionary Trusts Report (n 562) 13-14, [57]-[61].

572 Ibid 32-34, [126]-[137].

573 Ibid 14, [62]-[67]. Whether the Board of Taxation's view that fundamental change to the tax treatment of discretionary trusts was not required would be the same today is doubtful. See Sonali Walpola, 'A Critical Examination of the Tax-motivated Use of Discretionary Trusts: Evidence, Identifying Tax Avoidance, and the Efficacy of Legislative Tools' (2022) 51 *Australian Tax Review* 153. Evans argues that the popularity of discretionary trusts is due in part to their favourable

The Board of Taxation recommended that the income tax law should be amended to make more effective the existing rules[574] that sought to prevent the use of corporate beneficiaries which allowed individuals access to the lower company tax rate.[575]

The Treasurer's announcement[576] in releasing the Taxation of Discretionary Trusts Report indicated that the Government would legislate to introduce provisions consistent with the Board of Taxation's recommendation in relation to distributions from trusts. The Treasurer also noted the Board of Taxation's recommendation to retain the current flow-through treatment of distributions of non-assessable amounts by discretionary trusts rather than a company type taxation model.

The February 2001 Press Release signalled the demise of the Government's proposal to tax trusts like companies under a uniform entity regime. Evans[577] has noted:

> The rationale for that [unified entity tax] reform was to create a system so that 'similar activities, investments and entities' were taxed similarly (referred to as tax neutrality and also ensuring equity). While this objective is desirable, the proposal has since been criticised for being too focused around an anti-avoidance concern, and for giving rise to other problems, including creating new distortions between the treatment of individuals who owned property directly or were beneficiaries of a trust. It also would not have solved the income-splitting problem, and it would have encouraged deferral of tax.[578] (footnotes omitted).

As noted by Evans, Slater[579] had argued that the reform proposal had been 'framed solely as an anti-avoidance measure, rather than a structural reform'.[580] Marcarian[581] has noted that in addition to narrowly stated concerns about investment neutrality by the Ralph Review, the

tax treatment: Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' 41(2) (2019) *Sydney Law Review* 217, 238-45. Evans proposed a re-design of the rules relating to the taxation of trusts, which, broadly, allocates net amounts (including losses to the extent of owners cost bases in their interests in the trust) to the owners that own interests in the trust (excluding discretionary objects), their share is calculated as whatever they are entitled to, of all amounts as they are classified for tax purposes, as a proportion of the whole: at 251-3.

574 Contained in s 109 UB of the *ITAA 36* (n 40).

575 Taxation of Discretionary Trusts Report (n 562) 17 [81].

576 12 December 2002 Press Release (n 565).

577 Alex C Evans, 'Why We Use Private Trusts in Australia: The Income Tax Dimension Explained' 41(2) (2019) *Sydney Law Review* 217.

578 Ibid 244.

579 Anthony Slater, 'Taxing Trust Income after Bamford's Case' (2011) 40(2) *Australian Tax Review* 69.

580 Ibid 91.

581 Matthew Marcarian, 'The Future Taxation of Trusts in Australia – A Proposal' (2003) 38(5) *Taxation in Australia* 244.

Ralph Review proposals relating to discretionary trusts appeared to be driven by the revenue consideration of ensuring that tax preferred income did not escape taxation.[582]

5.9 2002 Draft Tax Consolidation Legislation

On 7 February 2002, The Minister for Revenue, Senator Coonan, announced ('7 February 2002 Press Release')[583] the release of a second exposure draft tax consolidation legislation (and explanatory material), the New Business Tax System (Consolidation) Bill 2002 ('2002 Draft Tax Consolidation Legislation'). Attachment A to the 7 February 2002 Press Release indicated that:

> Both fixed and non-fixed trusts will be eligible to be subsidiary members of a consolidated group where they are wholly owned by the group but will not be eligible to be the head company.
>
> - Allowing trusts to consolidate will remove the need to restructures (sic) to remove wholly owned trusts from between entities that could otherwise consolidate.
>
> - Trusts are ineligible to be the head entity of a consolidated group because they are not corporate taxpayers, rather, they are taxed as flow-through vehicles.

The 7 February 2002 Press Release also indicated that the rules contained in the 2002 Draft Tax Consolidation Legislation had been redrafted to take into account technical matters included in submissions following the release of the 2000 Draft Tax Consolidation Legislation and the rules had also been restructured and streamlined to improve their presentation.

In relation to trusts and partnerships as members of tax consolidated groups, the 2002 Draft Tax Consolidation Legislation provided:

1. A company,[584] subject to the satisfaction of certain income tax treatment, residence and ownership requirements,[585] was the only entity that could be a head company of a consolidatable group: a trust or a partnership was not eligible to be a head company.[586]

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582 Ibid 245.

583 Minister for Revenue and Assistant Treasurer, 'Making business easier' (Press Release, 7 February 2002).

584 Section 995-1 of the *ITAA 97* (n 7) defined a 'company' as a body corporate or any other unincorporated association or body or persons but not including a partnership or a 'non-entity joint venture'. A company of a kind specified in s 703-20(2) of the 2002 Draft Tax Consolidation Legislation was excluded from being eligible to be a member of a consolidated group or a consolidatable group because of the way their income was treated for income tax purposes.

585 2002 Draft Tax Consolidation Legislation s 703-15(3)(a), item 1.

586 The 2002 Draft Explanatory Material indicated (at para 3.32, p 39) that corporate unit trusts and public trading trusts cannot be head companies since their tax treatment was not identical to that of ordinary resident companies.

However, a corporate limited partnership[587] which was treated as a company for the purposes of the taxation law[588] was also eligible to be a head company.

2. A trust[589] was eligible to be a subsidiary member of a tax consolidatable group subject to it satisfying the Australian residence requirement and the wholly owned ownership requirement.[590] Broadly, the Australian residence requirement was that the trust was a resident trust estate within certain specified provisions of the income tax law which provisions varied depending on whether the trust was a trust other than a unit trust, a unit trust other than a corporate unit trust or a public trading trust, or a corporate unit trust or a public trading trust.[591]

3. The wholly owned ownership requirement for trusts[592] required the trust to be a wholly owned subsidiary of the head company. Broadly, a trust would be a wholly owned subsidiary of the head company if the trust's membership interests[593] were beneficially held by the head company, by one or more wholly owned subsidiaries of the head company, or by the head company and one or more of the head company's wholly owned subsidiaries.[594] Also, the wholly owned ownership requirement would be satisfied where interposed entities between the head company and the trust held membership interests in the a trust or in subsidiary members of the group as a nominee of the head company or a subsidiary member of the group.[595]

4. A partnership[596] was eligible to be a subsidiary member of a tax consolidatable group subject to it satisfying the wholly owned ownership requirement.[597] There was no residence requirement for partnerships.[598] Similar to trusts, a partnership would be a wholly owned

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587 See above (n 241).

588 *ITAA 36* (n 40) s 94J.

589 There was no definition of trust and, consistent with the discussion at ? above, its meaning should accord with that under the general law of trusts. Section 703-20 of the 2002 Draft Tax Consolidation Legislation excluded certain trusts from being eligible to be members of a consolidated group or a consolidatable group, for example, a trust that was a complying superannuation (as defined): 2002 Draft Tax Consolidation Legislation s 703-20(2), item 9(a).

590 2002 Draft Tax Consolidation Legislation s 703-15(3)(b), item 2.

591 Ibid s 703-25.

592 *A Tax System Redesigned* (n 508) had recommended against a 'wholly owned test' for the inclusion of discretionary and hybrid trusts in consolidated groups: 519-20. The 2002 Draft Explanatory Material indicated (at 34 [3.7]) that the inclusion of discretionary trusts and hybrid trusts in consolidated groups on the basis of a wholly-owned test departs from the recommendation in *A Tax System Redesigned* as it avoids introducing unnecessary complexity into the regime.

593 The membership interests in a trust were the interests by which an entity was a 'member' of a trust: 2002 Draft Tax Consolidation Legislation, s 960-135. A member of a trust (other than a corporate unit trust or a public trading trust) was a beneficiary, unitholder or object of the trust:2002 Draft Tax Consolidation Legislation, s 960-130(1), item 3. For a corporate unit trust or a public trading trust, a member was a unitholder in the trust: 2002 Draft Tax Consolidation Legislation, s 960-130(1), items 4 and 5.

594 2002 Draft Tax Consolidation Legislation s 703-30.

595 Ibid s 703-45(2).

596 At that time 'partnership' was defined is s 995-1(1) of the *ITAA 97* (n 7) as 'an association of persons carrying on business as partners or in receipt of ordinary income or statutory income jointly, but does not include a company'.

597 Ibid s 703-15(3)(b), item 2.

598 The 2002 Draft Explanatory Material indicated that in a consolidation context a partnership whose partners are subsidiary members would have satisfied the Australian residence requirements themselves and therefore it is unnecessary to impose a further residence test: para 3.60, 46.

subsidiary of the head company if the partnership's membership interests[599] were beneficially held by the head company, by one or more wholly owned subsidiaries of the head company, or by the head company and one or more of the head company's wholly owned subsidiaries.[600] Also, the wholly owned ownership requirement would be satisfied where interposed entities between the head company and the partnership held membership interests in the partnership or in subsidiary members of the group as a nominee of the head company or a subsidiary member of the group.[601]

5. An exception to the wholly-owned requirement was that minor holdings (1% or less) of shares in a company that had been issued under employee share acquisition arrangements were disregarded when considering the satisfaction of the requirement.[602] Also, an entity was to be treated as a wholly-owned subsidiary of another entity despite there being a trust that is not a fixed trust interposed between the entity and the head company of the consolidated group.[603] An interposed foreign resident test allowed certain interposed non-resident entities to be disregarded for the purposes of determining whether a trust or partnership was a member of a consolidatable or consolidated group.[604] However, the non-resident entities were not themselves part of the group.

5.10 Tax Consolidation Bill Introduced Into Parliament

On 16 May 2002, The Minister for Revenue, Senator Coonan, announced ('16 May 2002 Press Release')[605] the introduction of legislation[606] into the Australian Parliament to implement the new tax consolidation regime which was to commence from 1 July 2002. The 16 May 2002 Press Release indicated that a consolidated group would consist of an Australian resident holding company and all of its Australian resident wholly-owned subsidiaries (including companies, partnerships and trusts) and also allow, which was a change from the 2002 Draft Tax Consolidation Legislation, non-profit companies to be head companies and allow companies that were subject to the mutuality principle to be members of a consolidated group.[607]

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599 The membership interests in a partnership were the interests by which an entity was a member of a partnership: 2002 Draft Tax Consolidation Legislation, s 960-135. A member of a partnership was a partner in the partnership: 2002 Draft Tax Consolidation Legislation, s 960-130(1), item 2.

600 2002 Draft Tax Consolidation Legislation s 703-30.

601 Ibid s 703-45(2).

602 Ibid s 703-35.

603 Ibid s 703-40.

604 Ibid s 703-45(4).

605 Minister for Revenue and Assistant Treasurer, 'Consolidated Taxation of Corporate Groups' (Press Release, 16 May 2002) ('16 May 2002 Press Release').

606 Introduced as the New Business Tax System (Consolidation) Bill (No 1) 2002 (Cth) ("May 2002 Consolidation Bill") and ultimately enacted as the *New Business Tax System (Consolidation) Act (No 1) 2002* (Cth).

607 Ibid Attachment C.

The New Business Tax System (Consolidation) Bill (No 1) 2002 (Cth) ('May 2002 Consolidation Bill') and accompanying Explanatory Memorandum[608] ('May 2002 Consolidation Bill EM') were introduced into Parliament on 16 May 2002. The May 2002 Consolidation Bill EM contained the following explanation as to the inclusion of trusts and partnerships in a consolidated group:[609]

> 3.55 Companies in addition to trusts and partnerships may be eligible to be subsidiary members of a consolidatable or consolidated group. The inclusion of most trusts as subsidiary members of a consolidated group is appropriate on the basis that income generally maintains its character as it flows through the trust to the beneficiaries or objects. Likewise, most partnerships (other than corporate limited partnerships) are simply conduits through which amounts flow through to the partners.
>
> 3.56 The inclusion of trusts and partnerships in a consolidated group is also important to ensure generally that companies that are currently members of the same wholly-owned group under section 975-500 of the ITAA 1997 can continue to access grouping benefits within the confines of a consolidated group. Certain trusts and partnerships, for example, may currently form part of the ownership structure of such wholly-owned groups.

A Tax System Redesigned had proposed that discretionary trusts and hybrid trusts should be included in a consolidated group based on an 'objects test' rather than the 'wholly owned' test.[610] However, by the time the May 2002 Consolidation Bill was introduced into Parliament on 16 May 2002 that proposal had been abandoned on the basis that a wholly-owned test for the inclusion of discretionary trusts and hybrid trusts in consolidated groups, although departing from the recommendation in *A Tax System Redesigned*, avoided introducing unnecessary complexity into the regime.[611]

5.11 Conclusion

This chapter at 5.2 outlined the beginning of business tax reform in Australia commencing in 1998 with the ANTS White Paper and at 5.3 and 5.4 outlined the establishment of Ralph Review and its proposals for a re-designed business tax system including a re-designed company tax regime ('entity taxation regime') which included taxing trusts like companies and moving towards consolidated group taxation.

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608 2002 Consolidation EM (n 21).

609 The justification in the 2002 Consolidation EM (n 21) for the inclusion of trusts and partnerships is analysed in Chapter 2 at 2.2.

610 *A Tax System Redesigned* (n 508), 518-20. Broadly, a discretionary trust was to be included in a consolidated group if a member of the group was an object (that is a person in whose favour the trustee may, at its discretion, exercise a power of appointment to distribute income or corpus of the trust) of the trust. Similarly, a hybrid trust would be included in a consolidated group if all of the fixed interest of the trust were held by members of the consolidated group and at least one member of the group is a discretionary object of the trust (at 520).

611 2002 Consolidation EM (n 21) [3.7].

At 5.5 the Ralph Review's *A Tax System Redesigned* report and accompanying draft legislation released in September 1999 was summarised including the proposed entity taxation regime.

The release in October 2000 of the draft entity taxation legislation and explanatory material which presented a re-designed entity taxation regime, which would only apply to non-fixed trusts, was outlined at 5.6.

At 5.7 the October 2000 draft consolidation legislation and explanatory material was discussed which included non-fixed trusts (as they were within the entity taxation regime) and resident fixed trusts in consolidated groups. Partnerships were not included within consolidated groups.

The abandonment of the entity taxation regime by the Government in February 2001 was outlined at 5.8 including the Board of Taxation's 2002 review of the taxation of discretionary trusts.

The February 2002 draft tax consolidation legislation and explanatory material were outlined at 5.9 including the proposal for both fixed and non-fixed trusts to be subsidiary members of a tax consolidated group and also partnerships. It is not absolutely clear why in February 2002 partnerships were eligible to be included in consolidated groups but prior to that, including in the October 2000 draft consolidation legislation, they had not been included.

The introduction of the first tax consolidation Bill into Parliament in May 2002, which, consistent with the February draft consolidation legislation, included trusts and partnerships in consolidated groups, was outlined at 5.10.

Chapter 6 - Trusts as Members of Australian Tax Consolidated Groups and Multiple Entry Consolidated (MEC) Groups

6.1 Introduction

This Chapter analyses the eligibility requirements for trusts to be either a head company or a subsidiary member of a consolidated group or a consolidatable group and a member of a MEC Group. It also analyses the issues that arise in relation to the meaning and application of those eligibility requirements.

Section 6.2 analyses the requirements for a trust to be the head company of a consolidated group and a consolidatable group. Section 6.3 analyses the requirements for a trust to be a subsidiary member of a consolidated group or a consolidatable group.

Section 6.4 analyses the requirements for a trust to be a member of a MEC Group.

Section 6.5 analyses certain issues arising from the analysis in sections 6.2, 6.3 and 6.4.

6.1.1 Consolidatable group and consolidated group – Formation and Membership

A consolidated group comes into existence on the day that the head company of a consolidatable group chooses in writing as the day (which is after 30 June 2002) from which the consolidatable group is taken to be consolidated.[612] A consolidated group may also come into existence at the time a MEC group ceases to exist.[613]

A consolidatable group consists of a single head company and all the subsidiary members of the group.[614] However, a consolidatable group cannot consist of a head company alone.[615]

At any time while in existence, a consolidated group consists of the head company and all of the subsidiary members (if any) of the group at the time.[616] However, a consolidated group can consist of the head company alone.[617] This may occur, for example, where all subsidiary members of a consolidated group have ceased to be members of the consolidated group

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612 *ITAA 97* (n 7) ss 703-5(1)(a), 703-50(1). The choice is irrevocable (s 703-50(2)) and a notice in the approved form and containing the required information is required to be given to the Commissioner of Taxation (s 703-58(1)).

613 Ibid ss 703-5(1)(b), 703-55.

614 Ibid s 703-10(1).

615 Ibid s 703-10(2).

616 Ibid s 703-5(3).

617 Ibid note to s 703-5(3).

because they have been transferred outside the wholly owned group,[618] or have been liquidated. Where a consolidated group consists solely of the head company, the subsequent acquisition of entities that satisfy the eligibility requirements[619] for subsidiary members has the effect that those entities join an existing consolidated group.

An entity is a member of a consolidatable group or a consolidated group while the entity is the head company of the group or is a subsidiary member of the group.[620] It is only those entities that satisfy the requirements set out in s 703-15(2)(a) of the *ITAA 97* in relation to head companies, and in s 703-15(2)(b) in relation to subsidiary members, that are eligible to be a head company or a subsidiary member of a consolidatable group or consolidated group.[621]

Although the word 'entity' is widely defined in s 960-100(1) of the *ITAA 97*,[622] s 703-15(2) of the sets out the eligibility requirements for those types of entities that are eligible to be head companies or subsidiary members of a consolidatable group or a consolidated group.

Certain trusts are eligible to be the head company of a consolidated group or consolidatable group (discussed in 6.2) and certain trusts are eligible to be subsidiary members of a consolidatable group or consolidated group (discussed in 6.3).

6.1.2 MEC Groups and potential MEC groups – Formation and Membership

The tax consolidation provisions contained in Part 3-90 of the *ITAA 97*, other than Division 703 and subject to Division 719, have effect in relation to a 'MEC group' in the same way that they have effect in relation to a consolidated group.[623] A MEC group is a multiple entry consolidated group.[624]

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618 The wholly owned requirement for subsidiary members in a consolidated group (see column 4 of item 2 of the table in s 703-15(2) of the *ITAA 97* (n 7)) has the consequence that from the time that a subsidiary member is not wholly owned by the head company of the consolidated group, that subsidiary member ceases to be a member of the consolidated group. Therefore, both significant and insignificant changes in the percentage ownership of membership interests that a head company or other subsidiary members have in a subsidiary member that cause the wholly owned requirement to cease being met have the consequence that the subsidiary member will exit the consolidated group.

619 The eligibility requirements are set out in item 2 of the table in s 703-15(2) of the *ITAA 97*.

620 *ITAA 97* s 703-15(1).

621 Section 703-20 of the *ITAA 97* specifies certain entities and their features which cannot be members of a consolidated group or a consolidatable group.

622 Section 995-1(1) of the *ITAA 97* provides that the word 'entity' has the meaning given by s 960-100. Section 960-100(1) defines an entity to mean an individual, a body corporate, a body politic, a partnership, any other unincorporated association or body of persons, a trust, a superannuation fund, and an approved deposit fund.

623 *ITAA 97* s 719-2.

624 Ibid s 719-5(1).

The MEC group provisions[625] in the tax consolidation legislation allow, broadly, wholly-owned Australian resident subsidiaries (referred to as 'tier-1 companies'[626]) of a foreign resident company (referred to as a 'top company'[627]), to form a consolidated group where the top company has more than one investment entry point (through the tier-1 companies) into Australia. The explanatory memorandum to the Bill[628] that introduced the MEC group provisions noted that each 'entry level' entity (that is, each tier-1 company) was free to choose: to group with other 'entry level' entities and form a MEC group, to form a consolidated group, or to remain unconsolidated.[629]

A 'top company' is, broadly, a company that is a foreign resident[630] and is not a wholly-owned subsidiary of another company.[631]

A 'tier-1 company' is, broadly, an Australian resident company[632] that has all or some of its taxable income taxed at the corporate tax rate and is not covered by an item in the table in s 703-20 of the *ITAA 97*.[633] Further requirements are that the company must be a wholly-owned subsidiary of the top company and must not be a wholly-owned subsidiary of a company that is an Australian resident.[634]

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625 Contained in *ITAA 97* (n 7) div 719.

626 Ibid s 719-20(1)(b) item 2 of the table.

627 Ibid s 719-20(1)(a) item 1 of the table.

628 2002 Consolidation EM (n 21).

629 Ibid [4.3].

630 Section 719-20(1)(a) item 1 column 3 of the table. A 'foreign resident' is defined as meaning a person that is not a resident of Australia for the purposes of the *ITAA 36* (n 40): *ITAA 97* s 995-1(1) (definition of 'foreign resident').

631 Section 719-20(1)(a) item 1 column 4 of the table. An exception to this requirement is where the top company is wholly owned by a company that is a 'prescribed dual resident' which is defined as meaning a company that is a 'prescribed dual resident' for the purposes of *ITAA 36* s 6(1): *ITAA 97* s 995-1(1) (definition of 'prescribed dual resident'). A company is a 'prescribed dual resident' where, first, broadly, it is an Australian resident company and it is also a resident of a foreign country with which Australia has a tax treaty and that treaty treats it as solely a resident of the foreign country pursuant to a residence tie-breaker clause in that treaty: *ITAA 36* (para (a) 'definition of prescribed dual resident'). Secondly, broadly, a company is a 'prescribed dual resident' where it is a resident of Australia solely because it carries on business in Australia and has its central management and control in Australia and it is also a resident of another foreign country and has its central management control in another country. A further exception to this requirement is where the top company is wholly owned by a company that is an Australian resident that fails a condition in *ITAA 97* s 719-20(1) item 2 column 2 of the table, that is, it is not taxed at the corporate tax rate or is covered by an item in the table in *ITAA 97* s 703-20.

632 *ITAA 97* s 719-20(1) item 2 column 2 of the table. It cannot, however, be a 'prescribed dual resident' (see in this regard above n (631)).

633 Ibid s 719-20(1) item 2 column 3 of the table.

634 Ibid column 4 of the table. An exception is where the company is wholly owned by an Australian resident company that fails a condition in s 719-20(1) item 2 column 2 of the table, that is, it is not taxed at the corporate tax rate or is covered by an item in the table in s 703-20.

A tier-1 company of a top company is an 'eligible tier-1 company' if it is not disqualified from being an eligible tier-1 company.[635]

A MEC group comes into existence on the day (which must be after 30 June 2002) that two or more eligible tier-1 companies of a top company jointly make a choice in writing that the potential MEC group[636] derived from those companies be consolidated on and after that day.[637] The MEC group that results from such a choice consists of the potential MEC group derived from time to time from whichever of one or more of those companies continue to be eligible tier-1 companies of the top company.[638] The choice to consolidate must include an appointment, made jointly by the eligible tier-1 companies, of one of those companies to be the provisional head company of the MEC group.[639]

A MEC group also comes into existence when a special conversion event happens to a potential MEC group derived from an eligible tier-1 company of a top company.[640] Broadly, a special conversion event happens when a MEC group is created from a consolidated group. This may occur, for example, where a top company acquires a company that becomes an eligible tier-1 company and the head company (which is also an eligible tier-1 company of the top company) of a consolidated group chooses to make a MEC group from the consolidated group including the just acquired eligible tier-1 company.

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635 Ibid s 719-15(1). A tier-1 company will not be an eligible tier-1 company where there are one or more entities interposed between the tier-1 company and the top company and the three conditions set out in s 719-15(3)(a)-(c) are satisfied in relation to at least one of the interposed entities. An example of a situation where a tier-1 company is not an eligible tier-1 company by reason of s 719-15(3) applying is where a foreign company is interposed between the top company and the tier-1 company and membership interests are held in the interposed foreign company by another tier-1 company of the top company or a wholly owned subsidiary of another tier-1 company of the top company.

636 A potential MEC group derived from one or more eligible tier-1 companies of a top company comprises those eligible tier-1 companies and all the entities that satisfy the requirements in s 719-10(1)(b): s 719-10(1).

637 *ITAA 97* ss 719-5(1)(a), 719-50(1) and 719-55. The Commissioner of Taxation considered s 719-15(3) in Taxation Determination TD 2005/39, 'Income tax: Consolidation: Membership: can an Australian resident company qualify as an eligible tier-1 company of a MEC group if a foreign resident entity is interposed between the Australian resident company and the top company of the group?'

638 Ibid s 719-5(2). It is not a requirement that all eligible tier-1 companies of a top company become members of a MEC group. As noted at (n 14) above, new eligible tier-1 companies, that is, those companies that were not eligible tier-1 companies at the earlier time that the MEC group came into existence, may later join that MEC group: s 719-5(4). However, eligible tier-1 companies of a top company that did not join the MEC group cannot later join that MEC group (s 719-5(2)). They may, however, choose to form a consolidated group, choose to form another MEC group (if there is more than one eligible tier-1 company that is not within a MEC group), or remain outside consolidation.

639 Ibid s 719-60(1). The choice is irrevocable and the specified day cannot be amended (s 719-50(2). A notice in the approved form and containing the required information is required to be given to the Commissioner of Taxation (s 719-76(2)).

640 Ibid ss 719-5(1)(b), 719-40.

The members of a potential MEC group derived from one or more eligible tier-1 companies of a top company consist of those eligible tier-1 companies[641] and all other entities (if any) that meet the requirement in s 719-10(b) of the *ITAA 97*. Whether, and in what circumstances, a trust can be a top company, an eligible tier-1 company, or satisfy the entity requirements in s 719-10(b) is discussed in 6.4.

If a company that is the provisional head company of a MEC group at the end of an income year of the company and the MEC group was in existence throughout the income year, that company is the head company of the group at all times during the income year.[642] If a company that is the provisional head company of a MEC group at the end of an income year, the group is in existence at the end of the income year, and the group came into existence in the income year, that company is the head company of the group at all times during the period beginning at the time the group came into existence and ending at the end of the income year.[643]

The members of a MEC group are the head company of the group and the subsidiary members of the group.[644] The subsidiary members of the MEC group are those members of the group other than the head company.[645]

6.2 Trusts as Head Companies of Tax Consolidated Groups

An entity is a member of a consolidated group or consolidatable group while it is the head company of the group or a subsidiary member of the group.[646] There are three eligibility requirements for an entity to qualify as the head company of a consolidated group or consolidatable group.[647] The first requirement[648] ('company requirement') is that the entity must be a 'company' (not excluded by s 703-20 of the *ITAA 97*) that has all or some of its taxable income (if any) taxed at a rate that is or equals the 'corporate tax rate'.[649]

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641 Ibid s 719-10(a).
642 Ibid s 719-75(1).
643 Ibid s 719-75(2).
644 Ibid s 719-25(3).
645 Ibid s 719-25(2).
646 Ibid s 703-15(1).
647 Ibid s 703-15(2)(a) item 1 columns 2, 3 and 4 of the table.
648 Ibid s 703-15(2)(a) item 1 column 2 of the table.
649 The expression 'corporate tax rate' is defined in s 995-1(1) of the *ITAA 97* (n 7) as the rate of tax in respect of the taxable income of a company covered by s 23(2) of the *Rates Act* (n 116). That rate is 30%.

The second requirement ('residence requirement') is that the entity that is a company, having satisfied the company requirement, must be an 'Australian resident' but not a 'prescribed dual resident'.[650] A company is an Australian resident if it is a person that is a resident of Australia for the purposes of the *ITAA 36*.[651] The *ITAA 36* provides that a company is a resident of Australia if it 'is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia'.[652] The expression 'prescribed dual resident' is defined in the *ITAA 36*.[653]

The third requirement ('ownership requirement') is that the entity that is a company, having satisfied the company requirement, must not be a wholly owned subsidiary of another entity that meets the company requirement and the residence requirement or, if it is, it must not be a subsidiary member of a consolidatable group or a consolidated group.[654]

Where an entity does not satisfy the company requirement it is unnecessary to determine whether the residence requirement and the ownership requirement are met.

6.2.1 Company requirement

From the above, for a trust to qualify as a head company it must meet, inter alia, the company requirement. Unlike the legislative requirements for subsidiary members of a consolidated group or consolidatable group that expressly provide for a trust to be a subsidiary member, subject to satisfaction of the relevant requirements,[655] the legislative provisions do not expressly provide for a trust to be a head company. In considering the satisfaction of the company requirement in respect of a trust, first element of the company requirement is that the relevant trust must be a 'company'. Section 995-1(1) of the *ITAA 97* defines 'company' to

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650 *ITAA 97* (n 7) s 703-15(2)(a) item 1 column 3 of the table.

651 Ibid s 995-1(1) (definition of 'Australian resident').

652 *ITAA 36* (n 40) s 6(1) (definition of 'resident or resident of Australia' par (b)). The meaning of 'central management and control in Australia' contained in the s 6(1)(b) definition was considered by the High Court in *Bywater Investments v Federal Commissioner of Taxation* (2016) 260 CLR 169, 191-208 [39]-[77] (French CJ, Kiefel, Bell and Nettle JJ); 216-221 [109]-[123] (Gordon J).

653 A 'prescribed dual resident' has the meaning given by the *ITAA 36* s 6(1): *ITAA 97* s 995-1(1) (definition of 'prescribed dual resident'). See above (n 631) which outlines that meaning.

654 *ITAA 97* s 703-15(2)(a) item 1 column 4 of the table.

655 Ibid s 703-15(2)(b).

mean 'a body corporate', or 'any other unincorporated association or body of persons' but does not include a 'partnership'[656] or a 'non-entity joint venture'.[657] Note 2 to the partnership definition provides that a reference to a company includes a reference to a 'corporate limited partnership' within Division 5A of the *ITAA 36* pursuant to s 94J for the purposes of the *ITAA 36*.[658]

The issue, therefore, arises as to whether a trust is a 'body corporate' or an 'unincorporated association or body of persons' or a 'corporate limited partnership'. In determining this issue, it is necessary to first consider the nature of a trust.

The discussion in relation to the meaning of a trust in considering the trust issue at 2.3 above, noted that a trust is a not a legal person, rather it is a term, rooted in medieval England and the Court of Chancery, that describes a relationship between a trustee and a beneficiary in respect of property.[659] Heydon and Leeming[660] describe a trust in the following terms:

> A trust is an institution developed by equity and cognisable by a court of equity. A trust is not a juristic person with a legal personality distinct from that of the trustee and beneficiary. Nor is it merely descriptive of an equitable right or obligation. Instead, a trust is a relation between a trustee and beneficiary in respect of certain property. More particularly, a trust exists when the owner of a legal or equitable interest in property is bound by an obligation, recognised by and enforced in equity, to hold that interest for the benefit of others, or for some object or purpose permitted by law. [661]

Given the nature of a trust as discussed above, it is necessary to consider whether it is a 'body corporate' or an 'unincorporated association or body of persons' or a 'corporate limited partnership'.

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656 The word 'partnership' is defined in s 995-1(1) of the *ITAA 97* (n 7) as an association of persons (other than a company or a limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly; or a limited partnership.

657 The expression 'non-entity joint venture' is defined in s 995-1(1) as, effectively, a contractual arrangement under which two or more parties jointly control an economic activity and they share the output of the arrangement rather than profits.

658 Section 94J of the *ITAA 36* (n 40) provides that a reference in the 'income tax law', save for certain exceptions, to a company or to a body corporate includes a reference to the corporate limited partnership. The expression 'income tax law' is defined to mean, inter alia, the *ITAA 97*, the *ITAA 36*, the *Rates Act* (n 116) and the *Taxation Administration Act 1953* (Cth) to the extent that it relates to the first three Acts: *ITAA 36* s 94B (definition of 'income tax law').

659 See above (n 73) and accompanying text.

660 Heydon and Leeming (n 74).

661 Heydon and Leeming (n 74) 1 [1.01]. See also *Harmer v Federal Commissioner of Taxation* (1989) 91 ALR 550, 557–8 (French J); *DKLR Holding Co (No. 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510, 518–19 [15] (Hope JA); *Registrar of the Accident Compensation Tribunal v Federal Commissioner of Taxation* (1973) 178 CLR 145, 175 (Brennan, Dawson and McHugh JJ).

As to whether a trust is a 'body corporate', that term is not defined in the *ITAA 97* and therefore it is necessary to consider its meaning. Ordinarily, the starting point in interpreting the words of a statue is to consider the ordinary and grammatical meaning of the words having regard to their context and purpose.[662] However, where words have been used in a statute that have acquired a legal meaning, it is assumed, prima facie, that the legislature has intended them to have that meaning unless a contrary intention is evinced from the context.[663]

The term 'body corporate' derives from the common law and refers to 'vehicles to which the legal system, by the process of incorporation, has given the capacity to have legal rights and duties as a fictional person'.[664] The corporation law provides for the registration of a company[665] which comes into existence as a body corporate at the beginning of the day on which it is registered.[666] Therefore, as a trust, as discussed above, is not a juristic person but a relation between a trustee and a beneficiary in relation to certain property, it does not constitute a 'body corporate' that has been incorporated pursuant to the *Corporations Act*.[667]

Similarly, a trust is not an 'unincorporated association or body of persons'. In *Watson v J & AG Johnson Ltd,*[668] a members' club (that is, an unincorporated non-profit association) case, Starke J said:[669]

> The club is not a juristic entity: it is not even a partnership; it is simply a voluntary association of a number of persons for the purpose of affording its members and their friends facilities for social intercourse and recreation and the usual privileges, advantages and accommodation of a club. The property acquired for or arising from the conduct of the club, though vested in trustees, belongs to the general body of members. The interest, however, of each member in the general assets of the club exists only during membership, and it is not transmissible: it is a right of admission to and enjoyment of the club while it continues.

662 See above (n 63) for relevant case references.
663 See above (n 70) for relevant case references.
664 Austin and Ramsay (n 255) ch 1 [1.051]. See also chapter 2 for an outline of the origins of company law including bodies corporate.
665 *Corporations Act* (n 274) pt 2A.2.
666 Ibid s 119.
667 Austin and Ramsay (n 255) ch 1 [1.370] sets out the major legal distinctions between trusts and companies.
668 (1936) 55 CLR 63.
669 Ibid 69.

Therefore, although the property of an unincorporated association may be held on trust, a trust cannot be considered an unincorporated association or body of persons in the sense described above by Starke J.

As to whether a trust is a 'corporate limited partnership' and therefore within the definition of company[670] in s 995-1 of the *ITAA 97*, it is necessary to have regard to the definition of 'corporate limited partnership' in s 94D(1) of the *ITAA 36*. That section provides that a 'limited partnership' is a corporate limited partnership if certain requirements are met. First, it is necessary to consider whether a trust is a limited partnership – if a trust is not a limited partnership, the definition of 'corporate limited partnership' will not be met and therefore it will not be regarded as a company for the purposes of the taxation law pursuant to s 94J of the *ITAA 97*.[671]

A 'limited partnership' is defined in section 995-1(1) of the *ITAA 1997* as:

> a. an association of persons (other than a company) carrying on business as partners or in receipt of income jointly, where at least one partner has limited liability; and
> b. an association of persons (excluding one covered by para (a)) with a separate legal personality to those persons, formed solely for becoming a "venture capital entity.

From the discussion of the nature of a trust above, a trust does not satisfy the above definition of limited partnership as it is not an 'association of persons (other than a company) carrying on a business as partners' within paragraph (a) and it is not an 'association of persons … with a separate legal personality' within paragraph (b). Therefore, a trust, not being a limited partnership, is not a corporate limited partnership within s 94D(1) and, accordingly, will not be taken to be a company for the purposes of the taxation law.

Accordingly, the first element of the company requirement, namely, that the trust is a 'company', is not satisfied in respect of a trust.

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670 By reason of it being regarded as a company under *ITAA 36* s 94J (n 40) (see above (n 658)).
671 See above (n 658).

The second element of the company requirement, namely, that all or some of the taxable income of the trust is taxed at the 'company tax rate', will not be met since the 'company tax rate' is only relevant to an entity that is a 'company'.[672]

Failing to meet the company requirement, save for express statutory inclusion, results in a trust being unable to qualify as a head company of a consolidated group or a consolidatable group. It is unnecessary to consider the residence requirement and the ownership requirement since the company requirement is not met.

There is an express statutory inclusion in Subdivision 713-C of the *ITAA 97.* That Subdivision permits, subject to certain requirements, public trading trusts[673] ('PTTs') to make a choice[674] to consolidate a consolidatable group as if PTTs were a company.[675]

Although Subdivision 713-C applies from the date the consolidation regime came into effect on 1 July 2002, it was only introduced[676] in 2004. The explanatory memorandum[677] to the amending Bill noted that allowing PTTs to act as head companies 'is in keeping with an underlying principle of consolidation that entities that are taxed like companies should be able to head consolidated groups'.[678] The amendments made by Subdivision 713-C were necessary since although PTTs were treated like companies under Division 6C of the *ITAA 36*,[679] they were not taken to be companies.[680]

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672 See above (n 649).

673 Ibid s 713-125(2). A PTT is defined in s 102R of the *ITAA 36* (n 40). Broadly, a PTT, inter alia, is a unit trust which is a 'public unit trust' within s 102P of the *ITAA 36*. It is not intended to analyse these provisions, however, the provisions are considered in *Federal Commissioner of Taxation v Trustee for the Michael Hayes Family Trust* (2019) 273 FCR 567, 570-2 (Steward J).

674 Pursuant to *ITAA 97* (n 7) ss 703-50 and 713-130.

675 Division 713-C originally also applied to corporate unit trusts ('CUTs') which were defined in former s 102J of the *ITAA 36*. The regime that taxed CUTs as companies was contained in Division 6B of Part III of *ITAA 36* and was repealed effective 1 July 2016 by the *Tax Laws Amendment (New Tax System For Managed Investment Trusts) Act 2016* (Cth) sch 5 with consequential amendments made to Division 713-C which deleted references to CUTs.

676 By *Tax Laws Amendment (2004 Measures No 2) Act 2004* (Cth).

677 Explanatory Memorandum, Tax Laws (2004 Measures No 2) Bill 2004 ('2004 No 2 EM').

678 Ibid [2.25].

679 *ITAA 36* ss 102L, 102T, respectively.

680 See 2004 No 2 EM (n 677) [2.26].

Section 713-130 of the *ITAA 97* permits a trust to make a choice under s 703-50 to consolidate a consolidatable group as if the trust were a company, if: it could make the choice if it beneficially owned the membership interests in other entities that are legally owned by it,[681] and if the day specified in the choice is the first day of an income year for which the trust is a PTT.[682] Accordingly, the beneficial ownership requirement in respect of subsidiary members[683] is tested in relation to entities that a PTT legally owns (since trustees of unit trusts do not beneficially own trust property)[684] and it can only choose to consolidate from the first day of an income year.

A choice to form a consolidated group by a PTT has the effects set out in s 713–135. Broadly, the PTT will have certain income tax law[685] ('applied law') applied to it in the same way as it applies to a company[686] and the income tax law that applies to a trust (or trustee) will not apply to it.[687] The applied law is subject to the modifications set out in s 713-140. The applied law is applicable at all times from the date of consolidation[688] and, therefore, the failure to meet a requirement for eligibility as a PTT under Division 6C after that date is not relevant. A consequence of the applied law applying from the date of consolidation is that if a corporate unit trust[689] had been a head company prior to the date of repeal of Division 6B of Part II of the *ITAA 36*, it remained as a head company notwithstanding the repeal of Division 6B.

It is noted that there is no legal impediment that prevents a company from becoming the head company of a consolidatable or consolidated group (assuming the relevant requirements discussed above are satisfied) in its capacity as a company notwithstanding that it is also a

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681 *ITAA 97* (n 7) s 713-130(a).

682 Ibid s 713-130(b). The 2004 No 2 EM indicated (at [2.30]) that this requirement 'reduces compliance costs' as it is 'simpler and less complex' to work out the tax liability under the consolidation regime for the whole of the year rather than under two regimes (that is, *ITAA 36* div 6C for part of the income year and the tax consolidation regime for the other part of the income year) if part-year formation of a consolidated group was permissible under Division 713-C.

683 Ibid s 703-15(2) item 2 column 4 and s 703-30(1).

684 See 6.3.3.1 for a discussion of the meaning of 'beneficial ownership'. It seems clear from that analysis that a trustee does not beneficially own trust property notwithstanding that there may be beneficiaries that do not have an actual equitable interest in the trust property, such as in the case of discretionary trusts.

685 *ITAA 97* s 713-135(2).

686 Ibid s 713-135(1).

687 Ibid ss 713-140(3). The deeming provisions in Division 713-C were considered in *Intoll Management Pty Ltd v Commissioner of Taxation* (2012) 208 FCR 115 (Edmonds, McKerracher and Jagot JJ) and found them to be clear and effected a complete deeming.

688 Ibid s 713-135(1)(b).

689 See above (n 675).

trustee of a trust. It would, however, be rare in practice for a company that is a trustee to own substantial assets in its own right (since those assets are put at risk where there is an excess of trust liabilities over trust assets) and therefore unlikely that a company that is a trustee would become the head company of a consolidated group in its personal capacity.

6.3 Trusts as Subsidiary Members of Tax Consolidated Groups

There are three eligibility requirements[690] for an entity that is a trust to qualify as a subsidiary member of a consolidated group or consolidatable group. First, the entity must be a 'trust' but not a trust covered by s 703-20 of the *ITAA 97* ('trust requirement'). [691] Secondly, the trust must comply with the residence requirements for trusts in s 703-25 ('residence requirement').[692] Thirdly, it must be a wholly-owned subsidiary of the head company and, if there are interposed entities between them, the requirements in s 703-45, and s 701C-10 and s 701C-15 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) ('*TP Act*'), as relevant, must be met ('wholly-owned requirement').[693]

The trust requirement, the residence requirement and the wholly-owned requirement are considered below at 6.3.1, 6.3.2 and 6.3.3, respectively.

6.3.1 Trust Requirement

The trust requirement[694] requires that the entity is a 'trust' but not a trust covered by s 703-20.[695] Included within the definition of 'entity' for the purposes of the *ITAA 97* is a 'trust'.[696] The term 'trust' is not defined and, accordingly, as discussed in 2.3 above, it is necessary to consider the ordinary and grammatical meaning of the word having regard to its context and purpose.[697] However, if the word used in a statute has acquired a technical legal meaning, it

690 *ITAA 97* (n 7) 703-15(2)(b) item 2 columns 2, 3 and 4 of the table.
691 Ibid s 703–15(2)(b) item 2 column 2 par (a).
692 Ibid s 703–15(2)(b) item 2 column 3 par (b).
693 Ibid s 703–15(2)(b) item 2 column 4.
694 See above (n 691).
695 Relevant to trusts are items 1, 7 and 8 of s 703–20(2). Item 1 refers to a trust whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 97*. Item 7 refers to a trust that is a 'complying superannuation entity' (see *ITAA 97* s 995-1(1) (definition of 'complying superannuation entity'), a 'non-complying approved deposit fund' (see *ITAA 97* s 995-1(1) (definition of 'non-complying approved deposit fund') or a ' non-complying superannuation fund' (see *ITAA 97* s 995-1(1) (definition of 'non-complying superannuation fund'). Item 8 refers to a trust that is a 'CCIV sub-fund trust' (see *ITAA 97* s 195-110(2)).
696 *ITAA 97* s 960-100(1)(f).
697 See above n 63 and accompanying text.

is assumed that the legislature has intended it to have that meaning unless a contrary intention is evinced from the context.[698]

At 2.3 it is submitted that, taking into account the context and purpose of the legislative provisions,[699] 'trust' is used in its technical legal sense and its meaning for the purposes of the trust requirement should be governed by its technical legal meaning under the general law of trusts.[700] It is also noted at 2.3 that 'trust' is a term, originating in medieval England and the Court of Chancery, that describes a relationship between a trustee and a beneficiary in respect of property.[701] Also noted at 2.3 is that a trust arises 'when the owner of a legal or equitable interest in property is bound by an obligation, recognised by and enforced in equity, to hold that interest for the benefit of others, or for some object or purpose permitted by law.'[702]

Although a trust is not a legal person,[703] it is included in the definition of 'entity' in the *ITAA 97*.[704] As noted at 2.3, the judgement in *Sunlite Australia Pty Ltd v Commissioner of Taxation ('Sunlite')*[705] observed that the definition of entity in s 960-100(1) of the *ITAA 97* included legal persons and also particular types of legal relationships, such as partnerships and trusts, that are not separate persons nor do they have separate legal personality.[706]

Slater has criticised this drafting, that is, the use of the term trust, which describes 'a relationship among trustee, property and beneficiary or purposes',[707] to define 'an entity', 'a concept that can only mean " a person in [tax] law"...'[708]

The issue arises as to whether a trust that is within the definition of 'entity' should be regarded as a statutory 'personification' of the trust concept. As noted at 2.3, the trustee of a trust in its trustee capacity is an 'entity' for the purposes of the *ITAA 97*.[709] Also, a legal person, to the

698 See above n 70 and accompanying text.
699 See above n 71 and accompanying text.
700 See above n 72 and accompanying text.
701 See above n 73 and accompanying text.
702 See above (n 74).
703 Ibid.
704 Section 960-100(1)(f).
705 See above (n 77).
706 See above (n 78).
707 AH Slater, 'Unit Trusts: Law and Lore' (2006) 35 *Australian Tax Review* 185, 186.
708 Ibid 187.
709 See above (n 81).

extent that they have different capacities, is a separate entity in respect of each of those capacities.[710] Thus, a company that is the trustee of a trust is an entity in its own right as a company[711] and is an entity in its capacity as a trustee. Where a provision of the *ITAA 97* refers to an entity of a particular kind, it refers to the entity in its capacity as that kind of entity and not in any other capacity.[712] The example at the end of s 960–100(4) of the *ITAA 97* provides that a 'provision that refers to a company does not cover a company in a capacity as trustee, unless it also refers to a trustee.'

In *Sunlite* the Court said that s 960-100(2) of the *ITAA 97*[713] does not have the effect that in the case of a trust, the trustee is the relevant entity, rather in the case of a trust the trustee is also an entity, that is, there is not a single entity comprising the trust and the trustee.[714]

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From the above and as concluded at 2.3, it is submitted that it is a 'trust', not the trustee, within the general law of trusts concept of a trust that is an entity under s 960-100(1)(f) of the *ITAA 97* and that it is also a 'trust' within the general law of trusts concept that satisfies the trust requirement in the tax consolidation provisions.[715] For tax consolidation purposes it is the trust and not the trustee that is potentially[716] eligible to be a subsidiary member.[717] The trustee of a trust is an 'entity' in its trustee capacity and is also an entity in its own right, for example, as a company[718] or an individual[719].

Trusts are often classified as express or declared trusts and those arising by operation of law.[720] In the first category, a trust arises by an express declaration (for example, so-called 'discretionary trusts' and 'unit trusts' constituted under trust deeds) and include charitable

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710 Ibid s 960-100(3).
711 Ibid s 960-100(1)(b).
712 Ibid s 960-100(4).
713 Section 960-100 (2) relevantly provides that the 'trustee of a trust.. is taken to be an entity consisting of the person who is the trustee…'.
714 See above (n 77) 607, [36]–[37].
715 See above nn 59-60 and accompanying text.
716 The Australian residence requirement and the ownership requirement also need to be satisfied for the trust: see 6.3.2 (residence requirement) and 6.3.3 (wholly-owned requirement).
717 Whether the entity that is the trustee of a trust is eligible to qualify as a subsidiary member of a consolidated group will depend on whether it satisfies the membership requirements in *ITAA 97* (n 7) s 703-15(2)(b) item 2 column 2.
718 Ibid s 960-100(1)(b).
719 Ibid s 960-100(1)(a).
720 Heydon and Leeming (n 74) 36-7 [3.01]; Evans (n 73) 568-70 [23.13]-[23.16].

purpose trusts.[721] In the second category, a trust arises by operation of law and consists of resulting (or implied) trusts[722] and constructive trusts.[723] It is submitted that the tax consolidation provisions are concerned with express non-charitable trusts.[724]

For trusts arising by operation of law, it seems theoretically possible that they may qualify as trusts for consolidation purposes and their membership of a consolidated group will depend upon the satisfaction of the other eligibility requirements.[725] However, in practice, these circumstances will seldom be encountered. In most situations, and in all situations in respect of constructive trusts,[726] it will not be until a court makes an adjudication that it will be known that a resulting or constructive trust has arisen. Moreover, in many situations, upon a resulting or constructive trust being found by a Court, a transfer of property will occur from the trustee to the relevant beneficiary.

6.3.2 Residence Requirement

The residence requirements for trusts in s 703-25 of the *ITAA 97* differ according to whether the trust is a trust (except a unit trust),[727] a unit trust (except a PTT),[728] or a PTT.[729]

6.3.2.1 Trusts other than unit trusts

For trusts other than unit trusts, the trust must be a 'resident trust estate' for the purposes of Division 6 of Part III of the *ITAA 36.*[730] A 'resident trust estate' is a trust estate of which:[731]

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721 Heydon and Leeming (n 74) 37 [3.02].

722 Ibid 36-7 [3.01], 38-9 [3.07] and 229 [13.01]. Evans (n 73) 568 [23.13], ch 28 770-814. See also *Bosanac v Commissioner of Taxation* (2022) 275 CLR 37, 70 [93] (Gordon and Edelman JJ).

723 Heydon and Leeming (n 74) 36-7 [3.01], 39-40 [3.08] and 229 [13.01]. Evans (n 73) 568 [23.13], ch 50 1461-1518.

724 A charitable trust is a purpose trust and not a trust for beneficiaries: Heydon and Leeming (n 74) 141 [1005]; Evans (n 73) 881-82 {31.1]-[31.5]. Accordingly, a charitable trust will not have 'members' (within item 3 of the definition of 'member' s 960–130(1) of the *ITAA 97 (*n 7)) and therefore the wholly-owned requirement cannot be satisfied. Moreover, many charitable trusts will be covered by item 1 of s 703-20 of the *ITAA 97* (by reason of their exempt status under s 50–5 of the *ITAA 97*) and ineligible to become a subsidiary member of a consolidated or consolidatable group.

725 In this regard it is noted that constructive trusts, like express trusts and resulting trusts, have the 'staple ingredients … of subject matter, trustee, beneficiary (or, conceivably, purpose), and personal obligation attaching to the property…': *Muschinski v Dodds* (1985) 160 CLR 583, 614 (Deane J).

726 Constructive trusts only arise upon the decree of a court: Evans (n 73) 1462 [50.3].

727 *ITAA 97* s 703-25 item 1.

728 Ibid s 703-25 item 2.

729 Ibid s 703-25 item 3.

730 Ibid s 703–25 item 1.

731 *ITAA 36* (n 40) s 95(2).

a. a trustee of the trust estate is a resident of Australia at any time during the income year; or
b. the central management and control of the trust estate was in Australia at any time during the income year.

In relation to a. above, it is necessary that a trustee (it does not matter that there may be more than one trustee, only one is required to be an Australian resident) of the trust is a resident of Australia. A trustee will be a resident of Australia if the definition of 'resident of Australia' in s 6(1) of the *ITAA 36* is satisfied. That definition differs for a trustee that is an individual[732] and a trustee that is a company.[733]

In relation to b. above, a trust estate is also a resident trust estate if the 'central management and control' of the trust estate was in Australia at any time during the income year.

There is no definition of the phrase 'central management and control' in the *ITAA 36 or the ITAA 97*. Accordingly, it is required to be interpreted according to its ordinary and grammatical meaning having regard to its context and purpose.[734]

The 2002 EM has no guidance on the meaning of 'central management and control'. Brydges has indicated that there is no Australian court case that has considered central management and control in relation to trusts whereas there is 'considerable jurisprudence' in relation to the central management and control of companies.[735]

Brydges[736] and O'Donnell[737] referred to the Canadian case of *Fundy Settlement v Canada*[738] ('*Fundy Settlement*') in which the Supreme Court of Canada in having to decide the residence of two trust for Canadian tax purposes held that, similar to corporations, 'the residence of a trust should be determined by the principle that a trust resides … where

732 Ibid s 6(1) (definition of 'resident or resident of Australia' par (a)). Broadly, an individual is a resident of Australia if they reside in Australia; they have a domicile in Australia unless the Commissioner is satisfied that the individual's permanent place of abode is outside Australia; or the individual has actually been in Australia continuously or intermittently for more than one-half of the income year unless the Commissioner is satisfied the individual's usual place of abode is outside of Australia and they do not intend to take up residence in Australia.

733 Ibid s 6(1) (definition of 'resident or resident of Australia' par (b)). See above (n 652).

734 See above nn 61-74 and accompanying text.

735 Neil Brydges, 'Residency of a Trust: Don't Get it Wrong' (2019) 54(2) *Taxation in Australia* 90.

736 Ibid.

737 Jim O'Donnell 'Contemporary Cross-Border Issues with Trusts and Estates – Part 1: Tax Residency of a Trust' (2022) 25(4) *The Tax Specialist* 215, 219-20.

738 [2012] 1 SCR 520.

"its real business is carried on" … which is where the central management and control of the trust actually takes place.'[739]

In *Fundy Settlement* the lower court judge had found as a fact that the main beneficiaries exercised the central management and control of the trusts in Canada and that the trustee corporation, resident in Barbados, had a limited role to provide administrative services and little else. The Court noted that residence of the trustee will be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident.[740]

The High Court in *Bywater Investments v Federal Commissioner of Taxation* ('*Bywater*'),[741] in holding that 'the residence of a company is first and last a question of fact and degree and to be answered where the central management and control of the company actually abides',[742] found support in the *Fundy Settlement* decision of the Supreme Court of Canada where in relation to the residence of trust it was 'where central management and control of the trust actually takes place'.[743] The High Court in *Bywater* noted that non-resident corporate trustee 'had deferred to the recommendations of the Canadian resident beneficiaries in the substantive decisions made regarding the trusts'.[744]

From the above, it is submitted that a trust is, at least in the normal case, centrally managed and controlled by the trustee(s) and resides where that management and control is exercised by the trustee which ordinarily would be its place of residence. However, the facts and circumstances may lead to a different conclusion such that the management and control actually occurs in a different place and is exercised by, say, the settlor, a beneficiary or beneficiaries or other person(s) as was found on the facts of *Fundy Settlement*. The type of decision making encompassed in the concept of central and control of trusts should be that applicable to companies. In *Bywater* the High Court

739 Ibid 526-7 [15]. For an analysis of the decision in *Fundy Settlement* see Charles Ho Wang Mak and Matthew Chippin, 'Comparative Analysis of Trust Taxation: A Deep Dive into the Australian and Canadian Regimes' (2024) 30(4) *Trust & Trustees* 189. See also the decision of the Supreme Court of Ontario in *Theodoros Darmos Family Trust v Minister of Finance et al* (2023) ONSC 6431, [195]-[202] (Ramsay J) which agreed with the reasoning in *Fundy Settlement*.

740 Ibid.

741 (2016) 260 CLR 169.

742 Ibid 208 [77].

743 Ibid 211 [84].

744 Ibid.

indicated that such decision making was higher-level decisions which set the policy and determine the direction and operations and transactions of the company.[745]

6.3.2.2 Unit Trusts other than PTTs

For trusts that are unit trusts but not PTTs, there is a dual residence requirement, the unit trust must be a 'resident trust estate' for the purposes of Division 6 of Part III of the *ITAA 36* and a 'resident trust for CGT purposes' for each income year as defined in the *ITAA 97*.[746]

A 'resident trust estate' as defined in Division 6 [747] was analysed above in 6.3.2.1 in relation to the residence of trusts other than unit trusts.

A unit trust is a 'resident trust for CGT purposes' if, at any time during an income year, either any property of the trust is situated in Australia, or the trust carries on a business in Australia.[748] Additionally, it is required that, at any time during the income year, either the central management and control of the unit trust is in Australia, or more than 50% of the beneficial interests in income or property of the unit trust was held by Australian residents.[749]

Whether a trust is carrying on a business is a question of fact and degree and is determined having regard to the facts and circumstances.[750]

Although the term 'business' is defined in the *ITAA 97*[751] to include any profession, trade, employment, vocation or calling, but not occupation as an employee', the definition is not exhaustive and therefore could include any activities that would ordinarily be understood to be a business. The concept of 'carrying on' a business is not defined in the *ITAA 97* or the *ITAA 36.* In *Federal Commissioner of Taxation v Murry*[752] the High Court said that a 'business is not a thing or things. It is a course of conduct carried on for the purposes of profit and involves notions of continuity and repetition of actions'.[753]

745 Ibid 191 [41].
746 *ITAA 97* (n 7) s 703-25 item 2.
747 *ITAA 36* (n 40) s 95(2).
748 *ITAA 97* s 995–1(1) (definition of 'resident trust for CGT purposes' para (b) column 2 items 1 and 2 of the table).
749 Section 995–1(1) (definition of 'resident trust for CGT purposes' para (b) column 3 items 1 and 2 of the table).
750 *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1, 19 [59] (French CJ, Gummow, Heydon, Crennan, Kiefel and Bell JJ); *Evans v Federal Commissioner of Taxation* (1989) 20 ATR 922, 939 (Hill J).
751 Ibid s 995-1(1) (definition of 'business').
752 (1998) 193 CLR 605.
753 Ibid 626 [54] (Gaudron, McHugh, Gummow and Hayne JJ).

In *Spriggs v Federal Commissioner of Taxation*[754] the High Court said that:[755]

> The existence of a business is a matter of fact and degree. It will depend on a number of indicia, which must be considered in combination and as a whole. No one factor is necessarily determinative. Relevant factors include, but are not limited to, the existence of a profit-making purpose, the scale of activities, the commercial character of the transactions, and whether the activities are systematic and organised, often described as whether the activities are carried out in a business-like manner. (references omitted)

A further issue is the meaning of the term 'unit trust' which is not defined for the purposes of the tax consolidation provisions. Accordingly, it is necessary to determine its meaning by considering its ordinary or grammatical meaning having regard to context and purpose including considering whether it has a technical legal meaning.[756]

The High Court in *CPT Custodian Pty Ltd v Commissioner of State Revenue*[757] ('*CPT Custodian*') said that the term 'unit trust', in the absence of a statutory definition, 'does not have a constant fixed normative meaning'…[758] In *CPT Custodian* it was held[759] that the unit trust deed there under consideration did not confer on the unitholders an equitable interest in the assets of the unit trust which was unlike the position in *Charles v Federal Commissioner of Taxation*[760] where the trust deed establishing a unit trust there under consideration was found to confer on the unitholders 'a proprietary interest in all of the property…'[761] Accordingly, it is sufficient but not necessary to constitute a unit trust by reason that a unitholder has an equitable interest in the trust property since the decision in *CPT Custodian* confirms that a unit trust can be created whereby property is vested in a trustee notwithstanding there is no equitable ownership in someone else.[762] In *CPT Custodian*, although the beneficial interest in the fund was divided into units with each conferring an equal interest in all property from time to time, no unit conferred any interest in any particular part of the trust fund or any investment.[763]

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754 (2009) 239 CLR 1.
755 Ibid 19 [59] (French CJ, Gummow, Heydon, Crennan, Kiefel and Bell JJ).
756 See above nn 61-74 and accompanying text.
757 (2005) 224 CLR 98.
758 Ibid 110 [15] (Gleeson CJ, McHugh, Gummow, Callinan and Heydon JJ). The statement was cited with approval by the High Court in *ElecNet (Aust) Pty Ltd v Federal Commissioner of Taxation* (2016) 259 CLR 73, 87 [48] (Kiefel, Gageler, Keane and Gordon JJ).
759 Ibid 115-16 [36].
760 (1954) 90 CLR 598.
761 Ibid 609.
762 (2005) 224 CLR 98, 112 [25].
763 Ibid 111 [20].

Ford and Lee state:[764]

> The expression "unit trust" is a term of convenience and not a term of art capable of having legal consequences. Its only significance is as a label for a trust under the terms of which the benefit to the beneficiaries is divided into units.
>
> Common usage of the expression "unit trust" describes a species of trust in which the beneficial interest in the trust fund is divided into units as discrete parcels of rights themselves capable of being dealt with, like shares in a company, as items of commerce: see *ElecNet (Aust) Pty Ltd v Federal Commissioner of Taxation* (2016) 259 CLR 73; [2016] HCA 51 at [55]-[56]. A unit trust does not attract rules different from those that apply to trusts in which the beneficial interest is not so divided.

Slater, having traced the origins of the term 'unit trust', concluded that 'it helps to illuminate an understanding of the concept, but does not assist in arriving at a definition.'[765] Slater also concluded '[p]erhaps all that can be said is that 'unit trusts' are those in which the interest of beneficiaries are measured in 'units''.[766] Slater raised the issue of whether, for example, a fixed trust under which the beneficiaries are entitled to a fixed proportion of the income or corpus is a 'unit trust' notwithstanding that the trust deed does not utilise the 'unit' nomenclature.[767]

The Commissioner of Taxation in ATO Interpretative Decision 2010/57, after considering various authorities and authors of textbooks in relation to the definition of 'unit trust', concluded:

> where beneficiaries are made entitled to a share of a beneficial interest under a trust, such as an interest in the income and capital, or in either one of these, and which entitlement is measured by reference to a fixed standard of measurement howsoever described (for example a percentage or a fraction or a fixed formula), then whether or not the deed itself labels the interests 'units' the beneficial interest have been unitised and the trust would be a 'unit trust' for the purpose of considering the application of Division 6C of the *ITAA 36*.[768]

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764 Harold Ford, et al, *Ford and Lee: The Law of Trusts* (Thomson Reuters Australia, 2020) ch 1 [1.7330]. See also Heydon and Leeming (n 74) 40-41 [3.10]-[3.13].

765 Slater (n 707) 189.

766 Ibid.

767 Ibid.

768 It is noted that ATOID 2010/57 related to the term 'unit trust' in *ITAA 36* (n 40) s 102R which is not defined.

Prior to the decision of the High Court in *ElecNet (Aust) Pty Ltd v Federal Commissioner of Taxation* ('*ElecNet*')[769] it was not entirely clear that a Court would classify a trust that contained a fixed measurable interest in capital and income as a unit trust were it required to do so. However, it seems that *ElecNet* may have settled the issue.

In *ElecNet*, Kiefel Gageler, Keane and Gordon JJ said:

> … there is no reported case, in Australia or elsewhere, in which the expression "unit trust" has been applied other than in circumstances where, under the applicable trust deed, the beneficial interest in the trust fund is divided into units, which when created or issued are to be held by the persons for whom the trustee maintains and administers the trust estate.[770]

In *ElecNet*, Nettle J said:

> Following the remarks of this Court in *CPT Custodian*, it may be accepted that the notion of a unit trust is sufficiently broad to encompass a range of so-called unit trusts, and thus that a unit in one unit trust may comprise a beneficial interest in the trust estate of that trust that is different in kind from the beneficial interest comprised of a unit in another. But to observe the broad nature of beneficial interests that may be comprised of the units in different unit trusts does not detract from the understanding that a unit trust is one in which the beneficial interest in the trust estate is divided into units.[771]
>
> …
>
> …a "unit trust" is a trust in which the beneficial interest is divided into units analogous to shares in a company such that each unit, or each unit in a class of units, is the same as each other unit, or unit in the same class, and each such unit is capable of cancellation, extinguishment or redemption by processes akin to the cancellation, extinguishment or redemption of shares in a company.[772]

In *ElecNet* it was held that the scheme under consideration was not a unit trust for the purposes of Division 6C of Part III the of *ITAA 36*. The beneficial interests of employees under the scheme were not divided into units which were created under the deed, and then issued to and held by the employees. Payments, and the determination of their quantum, made to employees were not by reference to an employee's ownership of units in the scheme but by

769 (2016) 259 CLR 73.
770 Ibid 89-90 [56].
771 Ibid 99 [87].
772 Ibid 103 [99].

reference to the contributions paid on behalf of that employee and the circumstances of the employee.[773]

From the above, it can be concluded that although a unit trust has no fixed normative meaning, a unit trust is characterised by a trust under which the beneficial interest in the property of the trust is divided into units. This meaning should apply to a unit trust within the consolidation provisions as it accords with the common usage of the expression 'unit trust'.[774]

6.3.2.3 Public Trading Trusts

For trusts that are PTTs, they are required to be a 'resident unit trust' for each income year.[775] For a PTT, the requirements are set out in s 102Q of the *ITAA 36*.[776]

Section 102Q requires two sets of conditions to be satisfied for a unit trust to qualify as a 'resident unit trust' in relation to an income year. First, if, at any time during the income year, either any property of the trust is situated in Australia, or the trustee carried on business in Australia.[777] Secondly, if, at any time during the income year, either the central management and control of the trust is in Australia, or more than 50% of the beneficial interests in income or property of the trust was held by Australian residents.[778]

In relation to the 'carrying on business' requirement in the first condition mentioned above, this concept was analysed at 6.3.2.2 in relation to unit trusts and that analysis is relevant here.

In relation to the 'central management and control in Australia' requirement in the second condition mentioned above, this concept was analysed at 6.3.2.1 in relation to trusts other than unit trusts and that analysis is relevant here.

6.3.3 Wholly-owned Requirement

The wholly-owned requirement requires a trust to be a 'wholly-owned subsidiary' of the head company of the group.[779] Also, where there are interposed entities between the head

[773] Ibid 93 [67]-[69] (Kiefel, Gageler, Keane and Gordon JJ); 103-4 [99] and [104] (Nettle J).
[774] Ibid 89 [56].
[775] *ITAA 97* (n 7) s 703-25 item 3.
[776] *ITAA 97* s 995-1(1) (definition of 'resident unit trust').
[777] *ITAA 36* (n 40) s 102Q(a).
[778] Ibid s 102Q(b).
[779] *ITAA 97* s 703–15(2)(b) item 2 column 4.

company and the trust, s 703-45 of the *ITAA 97* and sections 701C-10 and 701C-15 of the *TP Act*, as relevant, must be satisfied.[780] These two requirements are considered below.

6.3.3.1 Wholly-owned Subsidiary

Section 703-30(1) of the *ITAA 97* has the result that a trust is a wholly-owned subsidiary of the head company if all the 'membership interests' in the trust are 'beneficially owned' by the head company, by one or more wholly-owned subsidiaries of the head company, or by the head company and one or more wholly-owned subsidiaries of the head company.[781]

The 'membership interests' in a trust are the interests or set of interests (or the right or set of rights) by virtue of which a person is a 'member' of the trust.[782] A beneficiary', 'unitholder' or 'object' of a trust (other than a PTT) is a 'member' of that trust.[783] A 'unitholder' is a member of a PTT.[784]

In *Kafataris v Deputy Commissioner of Taxation*[785] Lindgren J said:[786]

> The word "beneficiary" reaches beyond a person who has a beneficial interest in the trust property. It is possible for the legal estate in land to be vested in "trustees" without equitable ownership being vested in someone else. The trustees must, however, owe fiduciary obligations in respect of the trust property to persons who, although they may have no interest in the trust property and may never have an interest in the trust property, are called "beneficiaries". In *CPT Custodian Pty Ltd v Commissioner of State Revenue of the State of Victoria* … the High Court rejected:
>
> a "dogma" that, where ownership is vested in a trustee, equitable ownership must necessarily be vested in someone else because it is an essential attribute of a trust that it confers upon individuals a complex of beneficial legal relations which may be called ownership. (citations omitted)

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780 Ibid.

781 In determining whether a trust is owned, in whole or part, by 'wholly-owned subsidiaries' of the head company, an entity is a 'wholly-owned subsidiary' of the head company if it is a wholly-owned subsidiary of the head company (that is, pursuant to *ITAA 97* (n 7) s 703-30(1)) or it is a wholly owned subsidiary of a wholly-owned subsidiary of the head company: *ITAA 97* s 703-30(2). Although perhaps not expressed with great clarity, the underlying intention of s 703-30 is that each subsidiary member of a consolidated group or consolidatable group must, save for certain exceptions, be wholly owned by the head company, by a wholly-owned subsidiary or subsidiaries of the head company, or by the head company and other wholly-owned subsidiaries of the head company.

782 *ITAA 97* s 960–135.

783 Ibid s 960–130(1) item 3.

784 Ibid s 960–130(1) items 4-5.

785 (2008) 172 FCR 242.

786 Ibid 250.

> That is to say, there can be a trustee who owes fiduciary obligations in respect of trust property to "beneficiaries" without any of the latter having a beneficial interest in the property.

A membership interest in a trust is not taken into account where it is characterised as a 'debt interest'[787] in the trust.[788]

In many situations it will not be difficult to identify the beneficiaries[789] or unitholders[790] or objects[791] that are members of the relevant trust: their 'membership interests' in the trust being their 'interest' or 'rights' in the trust by which they qualify as a 'member'.[792] Practically, what is required in considering the satisfaction of the wholly-owned requirement is to identify *all* 'memberships interests' in the trust and to determine whether they are beneficially owned by the head company, or a wholly-owned subsidiary, or a combination of both.

The Commissioner of Taxation has taken the view that a discretionary trust can qualify as a subsidiary member of a consolidated group or consolidatable group notwithstanding that there is a power in the trustee to add or remove discretionary objects from a pre-existing class of beneficiaries named in the trust deed.[793] All the objects of the discretionary trust are

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787 *ITAA 97* (n 7) s 945-15.

788 Ibid s 960-130(3).

789 In a broad sense a beneficiary is a person(s) for whom a trustee holds the trust property, that is, is capable of benefiting under the trust. It is clear that a person will be a beneficiary of a trust where they have an equitable proprietary interest in the trust property: Heydon and Leeming (n 74) 4 [1.09]. However, it is not necessary that a beneficiary has such an interest: see below (n 790).

790 A 'unitholder' (not defined) would, it seems, be a person that holds 'units' in a 'unit trust'. At 6.3.2.2 above the meaning of 'unit trust' was discussed. To the extent that it is unclear whether a trust is a unit trust it would seem equally uncertain whether a relevant person is a unitholder. Presumably, if a person is not a 'unitholder' they would be regarded as a 'beneficiary'.

791 The term 'object' usually refers to those persons that under a discretionary trust are capable of benefiting upon the exercise of a power of appointment (whether as to capital and/or income) by the trustee. Although the objects do not have an equitable or beneficial interest in the trust property they have a right to be considered by the trustee in their exercise of their power of appointment and a right to 'due administration' of the trust. These latter rights being in the nature of equitable choses in action. See *Kennon v Spry* (2008) 238 CLR 366, 386–7, 393 (French CJ); 407-8 (Gummow and Hayne JJ). See also Evans, (n 73) 571–73 [23.21]–[23.24]; Heydon and Leeming, (n 74) 4 [1.09] and Lionel Smith, 'Massively Discretionary Trusts' (2017) 70(1) *Trust and Trustees* 17, 24-5; John Glover, '"Resettlements": Revenue Consequences of Varying Discretionary Trusts' (2005) 79 *Australian Law Journal* 620, 620-2.

792 Section s 960–135.

793 Australian Taxation Office, ATO Interpretative Decision 2005/74, 'Consolidation: Membership and Discretionary Trusts'. The view was taken, relying on *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 425 (Mahoney JA), that conferring a power on a trustee to nominate any person as an object of a trust does not result in the conferral of 'interests' or 'rights' on a broad range of persons. In Private Advice Authorisation Number 1052078846027 dated 2 February 2023 (<https://www.ato.gov.au/law/view/document?src=qa&pit=99991231235958&arc=true&start=1&pageSize=10&total=1&num=0&docid=EV%2F1052078846027&dc=false&qaid=qa_ev&stype=find&cat=WA&tm=phrase-docref-1052078846027>) the Commissioner of Taxation ruled that a discretionary trust was eligible to be a subsidiary of a consolidated group on the basis that, inter alia, the rights of a discretionary object under a discretionary trust constituted a membership interest within *ITAA 97* s 906-135(b) ([19]-[22]) and that the definition of a 'member' in

required to be members of the relevant consolidated group or consolidatable group in order for the discretionary trust to be a subsidiary member of the group.[794]

Once the 'membership interests' in a trust are identified, it is necessary to determine whether they are 'beneficially owned' by the head company and/or a wholly-owned subsidiary(ies) for the purposes of s 703-30(1) of the *ITAA 97*. The term 'beneficially owned', which is undefined, has been used in many different contexts in Commonwealth and State tax legislation and a number of cases have considered its meaning.[795] Bean[796], having considered that 'beneficial ownership' may, to the layman, mean 'entitled to the benefit of property' or, in a more technical sense, could mean 'having an equitable interest in property', concluded that the 'inconsistent use of the term means that 'we may have to recognise that "beneficial ownership" means different things in different contexts.'[797]

In *Federal Commissioner of Taxation v Linter Textiles Australia Ltd (in liq)* (*'Linter Textiles*'),[798] in considering whether a company in liquidation could be said to beneficially own its assets for the purposes of certain tax loss provisions, the High Court found that beneficial ownership by a company of its assets continued in liquidation since the ownership of the assets 'was not for the benefit of others'.[799] It is noted that s 703-30(3) of the *ITAA 97* achieves the same result as the decision in *Linter*: the sub-section was introduced[800] into the *ITAA 97* prior to the High Court handing down its decision in *Linter Textiles*.

Perhaps a Court would favour a view that membership interests will be beneficially owned for the purposes of s 703-30 where they are not held 'for the benefit of others'.

ITAA 97 (n 7) s 906-130 is concerned with persons who are currently capable of benefiting from the trust, not with persons who might at some future date become capable of benefiting from the trust as a consequence of being appointed or nominated by the Trustee under a separate power ([13]).

794 *ITAA 97* s 703–15(2)(b), item 2.

795 See, for example, *Federal Commissioner of Taxation v Linter Textiles Australia Ltd (in liq)* (2005) 220 CLR 592; *CPT Custodian v Commissioner of State Revenue* (2005) 224 CLR 98.

796 Gerry Bean, 'Tax Treatment of Beneficial Ownership, Equitable Interests and "Absolutely Entitled" Interests' (Conference Paper, Taxation Institute of Australia, 11–13 October 2007).

797 Ibid at 4-5 [2.1]. See also Robin Speed, 'Beneficial Ownership' (1997) 26 *Australian Tax Review* 34, where it was concluded that 'beneficial ownership has no historical or contemporary universal meaning…[i]t is necessary on each occasion where the words appear to carefully determine their meaning having regard to, but not enslaved by, past use and analysis': at 50.

798 (2005) 220 CLR 592.

799 Ibid 614 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ). See also JD Heydon, MJ Leeming and PG Turner, *Meagher Gummow and Lehane's Equity* (LexisNexis. 5th ed, 2014) 118-120 [4-115] and [4-120].

800 Section 703-30(3) was introduced by the *Tax Laws Amendment (2004 Measures No 6) Act 2005* (Cth). See also, Explanatory Memorandum, Tax Laws Amendment (2004 Measures No 6) Bill 2004 that indicated that the amendment to introduce s 703-30(3) ensures that beneficial ownership is not affected by a member of a consolidated group being or becoming an externally administered body corporate: at [1.24].

There are three exceptions to the wholly-owned requirement in s 703-30. First, s 703–40 has the effect that an entity ('test entity') that is held by a trust that is not a fixed trust[801], for example, a discretionary trust, will not be prevented from being a subsidiary member of a consolidated group if the test entity would have been a wholly owned subsidiary of the head company had the interposed trust been a fixed trust and all its objects been beneficiaries. The 2002 EM noted that the purpose of s 703-40 is to 'ensure, that an entity is not prevented from being a subsidiary member of a consolidatable or consolidated group just because there is a trust other than a fixed trust interposed between the test entity and the head company of the group'.[802] The deeming in s 703-40(2) results in the objects of a discretionary trust being taken to have beneficial ownership of trust property, such as membership interests in another entity, by reason of their membership interests in the trust being regarded as fixed trust entitlements which overcomes the position under the general law of trusts that objects of a discretionary trust do not beneficially own trust property.[803]

The second exception to the wholly-owned requirement is where, broadly, following an 'ADI restructure', certain preference shares have been issued which would otherwise have prevented a body corporate from being a subsidiary member of a consolidated group or consolidatable group.[804]

The third exception to the wholly-owned requirement is that an entity will be taken to be a wholly-owned subsidiary of another entity if, broadly, it would not have been a wholly-owned subsidiary by reason that employee share scheme shares or membership interests have been issued to employees and the shares or membership interests are not more than 1% of the total number of ordinary shares in the company or 1% of the total number of membership interests in the entity.[805]

6.3.3.2 Interposed Entities

An entity ('test entity'), including a trust, will only be a subsidiary member of a consolidated group or a consolidatable group if all the interposed entities between the head company and

801 Effectively defined in the *ITAA 97* (n 7) s 995–1(1) as a trust in which entities have fixed entitlements to all of the income and capital of the trust. See *Colonial First State Investments Ltd v Federal Commissioner of Taxation* (2011) 192 FCR 298, 321–24 [94]–[106] (Stone J).

802 2002 Consolidation EM (n 21) [3.79].

803 See above (n 791).

804 *ITAA 97* s 703-37.

805 Ibid s 703-35.

the test entity are subsidiary members of the group.[806] Also, the test entity will be a subsidiary member where an interposed entity holds memberships interests in the test entity as a 'nominee' of the head company or another subsidiary member of the group.[807] In this latter case the nominee is not a subsidiary member of the group but the test entity will be a subsidiary member of the group. Although 'nominee' is not defined, it would apply to the situation where the relevant membership interests are held by an entity on a 'bare trust'[808] for the head entity or another subsidiary member of the group. Usually, the term 'bare trust' is used to describe a trust in which the trustee has no 'active duties to perform although it may be more precisely be taken to refer to a trustee that has no interest in the trust assets other than that existing by reason of the office of trust and the holding of legal title'.[809]

Section 703-45(2)(b) of the *ITAA 97* may also extend to a nominee that is an agent, rather than a bare trustee, that holds membership interests in that agency capacity. Such a situation may be rare as in the usual case it will probably be found that the agent holds the membership interests as a bare trustee, or perhaps, as trustee under a resulting trust.[810]

Section 701C–10 and s 701C–15 of the *TP Act* effectively allow, subject to satisfaction of various requirements, trusts, companies and partnerships to be members of a consolidated group notwithstanding that there are interposed non-member foreign residents between them and the head company. These provisions are transitional and were required to be satisfied by consolidated and consolidatable groups before 1 July 2004.

6.4 Trusts as Members of MEC Groups

The analysis in 6.3 in relation to trusts as members of consolidated groups and consolidatable groups is relevant to the analysis of trusts as members of a MEC group or a potential MEC

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806 Ibid s 703-45(2)(a).

807 Ibid s 703-45(2)(b).

808 For a discussion of the meaning of 'bare trust' see *Herdegen v Federal Commissioner of Taxation* (1988) 20 ATR 24, 32–33 (Gummow J); *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 24 NSWLR 370, 397-8 (Meagher JA).

809 Heydon and Leeming (n 74) 42 [3.15]. See also *Byrnes v Kendle* (2011) 243 CLR 253, 264-5 [21] (French CJ). See also Paul Stacey, 'The GST Treatment of Bare Trusts' (2006) 9(1) *Journal of Australian Taxation* 36, 38-42.

810 See Stacey (n 809) 41-2; Evans (n 73) 578 [23.38]-[23.39]. Goods and Services Tax Ruling GSTR 2008/3 examines bare trusts in relation the goods and services tax consequences of dealings in real property by bare trusts and indicates that a 'form of bare trust (known as a resulting trust)' arises where funds are provided by a purchaser to a nominee to purchase property with the legal title to the property being held by the nominee upon its transfer to the nominee rather than the actual purchaser ([4]).

group as many of the eligibility requirements in the MEC group provisions[811] overlap with the eligibility requirements[812] for trusts in consolidated groups and consolidatable groups.

Section 6.1.2 outlined the formation and membership requirements for MEC groups and potential MEC groups contained in Division 719 of the *ITAA 97*. Considered below is the eligibility of a trust as a member of a MEC group or potential MEC group in terms of its eligibility to be a 'top company',[813] a 'tier-1 company'[814] and a wholly-owned subsidiary of a tier-1 company.[815]

6.4.1 Trust as a Top Company

A trust will not be eligible to be a 'top company' since a requirement of the definition of 'top company' requires there to be a 'company' that is a 'foreign resident'.[816] As concluded at 6.2.1 and for the reasons there stated, a trust is not a 'company' for the purposes of the *ITAA 97* and therefore it cannot be a 'top company' with s 719-20(1)(a). It is therefore not necessary to consider the ownership requirements relevant to a top company[817].

6.4.2 Trust as a Tier-1 Company

A trust will not meet the requirements to be a tier-1 company[818] for the same reasons as discussed in 6.2 in relation to a trust's ineligibility to be a head company. That is, a trust will not meet the company requirement[819] for the same reasons stated in 6.2.1 in relation to a trust not being a company for the purposes of *ITAA 97*. As the company requirement is not met, a trust cannot be a tier-1 company and therefore it is unnecessary to consider the residence requirement[820] and the ownership requirement[821] in s 719-20(1)(b).

It is noted that since there is no equivalent to Subdivision 713-C of the *ITAA 97* for PTTs in Division 719 in relation to MEC groups or potential MEC groups, a PTT cannot be a tier-1 company.

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811 *ITAA 97* (n 7) div 719.
812 *ITAA 97* (n 7) div 703.
813 Ibid s 719-20(1)(a) item1 of the table.
814 Ibid s 719-20(1)(b) item 2 of the table.
815 Ibid s 719-10(1)(b).
816 Ibid s 719-20(1)(a) item 1 column 3 of the table.
817 Ibid s 719-20(1)(a) item1 column 4 of the table.
818 Ibid s 719-20(1)(b) item 2 of the table.
819 Ibid s 719-20(1)(b) item 2 column 2.
820 Ibid s 719-20(1)(b) item 2 column 3.
821 Ibid s 719-20(1)(b) item 2 column 4.

6.4.3 Trust as a wholly-owned subsidiary of a Tier-1 Company

A trust will be eligible to be a wholly-owned subsidiary of a tier-1 company where the requirements in s 719-10(1)(b) are met.

First, the entity must be a trust ('MEC trust requirement').[822] The trust requirement analysed in 6.3.1 in respect of trusts in consolidated groups or consolidatable groups is equally applicable to the 'MEC trust requirement' and therefore that analysis is adopted here in respect of the 'MEC trust requirement'.

Secondly, the trust must meet the residence requirement ('MEC residence requirement').[823] The 'MEC residence requirement' for trusts is contained in s 703-25 of the *ITAA 97*. That section was analysed in 6.3.2 in relation to trusts in consolidated groups and consolidatable groups as it contained the conditions of the residence requirement[824] for trusts in consolidated groups and consolidatable groups . Accordingly, the analysis in 6.3.2 is equally applicable to the 'MEC residence requirement' and that analysis is adopted here in respect of the 'MEC residence requirement'.

Thirdly, the trust must meet the ownership requirement ('MEC wholly-owned requirement').[825] The MEC wholly-owned requirement, first limb, requires that the trust be a wholly-owned subsidiary of any of the eligible tier-1 companies of the potential MEC group.[826] Alternatively, the MEC wholly-owned requirement, second limb, is satisfied if an entity that would satisfy the first limb if it were assumed that all of the membership interests that are beneficially owned by any of those eligible tier-1 companies were owned by a single one of those eligible tier-1 companies.

Applying 703-30(1) of the *ITAA 97* to the first limb of the 'MEC wholly-owned requirement', a trust is a wholly-owned subsidiary of an eligible tier-1 company if all the 'membership interests' in the trust are 'beneficially owned' by the tier-1 company, by one or more wholly-owned subsidiaries of the tier-1 company or by the tier-1 company and one-or more wholly owned subsidiaries if the tier-1 company.

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822 Ibid s 719-10(1)(b) column 1 of the table.
823 Ibid s 719-10(1)(b) column 2 of the table.
824 Ibid s 703-15(2)(b) item 2 column 3 para (b) of the table.
825 Ibid s 719-10(1)(b) column 3 of the table.
826 Ibid s 719-10(1)(b) column 3 para (a) of the table

The concepts of 'membership interests' in a trust and 'beneficially owned' were analysed in 6.3.3.1 and that analysis is adopted here. Also, the three exceptions to the wholly-owned requirement contained in s 703-35, s 703-37, s 703-40 which are analysed at 6.3.3.1 above, are equally applicable here and that analysis is adopted here in respect of the 'MEC wholly-owned requirement'.

The second limb of the 'MEC wholly-owned requirement' allows the requirement to be met if it is assumed that the aggregated membership interests of any of the tier-1 companies that own membership interests in an entity ('test entity') were owned by one of those tier-1 companies ('hypothetical tier-1 company'). The wholly-owned requirement will be met if the test entity is a wholly-owned subsidiary of the hypothetical tier-1 company under the first limb of the 'MEC wholly-owned requirement'.

In considering whether the 'MEC wholly-owned requirement' is met in respect of an entity, including a trust, where there are one or more entities interposed between an entity ('test entity') and an eligible tier-1 company, the test entity can only be a wholly-owned subsidiary of the eligible tier-1 company if each of those meets the conditions in columns 1 and 2 of the table in s 719-10 of the *ITAA 97*.[827] Also, the test entity will be a wholly-owned subsidiary of the eligible tier-1 company where an interposed entity holds membership interests in the test entity as a nominee of one or more entities each of which is an eligible tier-1 company of the top company, or a wholly-owned subsidiary of an eligible tier-1 company of the top company, being a subsidiary that meets the conditions in columns 1 and 2 of the table in s 719-10.[828]

6.5 Analysis of Issues Arising

The following analyses certain issues that arise from the analysis in this chapter of trusts as members of consolidated groups and MEC groups.

6.5.1 Trust (and not trustee) as a member of a consolidated group or MEC group

The conclusion at 2.3 and 6.2.1 is that it is a trust (and not the trustee), having its general law of trusts meaning of a relationship between a trustee and beneficiary in respect of certain property, that is the entity which, subject to certain residence and ownership requirements,

827 Ibid 719-10(2)(a).
828 Ibid 719-10(2)(b).

is a member of a tax consolidated group or a MEC group (hereinafter jointly referred to as a 'consolidated group').

6.5.1.1 Legislative amendment to include trustees in consolidated groups

An implication from the conclusion that it is a trust and not the trustee that is the member of a consolidated group, as recognised by the Board of Taxation in its Review[829] and noted at 2.3, is that it is not necessary (and there is no legislative requirement) for the trustee of a trust to be a member of the consolidated group of which the trust is a member. To overcome the perceived problem that such a consequence produced (broadly, that the assets of a trust were legally owned by the trustee and that the liabilities of a trust were those of the trustee, but the trustee remained outside the consolidated group), the Board recommended that a legislative amendment should be made which treated the trustee, in its trustee capacity as a member of the same consolidated group as the trust.[830]

It is not clear that such a legislative deeming achieves anything more than the current legislative position other than it would be explicit and clear that it is the assets and liabilities of the trustee in its capacity as a trustee of a trust that are being brought into the consolidated group. At present, Division 705 of the *ITAA 97*, which sets the tax cost of the assets when an entity becomes a subsidiary member of a consolidated group, is required to be interpreted on the basis of an assumption (albeit non-explicit) that the assets and liabilities of a trust that joins a consolidated group are those of the trustee of that trust notwithstanding that the trustee is not a subsidiary member of the group.

Such an assumption is reasonable and is justified on the basis that, relevant to tax cost setting of assets for tax consolidation purposes, s 701-10(2) of the *ITAA 97* relevantly provides that the assets to which tax cost setting relates is 'each asset that would be an asset of the entity at the time it becomes a subsidiary member of the group'.

It is submitted, based on the statutory interpretation principles discussed in 2.3, taking into account the text, context and purpose of the legislative provisions, since it is the trust that is the subsidiary member, which, as concluded above, is an entity but not the trustee, the reference in s 701-10(2) to assets of a subsidiary member is to those assets of the trust which

829 See above (n 90).
830 See above (n 107).

are legally owned by the trustee regardless of whether the trustee is also a member of the group. To interpret the reference to assets of a trust that joins a group to only include assets of a trust that are held by a trustee that is also a member of the consolidated group is inconsistent with the conclusion that a trust can be a member of a consolidated group notwithstanding that the trustee of is not a member of the consolidated group. It would be an odd, if not absurd, outcome if a trust without the trustee is eligible to be a member of a group but no assets and liabilities are brought into the consolidated group since the trustee is not a member of the group. Such an interpretation should be rejected and the interpretation whereby assets and liabilities of a trust are brought into consolidation albeit that the trustee is not a member of the group, is to be preferred which is consistent with the purpose of the legislation and coherent with the object and policy of the legislative provisions to allow trusts as members of tax consolidated groups.

However, to put the matter beyond doubt, a legislative amendment should be made in conformity with the recommendation of the Board of Taxation.[831]

6.5.1.2 Group Liability Issue

Subsidiary members ('contributing members') of a consolidated group have joint and several liability under s 721-15(1)(b) for a 'group liability' that arose by reason of the head company not having discharged in full a 'tax-related liability'[832] by the time it became due and payable. The liability of a subsidiary member for a group liability arises if that member was a member of the group for at least part of the period to which the group liability relates.[833]

Broadly, the Commissioner is required to give notice to a subsidiary member of their joint and several liability which becomes due and payable 14 days after the notice is given.[834] The liability of a subsidiary member is recoverable using the general collection provisions contained in Part 4-15 of Schedule 1 to the *Taxation Administration Act 1953 ('TAA')*.

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831 See above n 107 and accompanying text.

832 The 'tax-related liabilities' are set out in s 721-10(2) of *ITAA 97* (n 7).

833 *ITAA 97* s 721-10(1)(b). A group liability may not arise if it is covered by a valid tax sharing agreement: s 721-15(3). Section 721-25 sets out the circumstances in which a group liability is covered by a tax sharing agreement. Practice Statement Law Administration PS LA 2013/5 sets out the Commissioner of Taxation's policy in respect of the collection of consolidated group liabilities.

834 *ITAA 97* ss 721-15(4) and (5).

The group liability mentioned above is that of a 'subsidiary member' of the tax consolidated group. A 'subsidiary member' of a consolidated group is an entity that satisfies the requirements in item 2 of the table in s 703-15(2)(b). Where that entity is a trust it is difficult to see that there can be the incurrence of a group liability by the trust. As discussed above, a trust is not a separate legal person – it is the trustee that has a personal liability for expenses of a trust that are incurred by the trustee.[835] There is, however, no provision, express or otherwise, in the *ITAA 97*, the *ITAA 36* or the *TAA* which provides that it is the trustee of a trust that is liable under s 721-15(1)(b) in respect of a trust that is a member of the consolidated group nor a provision that treats the trust as if it were a legal person. It would not seem to make a difference if the trustee was a member of the consolidated group or not. There has been no incurrence of a liability by the trustee – the liability is that of the subsidiary member which is the trust.[836]

Whether this is an oversight by the legislature or incomplete drafting, it does not seem to be curable by statutory interpretation principles relating to reading in additional words so that it can be taken to refer to a liability of the trustee. Such a reading in of additional words would be, it is submitted, 'a construction that fills gaps disclosed in legislation or makes an insertion which is too big or too much at variance with the language in fact used by the legislature'[837] and therefore impermissible.

In *Trevisan v Commissioner of Taxation*[838] Burchett J refused to read into a statutory definition something that should have been within that definition, having regard to the purpose of legislation, but was not included according to the meaning of the legislative provision. Burchett indicated that s 15AA of the *Acts Interpretation Act 1901* (Cth), which requires that in interpreting a statute an interpretation that promotes the purpose or object of the Act is to be preferred to one that does not, 'is not a warrant for redrafting legislation nearer to an assumed desire of the legislature. It is not for the courts to legislate; a meaning, though illuminated by the statutory injunction to promote the purpose or object underlying the Act,

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835 *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524, 540 [24] (Kiefel CJ, Keane and Edelman JJ).

836 It is noted that s 284-30 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) provides for a trustee to be liable for an administrative penalty on shortfall amounts relating to trusts that would otherwise have been shortfall amounts of a beneficiary of the trust. This indicates that express legislative imposition of a liability on the trustee is required.

837 *Taylor v The Owners – Strata Plan No 11564* (2014) 253 CLR 531, 548 [38] (French CJ, Crennan and Bell JJ).

838 (1991) 29 FCR 157.

must be found in the words of Parliament'.[839] Parallel reasoning should apply here in seeking to argue that the liability of the trust is the liability of the trustee under s 721-15(1)(b).[840]

It is recommended that legislative amendment is made to s 721-15(1)(b) to ensure that it is the liability of a trustee of a trust where that trust is a member of a consolidated group or MEC group that has the liability for a group liability.

6.5.2 Residence of Trusts

The residence requirements identified in 6.3.2.1 (for trusts other than unit trusts)[841] and 6.3.2.2 (for unit trusts other than PTTs)[842] do not expressly or, it is submitted, implicitly require trustees to be non-individuals. Accordingly, the satisfaction of the 'resident trust estate' requirement[843] and the 'resident trust for CGT purposes' requirement[844] may be satisfied by reference to an individual(s) that is an Australian resident trustee(s) and by reference to central management and control exercised by a trustee(s) that is an individual(s), or carrying on business conducted by a trustee(s) that is an individual.

It is necessary to continuously monitor the satisfaction of the residence requirements whilst a trust is a subsidiary member of a consolidated group since a failure to satisfy those requirements has the consequence that the trust ceases to satisfy all of the requirements to be a 'subsidiary member' of a consolidated group under s 703-15(2)(b) and therefore ceases to be a member of the consolidated group at the time of the failure. Accordingly, the head company's tax cost in the membership interests in the trust are set at the interest's 'tax cost setting amount'[845]

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839 Ibid 162.

840 The decision of the High Court in *Federal Commissioner of Taxation v Prestige Motors Pty Ltd* (1994) 181 CLR 1 can be distinguished in the current circumstances. In that case the Commissioner of Taxation had issued an assessment in the name of a trust rather than the trustee. The High Court held that it was a valid assessment as it was not essential to the validity of the notice of assessment that it state the name of the taxpayer liable to pay the tax. What is required is that the notice must bring to the attention of the person to whom it is served that the assessment to which it relates is an assessment of that person to tax. On the facts, it was held there was a service of the notice to assessment on the trustee, the person liable to tax. In the present case, the statutory liability under s 721-15(1)(b) of the *ITAA 1997* (n 7) is that of the trust (albeit that it lacks legal personality and has not been given legal personality under the legislation) and recovery of that liability from the trustee would not be in accordance with the s 721-15(1)(b).

841 *ITAA 97* s 703-25 item 1.

842 Ibid s 703-25 item 2.

843 See above (n 731).

844 See above (nn 748-9).

845 *ITAA 97* s 701-15. The provisions relating to the 'tax cost setting amount' are contained in Division 711.

Taxation Determination 2004/42 confirms the above result that there is an exit from a consolidated group by the subsidiary member if there is a failure to meet the residence requirement whilst an entity is a subsidiary member of a consolidated group and that the single entity rule in s 701-1 of the *ITAA 97* does not affect that result .[846]

6.5.3 Interposed Entities

As discussed in 6.3.3.2, s 703-45 sets out the requirements for the purpose of the ownership requirements in column 4 of item 2 of s 703-15(2)(b) in relation to interposed entities between the head company and an entity ('test entity') for which its eligibility to be a subsidiary member of the consolidated group or consolidatable group is being tested.

Section 703-45(2) requires that each of the interposed entities must either be a subsidiary member of the group ('first alternative')[847] or, alternatively, hold membership interests in the test entity or a subsidiary member of the group interposed between the head company of the group and the test entity only as a nominee of one or more entities each of which is member of the group ('second alternative').

In relation to the first alternative, an interposed entity will be a subsidiary member of a group if all of the requirements in item 2 of the table in s 703-15 are met in relation to that interposed entity.[848] Accordingly, where, for example ('Example 1'), a head company wholly owns a company ('Coy Sub') which wholly owns all of the units in a unit trust, Coy Sub will qualify as an 'interposed entity' as it is a subsidiary member of the group by reason of it being wholly-owned by the head company (and assuming the other eligibility requirements are met). Therefore, the unit trust should satisfy the ownership requirement in column 4 of item 2 in the table in s 703-15(2) since it will be a 'wholly-owned subsidiary'[849] of the head company since its membership interests (that is, the units in the unit trust) will be beneficially owned by a wholly owned subsidiary (that is, Coy Sub) of the head company.

If the facts in Example 1 were changed to substitute a discretionary trust for the unit trust and Coy Sub was the only object of that discretionary trust, the result above should not change,

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846 Taxation Determination TD 2004/42 'Income Tax: Consolidation: Capital Gains: Does the Single Entity Rule in Section 701-1 of the *Income Tax Assessment Act 1997* Affect the Application of CGT I1 in Section 104-160 if a Company which is a Subsidiary Member of a Consolidated Group Stops being an Australian Resident?'

847 *ITAA 97* (n 7) s 703-45(2)(a).

848 Ibid s 703-15(2)(b).

849 Ibid s 703-30(1)(b).

that is the discretionary trust should satisfy the ownership requirement. Coy Sub will beneficially own all the membership interests in the discretionary by reason of it being the sole object of the discretionary trust.[850]

If the facts in Example 1 were further changed such that head company was the sole object of a discretionary trust and the discretionary trust owned all the units in a unit trust, it is necessary to consider whether the unit trust meets the ownership requirement in in column 4 of item 2 in the table in s 703-15(2). Although the discretionary trust should be a wholly-owned subsidiary of the head company by reason of it owning all the membership interests in the trust and being the sole object of the discretionary trust as discussed above, the issue is whether the discretionary trust beneficially owns all the units in the unit trust. As discussed in 6.3.3.1, s 703-40 of the *ITAA 97* has the effect that the unit trust is not prevented from being a wholly subsidiary member of a consolidated group if it would have been had the discretionary trust been a fixed trust and all its objects (here the head company). Accordingly, the deeming in s 703-40(2) results in the head company being taken to have beneficial ownership of the units in the unit trust, by reason of those units being regarded as fixed trust entitlements. This overcomes the general law position that the objects of a discretionary trust do not beneficially own trust property.[851]

The second alternative in s 703-45(2) requires the interposed entities to hold membership interests in the test entity or a subsidiary member of the group interposed between the head company of the group and the test entity only as a nominee of one or more entities each of which is member of the group. As discussed in 6.3.3.2, the provision applies to the situation which the relevant membership interests in the test entity are held by an entity, referred to as a 'nominee', on a 'bare trust'[852] for the head company or another subsidiary member of the group. Usually, the term 'bare trust' is used to describe a trust in which the trustee has no 'active duties to perform although it may be more precisely be taken to refer to a trustee

[850] Coy Sub will be a member of the discretionary trust by reason of it being an object of the trust (s 960-130(1) item 3 of the table) and its membership interest in the discretionary trust its rights in relation to the discretionary trust as a member (s 960-135 (b)).

[851] See above (n 567).

[852] See above (n 808).

that has no interest in the trust assets other than that existing by reason of the office of trust and the holding of legal title'.[853]

An example of the application of the second alternative in s 703-45(2) is where all the membership interests are held in a company or unit trust by a trustee (the 'nominee') under a bare trust for the benefit of the head company or another subsidiary member of the consolidated group. The trustee of the bare trust is not a subsidiary member of the consolidated group. The effect of the second alternative in s 703-45 is to 'trace around' the trustee (nominee). Where, however, the relevant membership interests are held by a trustee that is a subsidiary member of the group on bare trust for the head company or another subsidiary member of the consolidated group, the second alternative in s 703-45(2) has no application and satisfaction of the ownership requirement in in column 4 of item 2 in the table in s 703-15(2) will be tested by 'tracing through' the bare trust.

It is recommended, to put the matter beyond doubt, that a legislative amendment is made to define the term 'nominee' in s 703-45(2) to ensure that it is only applicable to bare trust situations.

6.6 Conclusion

This chapter 6 at 6.2 analysed the eligibility for trusts to be the head company of consolidated groups including a consideration of their nature under the general law of trusts.

At 6.3 the eligibility of trusts to be subsidiary members of tax consolidated groups was analysed including the trust requirement (at 6.3.1), the resident requirement (at 6.3.2) and the wholly-owned requirement (at 6.3.2).

The residence requirement was considered in relation to trusts other than unit trusts (6.3.2.1), unit trusts other than public trading trusts (6.3.2.2) and public trading trusts (6.3.2.3).

At 6.4 the eligibility of trusts as members of MEC groups was analysed. At 6.4.1 the eligibility of a trust as a top company of a MEC group was analysed and at 6.4.2 the eligibility of a trust

[853] Heydon and Leeming (n 74) 42 [3.15]. See also *Byrnes v Kendle* (2011) 243 CLR 253, 264-5 [21] (French CJ). See also Paul Stacey, 'The GST Treatment of Bare Trusts' (2006) 9(1) *Journal of Australian Taxation* 36, 38-42.

as a tier-1 company was analysed. At 6.4.3 the eligibility of a trust as a wholly-owned subsidiary of a tier-1 company was analysed.

Issues arising from the analyses in 6.2 to 6.4 of this chapter 6 were outlined and analysed in 6.5.

Chapter 7 - Partnerships as Members of Consolidated Groups and Multiple Entry Consolidated (MEC) Groups

7.1 Introduction

Certain partnerships are eligible to be the head company of a consolidated group or consolidatable group (discussed in 7.2) and certain partnerships are eligible to be subsidiary members of a consolidated group or consolidatable group (discussed in 7.3).

The members of a potential MEC group derived from one or more eligible tier-1 companies of a top company consist of those eligible tier-1 companies (s 719-10(a) of the *ITAA 97*) and all other entities (if any) that fall within s 719-10(b) of the *ITAA 97*. Whether and in what circumstances a partnership can be a top company, an eligible tier-1 company or a wholly-owned subsidiary of a tier-1 company of a potential MEC Group is discussed in 7.4.

7.2 Partnerships as Head Companies of Tax Consolidated Groups

The three eligibility requirements[854] for an entity to qualify as a head company of a consolidated group or a consolidatable group were set out at the commencement of 6.2. These were the 'company requirement',[855] the 'residence requirement'[856] and the 'ownership requirement'.[857] The satisfaction of each of these requirements by a 'partnership' is considered below.

If a partnership does not satisfy the company requirement it is unnecessary to determine whether the residence requirement and the ownership requirement are met.

7.2.1 Company requirement

In considering the satisfaction of the company requirement in respect of a partnership, the first element of the company requirement is that the partnership must be a 'company'. Section 995-1(1) of the *ITAA 97* defines 'company' to mean 'a body corporate', or 'any other unincorporated association or body of persons' but does not include a 'partnership' or a 'non-

854 *ITAA 97* (n 7) s 703-15(2)(a) item 1 columns 2, 3 and 4 of the table.
855 Ibid s 703-15(2)(a) item 1 column 2 of the table.
856 Ibid s 703-15(2)(a) item 1 column 3 of the table.
857 Ibid s 703-15(2)(a) item 1 column 4 of the table.

entity joint venture'.[858] Accordingly, a 'company' does not include a 'partnership' which is defined in s 995–1(1) to mean:

> (a) an association of persons (other than a company or a * limited partnership) carrying on business as partners or in receipt of * ordinary income or * statutory income jointly; or
>
> (b) a limited partnership.
>
> Note 1: Division 830 treats foreign hybrid companies as partnerships.
>
> Note 2: A reference to a partnership does not include a reference to a corporate limited partnership: see section 94K of the *Income Tax Assessment Act 1936* .

Therefore, the definition of 'company' in s 995–1(1) excludes: (a) an association of persons (other than a company or a limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly and (b) a 'limited partnership'.

In relation to paragraph (a) of the definition of 'partnership', the first part, 'an association of persons (other than a company or a limited partnership) carrying on business as partners', relates to persons who are partners in a partnership under the general law and the second part, 'in receipt of ordinary income or statutory income jointly' relates to persons that are in receipt of income jointly and are regarded as partners in a 'tax partnership'.[859]

In relation to (b), a 'limited partnership' is defined, broadly, as a partnership in which at least one of the partners has limited liability.[860]

Accordingly, a partnership within the partnership definition in s 995–1(1) of the *ITAA 97* does not satisfy the company requirement.

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858 The expression 'non-entity joint venture' is defined in s 995-1(1) of the *ITAA 97* (n 7) as, effectively, a contractual arrangement under which two or more parties jointly control an economic activity and they share the output of the arrangement rather than profits.

859 *Federal Commissioner of Taxation v McDonald* (n 183) 967 (Beaumont J); *Tikva Investments Pty Ltd v Commissioner of Taxation* (1972) 128 CLR 158, 164 (Stephen J). See also Taxation Ruling TR 93/32 'Income tax: Rental Property – Division of Net Income or Loss Between Co-owners' [14]-[34].

860 *ITAA 97* s 995-1(1), definition of 'limited partnership'.

As indicated in Note 2 to the definition of 'partnership', excluded from the 'partnership' definition is a partnership that is a 'corporate limited partnership' ('CLP').[861] Section 94J of the *ITAA 36* provides that a reference in the income tax law (which includes the *ITAA 97* and *ITAA 36*)[862] 'to a company or a body corporate includes a reference to a [corporate limited] partnership'. Accordingly, a corporate limited partnership ('CLP') is a company for the purposes of the first element of the company requirement.

As indicated in Note 1 to the definition of 'partnership', a 'foreign hybrid company'[863] within Division 830 of the *ITAA 97* is treated as partnership for the purposes of the taxation law.[864] Accordingly, a foreign hybrid company does not satisfy the company requirement.

The second element of the company requirement requires that the CLP is not excluded by s 703-20 of the *ITAA 97* and that it has all or some of its taxable income (if any) taxed at a rate that is or equals the 'corporate tax rate'.[865]

Relevant to a CLP that is a company for the purposes of the tax law pursuant to s 94J of the *ITAA 1936* is item 1 of s 703–20(2). Item 1 refers to a company whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 97*.

A CLP satisfies the requirement that its taxable income is taxed at the 'corporate tax rate' under s 23(2) of the *Income Rates Act 1986* (Cth) ('*Rates Act*') since a CLP is a company for the purposes of the *Rates Act*.[866]

Accordingly, a CLP should satisfy the company requirement.

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861 The meaning of 'corporate limited partnership' is contained in s 94D of the *ITAA 36* (n 40). Broadly, a 'corporate limited partnership' is a limited partnership that is treated as a company for tax purposes under Division 5A of Part III of the *ITAA 36*. The meaning and effect of Division 5A was considered in *Federal Commissioner of Taxation v Resource Capital Fund IV LP* (2019) 266 FCR 1, 4-11 (Besanko, Middleton, Davies, Steward and Thawley JJ). In *D Marks Partnership v Federal Commissioner of Taxation* (2016) 245 FCR 247 the Federal Court held that a partnership that was incorrectly registered as a limited partnership under the *Partnership Act 1891* (Qld) since it was not a partnership for the purposes of s 5(1) of that Act as there was no 'carrying on a business', was not a corporate limited partnership for the purposes of s 94D of the *ITAA 36* as it was not a limited partnership as a matter of law: 275-283 [131]-[149] (Pagone J); 268 [96] (Griffiths J).

862 *ITAA 36* s 94B (definition of 'income tax law').

863 *ITAA 97* (n 7) s 830-15

864 Ibid sub-div 830-B.

865 See above (n 649).

866 The *Rates Act* is part of the 'taxation law' in respect of which a corporate limited partnership is treated as a company: *ITAA 36* s 94B (definition of 'income tax law' para (c)).

7.2.2 Residence Requirement

The 'residence requirement[867] requires that a CLP must be an 'Australian resident' entity but not a 'prescribed dual resident'. A company is an 'Australian resident' if it is a person that is a resident of Australia for the purposes of the *ITAA 36*.[868]

Section 94T of the *ITAA 36* affects the meaning of 'Australian resident' and a resident for the purposes of the *ITAA 36* for CLPs. The residence requirement is met if the CLP is formed in Australia ('Alternative 1')[869] or, either the CLP carries on business in Australia ('Alternative 2')[870] or the CLP's management and control is in Australia ('Alternative 3').[871]

In relation to Alternative 1, a limited partnership in Australia is formed upon registration pursuant to partnership acts in New South Wales, Queensland, South Australia, Western Australia, Victoria and Tasmania.[872]

In relation to Alternative 2, the concept of 'carrying on business' was considered at 6.3.2.2 in relation to the definition of 'resident trust for CGT purposes' for a unit trust[873] and that analysis is equally applicable to carrying on business in Australia by a CLP. The question of carrying on a business is a question of fact and degree and is determined having regard to the facts and circumstances.[874]

In relation to Alternative 3, the High Court's decision in *Bywater*[875] is relevant in determining whether a CLP's 'central management and control' is in Australia. In *Bywater*, the High Court held that 'the residence of a company is first and last a question of fact and degree and to be answered where the central management and control of the company actually abides'.[876] The management of limited partnerships is carried out by the general partner(s) and the limited

867 Ibid s 703-15(2)(a) item 1 column 3 of the table.
868 Ibid s 995-1(1) (definition of 'Australian resident').
869 *ITAA 36* (n 40) s 94T(1)(e).
870 Ibid s 94T(1)(f)(i).
871 Ibid s 94T(1)(f)(ii).
872 See Keith L Fletcher, *The Law of Partnership in Australia* (Thomson Legal and Regulatory Australia, 9th ed, 2007) 294-5 [8.10].
873 *ITAA 97* (n 7) s 995–1(1) (definition of 'resident trust for CGT purposes' para (b) column 2 item 2 of the table).
874 See above (n 750).
875 See above (n 741).
876 Ibid 208 [77].

partners are statutorily forbidden from taking part in the management of the business of the limited partnership.[877] Fletcher has indicated that, although not authoritatively determined, the concept of 'management' should encompass 'the development of policy, decision taking and the supervision of a business'.[878]

In *Bywater* the High Court indicated that the type of decision making encompassed in the concept of central management and control in the context of companies was the higher-level decisions which set the policy and determine the direction and operations and transactions of the company.[879]

Accordingly, it is submitted that the central management and control of a CLP in the sense described above is, in the usual case, exercised by the general partner of a CLP and is located at the place where that management and control is exercised which should be where the general partner resides. However, the facts and circumstances may result in a different conclusion where central management and control is exercised by, say, a limited partner(s) or another person, with the central management and control being located at the place where that central management and control is exercised by those persons which should be where they reside.

The residence requirement excludes a CLP from otherwise satisfying the requirement where it is a 'prescribed dual resident'. The expression 'prescribed dual resident' is defined in the *ITAA 36*.[880]

7.2.3 Ownership Requirement

The ownership requirement[881] requires that the CLP must not be a wholly owned subsidiary of another entity that meets the company requirement and the residence requirement ('first element') or, if it is owned by such an entity, the entity must not be a subsidiary member of

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877 See Fletcher (n 872) 295-6 [8.15]. Section 67(1) of the *Partnership Act 1892* (NSW) provides that 'a limited partner must not take part in the management of the business of the limited partnership and does not have the power to bind the limited partnership'. Other States have similar legislative provisions: Fletcher (n 845) 295 [8.15].

878 Ibid 295 [8.15]. In *Johnson v Mackinnon (No 2)* [2022] NSW CA 22 (Macfarlan JA, Brereton JA and Simpson AJA) the Court referred to actions of a limited partner in 'providing her image for advertising purposes, instructing solicitors, and engaging with Mr de Klerk' as appearing 'to involve taking part in the management of the business' for the purposes of s 67(1) of the *Partnership Act 1892* (NSW) ([41]).

879 See above (n 741) 191 [41].

880 A 'prescribed dual resident' has the meaning given by the *ITAA 36* s 6(1): *ITAA 97* (n 7) s 995-1(1) (definition of 'prescribed dual resident'). See above (n 631) which outlines that meaning.

881 *ITAA 97* s 703-15(2)(a) item 1 column 4 of the table.

a consolidatable group or a consolidated group ('second element'). Broadly, the first element requires that the membership interests in the CLP must not be beneficially owned by an entity that satisfies the company requirement[882] and the residence requirement.[883] It is noted that, pursuant to Division 5A of Part III of the *ITAA 36*, partnership interests in a CLP held by partners in the CLP are taken to be 'shares' and the partners are taken to be shareholders for the purposes of the taxation law.[884] Therefore, for the purposes of the ownership requirement, the membership interests in a CLP are the deemed 'shares' (that is, the partnership interests) held by the deemed 'shareholders' (that is, the general partner and limited partners).

The second element requires that, if an entity wholly owns the CLP and satisfies the company and the residence requirement, it must not be a subsidiary member of a consolidatable group or consolidated group.

7.3 Partnerships as Subsidiary Members of Tax Consolidated Groups

There are two eligibility requirements[885] for a partnership to qualify as a subsidiary member of a consolidatable group or a consolidated group. First, it must be a 'partnership' but not covered by s 703-20 of the *ITAA 97* ('partnership requirement'). [886] Secondly, it must be a wholly-owned subsidiary of the head company and, if there are interposed entities between them, the requirements in s 703-45, and s 701C-10 and s701C–15 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) ('*TP Act*'), as relevant, must be met ('wholly-owned requirement').[887]

7.3.1 Partnership Requirement

As indicated at 7.2.1, the definition of 'partnership' in section 995-1(1) of the *ITAA 97* includes, first, 'an association of persons (other than a company or a limited partnership) carrying on business as partners', which relates to persons who are partners in a partnership under the general law and, secondly, persons 'in receipt of ordinary income or

882 *ITAA 97* (n 7) s 703-15(2)(a) item 1 column 2 of the table
883 *ITAA 97* s 703-15(2)(a) item 1 column 3 of the table
884 *ITAA 36* (n 40) ss 94P and 94Q.
885 There is no residence requirement for a partnership to qualify as a subsidiary member of consolidatable group or consolidated group.
886 *ITAA 97* s 703-15(2) item 2 column 2 para (a).
887 Ibid column 4.

statutory income jointly' which relates to persons that are in receipt of income jointly and are regarded as partners in a 'tax partnership'.[888]

Discussed in 2.5[889] is the inclusion of 'foreign hybrids' in tax consolidated groups which are treated as partnerships for taxation law purposes (including the tax consolidation provisions)[890] pursuant to Division 830 of the *ITAA 97*.

Under Division 830 a 'foreign hybrid' is defined as a 'foreign hybrid limited partnership' ('FHLP') or a foreign hybrid company ('FHC').[891] The definitions of FHLPs[892] and FHCs[893] and their meanings are discussed in 2.5.

A limited partnership that is a FHLP within s 830-10 is not a CLP and therefore it is treated as a partnership and the exclusion for limited partnerships from the definition of 'partnership' is not applicable.[894]

An FHC is treated as if it were a partnership rather than as a company[895] and the provisions of Subdivision 830-B apply in relation to that deeming.

The second element of the partnership requirement requires that the partnership is not excluded by s 703-20 of the *ITAA 97.* Relevant to a partnership is item 1 of s 703–20(2). Item 1 refers to an entity (which includes a partnership)[896] whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 97*.

7.3.2 Wholly-owned requirement

The wholly-owned requirement requires a partnership to be a 'wholly-owned subsidiary' of the head company of the group.[897] Also, where there are interposed entities between the head company and the partnership, s 703-45 of the *ITAA 97* and sections 701C-10 and 701C-15 of the *TP Act*, as relevant, must be satisfied.[898] These two elements are considered below.

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888 See above (n 859).
889 See above nn 189-219 and accompanying text.
890 *ITAA 97* (n 7) s 830-20.
891 Ibid s 830-5.
892 Ibid s 830-10.
893 Ibid s 830-15.
894 *ITAA 36* (n 40) s 94D(5). The Note at the commencement of Subdivision 830-B of the *ITAA 97* indicates that the 'normal partnership provisions will apply of their own force to foreign hybrids that are foreign hybrid limited partnerships'.
895 *ITAA 97* s 830-20.
896 Ibid s 960-100(1)(d).
897 Ibid s 703–15(2)(b) item 2 column 4.
898 Ibid.

7.3.2.1 Wholly-owned Subsidiary

Section 703-30(1) of the *ITAA 97* has the result that a partnership is a wholly-owned subsidiary of the head company if all the 'membership interests' in the partnership are 'beneficially owned' by the head company, by one or more wholly-owned subsidiaries of the head company, or by the head company and one or more wholly-owned subsidiaries of the head company.[899]

The 'membership interests' in a partnership are the interests or set of interests (or the right or set of rights) by virtue of which a person is a 'member' of the partnership.[900] A partner in a partnership is a 'member' of the partnership.[901] In relation to a FHC that is treated as a partnership under Division 830 of the *ITAA 97*, the shareholders of the FHC are taken to be partners in the partnership.[902]

As a matter of law, the interest by which a partner is a partner in a partnership is an equitable interest and consists of a right to a proportion of the surplus after the realisation of the assets and payment of the debts and liabilities of the partnership.[903]

Once the 'membership interests' in a partnership are identified, it is necessary to determine whether they are 'beneficially owned' by the head company and/or a wholly-owned subsidiary for the purposes of s 703-30(1) of the *ITAA 97*. The meaning of 'beneficial ownership' was analysed at 6.3.3.1 and that analysis is adopted here.[904]

7.3.2.2 Interposed Entities

A partnership, will only be a subsidiary member of a consolidated group or a consolidatable group if all the interposed entities between the head company and the partnership are

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899 In determining whether a partnership is owned, in whole or part, by 'wholly-owned subsidiaries' of the head company, an entity is a 'wholly-owned subsidiary' of the head company if it is a wholly-owned subsidiary of the head company (*ITAA 97* (n 7) s 703-30(1)) or it is a wholly owned subsidiary of a wholly-owned subsidiary of the head company (*ITAA 97* s 703-30(2)). Although perhaps not expressed with great clarity, the underlying intention of s 703-30 is that each subsidiary member of a consolidated group or consolidatable group must, save for certain exceptions, be wholly owned by the head company, by a wholly-owned subsidiary or subsidiaries of the head company, or by the head company and other wholly-owned subsidiaries of the head company.

900 *ITAA 97* s 960–135.

901 Ibid s 960-130(1), item 2 of the table.

902 Ibid s 830-25.

903 See above (n 180).

904 See above nn 795-800 and accompanying text.

subsidiary members of the group.[905] Also, the partnership will be a subsidiary member where an interposed entity holds memberships interests in the partnership as a 'nominee' of the head company or another subsidiary member of the group.[906] In this latter case the nominee is not a subsidiary member of the group but the test entity will be a subsidiary member of the group. What constitutes a 'nominee' for these purposes is discussed in 6.3.3.3 and that discussion is equally applicable here.[907]

As discussed in 6.3.3.1, s 703–40 provides an exception to the wholly-owned requirement such that an entity ('test entity') that is held by a trust that is not a fixed trust[908] is not prevented from being a subsidiary member of a consolidated group if the test entity would have been a wholly owned subsidiary of the head company had the interposed trust been a fixed trust and all its objects been beneficiaries.[909]

Section 701C–10 and s 701C–15 of the *TP Act* effectively allow, subject to satisfaction of various requirements, trusts, companies and partnerships to be members of a consolidated group notwithstanding that there are interposed non-member foreign residents between them and the head company. These provisions are transitional and were required to be satisfied by consolidated and consolidatable groups before 1 July 2004.

7.4 Partnerships as Members of MEC Groups

The analysis in 7.3 in relation to partnerships as members of consolidated groups and consolidatable groups is relevant to the analysis of partnerships as members of a MEC group or a potential MEC group as many of the eligibility requirements in the MEC group provisions[910] overlap with the eligibility requirements[911] for partnerships in consolidated groups and consolidatable groups.

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905 *ITAA 97* (n 7) s 703-45(2)(a).
906 Ibid s 703-45(2)(b).
907 See above nn 808-810 and accompanying text.
908 Effectively defined in the *ITAA 97* s 995–1(1) as a trust in which entities have fixed entitlements to all of the income and capital of the trust. See *Colonial First State Investments Ltd v Federal Commissioner of Taxation* (2011) 192 FCR 298, 321–324 [94]–[106] (Stone J).
909 See above nn 801-3 and accompanying text.
910 *ITAA 97* div 719.
911 Ibid div 703.

Section 6.1.2 outlined the formation and membership requirements for MEC groups and potential MEC groups contained in Division 719. Considered below is the eligibility of a partnership as a member of a MEC group or potential MEC group in terms of its eligibility to be a 'top company',[912] a 'tier-1 company'[913] and a wholly-owned subsidiary of a tier-1 company.[914]

7.4.1 Partnership as a Top Company

A partnership will not be eligible to be a 'top company' since a requirement ('company requirement') of the definition of 'top company' requires there to be a 'company' that is a 'foreign resident'.[915] As concluded at 7.2.1 and for the reasons there stated, a partnership within the 'partnership' definition in s 995–1(1) of the *ITAA 97* does not satisfy the company requirement and therefore it cannot be a 'top company' within s 719-20(1)(a).

However, as discussed in 7.2.1, excluded from the definition of 'partnership' is a CLP which is treated as a company[916] for the purposes of the income tax law (which includes the *ITAA 97* and *ITAA 36*).[917] Accordingly, if the CLP is a 'foreign resident', that is, it is not an Australian resident,[918] the company requirement will be met. A CLP will not be an Australian resident if each of the residence requirements for CLPs in s 94T(1) of the *ITAA 36* is not satisfied.[919]

The s 94T residence requirements will not be met if the CLP is not formed in Australia,[920] the CLP does not carry on business in Australia,[921] and the CLP does not have its management and control in Australia.[922] The content of each of these requirements is discussed in 7.2.2.

A further eligibility requirement ('ownership requirement') for a top company is that the CLP must not be a wholly-owned subsidiary of another company (other than a company that is a

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912 Ibid s 719-20(1)(a) item1 of the table. Although a top company is not a member of a potential MEC group (s 719-10(1), the eligible tier-1 companies must be wholly-owned subsidiaries of a top company (s 719-20(1)(b) item 2, column 4 , para (a) of the table).

913 Ibid s 719-20(1)(b) item 2 of the table.

914 Ibid s 719-10(1)(b).

915 Ibid s 719-20(1)(a) item 1 column 3 of the table.

916 *ITAA 36* (n 40) s 94J.

917 Ibid s 94B (definition of 'income tax law').

918 A 'foreign resident' is defined as meaning a person that is not a resident of Australia for the purposes of the *ITAA 36*: *ITAA 97* (n 7) s 995-1(1) (definition of 'foreign resident').

919 Subdivision C of Division 5A of Part III of the *ITAA 36* sets out the provisions which change the way in which a CLP is treated under the taxation law (s 94H). Section 94T provides the requirements for residence of a CLP which affect the definition of 'resident or resident of Australia' in respect of a company in s 6(1) of the *ITAA 36*.

920 *ITAA 36* s 94T(1)(e).

921 Ibid s 94T(1)(f)(i).

922 Ibid s 94T(1)(f)(ii).

prescribed dual resident ('first exception'), or a company that is an Australian resident that fails to meet a condition in column 2 of item 2 of the table in s 719-20(1)(b) of the *ITAA 97* ('second exception').

In relation to the ownership requirement above, the circumstances in which an 'entity is a wholly-owned subsidiary of another entity' are contained in s 703-30 which are discussed in 6.3.3.1.[923] That discussion is equally relevant here in determining where the CLP as the top company is a wholly-owned subsidiary of another company.

In relation to the first exception to the ownership requirement, the concept of 'prescribed dual resident' is discussed in 6.1.2[924] and that discussion is equally relevant here in considering whether the CLP as the top company is a wholly-owned subsidiary of a company that is a prescribed dual resident.

In relation to the second exception to the ownership requirement, that exception applies where the CLP as a top company is wholly owned by an Australian resident company that does not have its taxable income taxed at the corporate tax rate[925] or is a company covered by s 703-20.[926]

7.4.2 Partnership as a Tier-1 Company

A partnership will not be eligible to be a tier-1 company[927] since a requirement ('company requirement') is that it is a 'company'. As concluded at 7.2.1 and for the reasons there stated, a partnership within the 'partnership' definition in s 995-1(1) of the *ITAA 97* does not satisfy the company requirement and therefore it cannot be a tier-1 company within s 719-20(1)(b). As the company requirement is not met and a partnership cannot be a tier-1 company, it is unnecessary to consider the residence requirement[928] and the ownership requirement[929] in s 719-20(1)(b).

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923 See above nn 795-805 and accompanying text.
924 See above n 631 and accompanying text.
925 See above (n 649).
926 Item 1 of s 703-20(2) applies to a company whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 1997* (n 7).
927 Ibid s 719-20(1)(b) item 2 of the table.
928 Ibid s 719-20(1)(b) item 2 column 3 of the table.
929 Ibid s 719-20(1)(b) item 2 column 4 of the table.

However, as discussed in 7.2.1, excluded from the definition of 'partnership' is a CLP which is treated as a company[930] for the purposes of the income tax law (which includes the *ITAA 97* and *ITAA 36*).[931]

Therefore, a CLP, being a company, must meet the residence requirement[932] and the ownership requirement[933] to qualify as a tier-1 company.

To satisfy the residence requirement, the CLP must be an Australian resident but not a 'prescribed dual resident'.[934] The circumstances in which a CLP will be an Australian resident are discussed in 7.2.2 and are equally relevant here. The residence requirement excludes a CLP from otherwise satisfying the requirement where it is a 'prescribed dual resident'. The expression 'prescribed dual resident' is defined in the *ITAA 36*.[935]

To satisfy the ownership requirement, the CLP must be a wholly-owned subsidiary of the top company ('first element') and must not be a wholly-owned subsidiary of a company that is an Australian resident (other than a company that fails to meet a condition in column 2 or 3 of item 2 of s 719-20(1)(b)) ('second element').

In relation to the first element, the circumstances in which an entity is a wholly-owned subsidiary of another entity are contained in s 703-30 which are discussed in 6.3.3.1.[936] That discussion is equally relevant here in determining where the CLP is a wholly-owned subsidiary of the top company.

In relation to the second element, the discussion at 6.3.3.1 is also relevant in determining whether the CLP is the wholly-owned subsidiary of an Australian resident. An exception to the second element is a company that does not have its taxable income taxed at the corporate

930 *ITAA 36* (n 40) s 94J.
931 Ibid s 94B (definition of 'income tax law').
932 *ITAA 97* (n 7) s 719-20(1)(b) item 2 column 3 of the table.
933 Ibid s 719-20(1)(b) item 2 column 4 of the table.
934 Ibid s 719-20(1)(b) item 2 column 3 of the table.
935 A 'prescribed dual resident' has the meaning given by the *ITAA 36* s 6(1): *ITAA 97* s 995-1(1) (definition of 'prescribed dual resident'). See above (n 631) which outlines that meaning.
936 See above nn 795-805 and accompanying text.

tax rate[937] or a company that is covered by an item in the table in s 703-20(2).[938] A further exception to the second element is a company that is not an Australian resident.[939]

7.4.3 Partnership as a wholly-owned subsidiary of a Tier-1 Company

A partnership will be eligible to be a member of a potential MEC group as a wholly-owned subsidiary of an eligible tier-1 company[940] where the requirements in s 719-10(1)(b) applicable to a partnership are met.

First, the entity must be a partnership ('MEC partnership requirement').[941] The partnership requirement analysed in 7.3.2 in respect of partnerships in consolidated groups and consolidatable groups is equally applicable to the 'MEC partnership requirement' and therefore that analysis is adopted here in respect of the 'MEC partnership requirement'.

Secondly, the partnership must meet either limb of the ownership requirement ('MEC wholly-owned requirement').[942] The first limb of the MEC wholly-owned requirement requires that the partnership is a wholly-owned subsidiary of any of the eligible tier-1 companies of the potential MEC group.[943] Alternatively, the second limb of the MEC wholly-owned requirement is satisfied if the partnership would satisfy the first limb if it were assumed that all of the membership interests that are beneficially owned by any of those eligible tier-1 companies were owned by a single one of those eligible tier-1 companies.

Applying 701-30(1) of the ITAA 97 to the first limb of the 'MEC wholly-owned requirement', a partnership is a wholly-owned subsidiary of an eligible tier-1 company if all the 'membership interests' in the partnership are 'beneficially owned' by the tier-1 company, by one or more wholly-owned subsidiaries of the tier-1 company or by the tier-1 company and one or more wholly owned subsidiaries if the tier-1 company.

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937 See above (n 649).

938 Item 1 of s 703-20(2) applies to a company whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 1997* (n 7).

939 See above (n 652) and accompanying text for the definition of an Australian resident company.

940 A tier-1 company is an eligible tier-1 company if it is not disqualified from being an eligible tier-1 company pursuant to s 719-15(2) of the *ITAA 97*: s 719-15(1). See above (n 635).

941 Ibid s 719-10(1)(b) column 1 of the table.

942 Ibid s 719-10(1)(b) column 3 of the table.

943 Ibid s 719-10(1)(b) column 3 para (a) of the table.

The concepts of 'membership interests' in a partnership and 'beneficially owned' were analysed in 6.3.3.1 and that analysis is equally applicable here.

There is an exception to the wholly-owned requirement contained in s 719-35 of the *ITAA 97* which mirrors the 703-40 exception in respect of consolidated groups or consolidatable groups. An entity ('test entity') that is held by a trust that is not a fixed trust is not prevented from being a wholly owned subsidiary of a company if the test entity would have been a wholly owned subsidiary of the company had the interposed trust been a fixed trust and all its objects are beneficiaries.[944]

The second limb of the 'MEC wholly-owned requirement' allows the requirement to be met if it is assumed that the aggregated membership interests of any of the tier-1 companies that own membership interests in an entity ('test entity') were owned by one of those tier-1 companies ('hypothetical tier-1 company'). The wholly-owned requirement will be met if the test entity is a wholly-owned subsidiary of the hypothetical tier-1 company under the first limb of the 'MEC wholly-owned requirement'.

A CLP, which is treated as company and not a partnership as discussed in 7.2.1, will be eligible to be a member of a potential MEC group as a wholly-owned subsidiary of a tier-1 company where the requirements in s 719-10(1)(b) in relation to a company are met. For a CLP, the company requirement,[945] the residence requirement[946] and the ownership requirement[947] must be satisfied.

The company requirement requires the CLP to be a company,[948] have all or some of its taxable income taxed at the corporate tax rate,[949] not be covered by an item in s 703-20[950] and must not be a 'non-profit company' as defined in the *Income Tax Rates Act 1986* (Cth).[951]

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944 See above nn 801-3 and accompanying text.

945 *ITAA 97* (n 7) s 719-10(1)(b) column 1 of the table.

946 Ibid s 719-10(1)(b) column 2 of the table.

947 Ibid s 719-10(1)(b) column 3 of the table.

948 A CLP is treated as a company: *ITAA 36* (n 40) s 94J.

949 See above (n 649).

950 Item 1 of s 703-20(2) applies to a company whose ordinary income and statutory income is exempt from tax under Division 50 of the *ITAA 1997*.

951 The *Rates Act* (n 116) relevantly defines a 'non-profit company' as 'a company that is not carried on for the purpose of profit or gain to its individual members and is, by the terms of its constituent document, prohibited from making any distribution, whether in money, property or otherwise to its members' (s 3(1) 'definition of 'non-profit company' para (a)).

The residence requirement requires the CLP to be an Australian resident but not a 'prescribed dual resident'.[952] The Australian resident issue and the 'prescribed dual resident' issue were discussed in relation to a CLP at 7.2.2.

The first limb of the ownership requirement requires that the CLP is a wholly-owned subsidiary of any of the eligible tier-1 companies of the potential MEC group.[953] That is, all of the membership interests in the CLP are required to be owned by any of those eligible tier-1 companies. Each of the partnership interests in a CLP held by an eligible tier-1 company are taken to be a 'share' and the partners are taken to be shareholders for the purposes of the taxation law.[954] Therefore, for the purposes of the first limb of the ownership requirement, the membership interests in a CLP are the deemed 'shares' (that is, the partnership interests) held by the deemed 'shareholders' (that is, the general partner and limited partners) which are all required to be beneficially owned by any of the eligible tier-1 companies.

Alternatively, under the second limb, the MEC wholly-owned requirement is satisfied if the CLP would satisfy the first limb if it were assumed that all of the membership interests that are beneficially owned by any of those eligible tier-1 companies were owned by a single one of those eligible tier-1 companies.[955] The meaning of 'beneficially owned' is analysed in 6.3.3.1 and that analysis is adopted here.[956]

There is an exception to the wholly-owned requirement in s 719-35. An entity ('test entity') that is held by a trust that is not a fixed trust is not prevented from being a wholly owned subsidiary of a company if the test entity would have been a wholly owned subsidiary of the company had the interposed trust been a fixed trust and all its objects are beneficiaries.

7.5 Analysis of Issues Arising

The following analyses certain issues that arise from the analysis in this chapter of partnerships as members of consolidated groups and MEC groups.

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952 *ITAA 97* (n 7) s 719-10(1)(b) column 2 para (a) of the table.
953 Ibid s 719-10(1)(b) column 3 para (a) of the table. The definition of wholly-owned is in *ITAA 97* s 703-30
954 *ITAA 36* ss 94P and 94Q.
955 *ITAA 97* s 719-10(1)(b) column 3 para (b) of the table.
956 See above nn 795-805 and accompanying text.

7.5.1 Corporate Limited Partnerships

The eligibility of corporate limited partnerships ('CLPs') to qualify as a head company of a consolidated group or consolidatable group was considered at 7.2 with the conclusion, at 7.2.1, that since CLPs are regarded as a company for the purpose of the income tax law they were eligible to be a head company subject to satisfying the residence requirement (discussed in 7.2.2) and the ownership requirement (discussed in 7.2.3). Also, for a CLP to qualify as a subsidiary of a consolidated group or consolidatable group, the requirements in item 2 of the table in s 703-15(2) are required to be met. The residence requirement for a head company (column 3 of item 1 of the table in s 703-15(2)) is the same as the residence requirement for a subsidiary member that is a company in column 3 of item 2 of the table in s 703-15(2).

It was noted at 7.2.2 that the resident requirement requires that the CLP is formed in Australia or, either the CLP carries on business in Australia or the CLP's management and control is in Australia. It is important that where a CLP is not formed in Australia and either the carrying on business in Australia test or the management and control in Australia test is being relied upon to satisfy the resident requirement, the satisfaction of these tests is continuously managed and monitored since a failure to meet at least one of the tests,[957] where the CLP is a head company, will result in the consolidated group ceasing to exist[958] or, where it is a subsidiary member of a consolidated group, it will exit the group and Division 711 will be relevant to set the tax cost of the CLP's membership interests.[959] The same considerations are relevant to CLPs within MEC Groups.

7.5.2 Foreign Hybrids

The monitoring of the satisfaction of the requirements for a limited partnership to meet the definition of a FHLP[960] and for a company to meet the definition of a FHC[961] is critical as both definitions require that the relevant requirements must be met at all times during an income year for the entity to qualify as a FHLP or FHC for that income year. The failure to meet the requirements for all of an income year has the consequence that the status of an entity as a

[957] It is noted that the satisfaction of the carrying on business test in Australia should be easier to satisfy than the management and control in Australia test.
[958] *ITAA 97* (n 7) s 703-5(2).
[959] Ibid s 701-15.
[960] Ibid s 830-10.
[961] Ibid s 830-15.

foreign hybrid will have ceased at the end of the previous year of income. In terms of the implications for tax consolidation, those foreign hybrids entities would cease to be partnerships and would have exited the group at the end of the prior year and would not be eligible to be subsidiary members of the consolidated group as a company as the residence requirements would not be expected to be satisfied. In future income years, where the requirements for a FHLP or a FHC are met for all of an income year, they will be regarded as foreign hybrids and therefore as partnerships and they will re-join the group. There are costs in monitoring the position and there may be tax costs associated with the exit. The same considerations are relevant to foreign hybrids as subsidiary members of MEC groups.

7.5.3 Interposed Entities

The discussion in 6.5.3 as to the application of the second alternative in s703-45(2)(b) is relevant to interposed entities between the head entity and a partnership. Accordingly, under the second alternative in s 703-45(2)(b), where all the membership interests in a partnership are held by a trustee (the 'nominee') under a bare trust for the benefit of the head company or another subsidiary member of the consolidated group, the trustee of the bare trust is not a subsidiary member of the consolidated group. The effect of the second alternative in s 703-45(2)(b) is to 'trace around' the trustee (nominee). Where, however, the partnership interests are held by a trustee that is a subsidiary member of the group on bare trust for the head company or another subsidiary member of the consolidated group, s 703-45(2)(b) has no application and satisfaction of the ownership requirement in column 4 of item 2 in the table in s 703-15(2) in respect of the partnership will be tested by 'tracing through' the bare trust.

7.6 Conclusion

The requirements for partnerships to be head companies of tax consolidated groups was analysed at 7.2. The first requirement, the company requirement is analysed at 7.2.1 in relation to corporate limited partnerships ('CLPs'), the second requirement, the residence requirement, was analysed at 7.2.2 in relation to CLPs. The third requirement, the ownership requirement, was analysed at 7.2.3 in relation to CLPs.

The requirements for partnerships to be subsidiary members of tax consolidated groups was analysed at 7.3. The first requirement, the partnership requirement, was analysed at 7.3.2. The second requirement, the wholly-owned requirement, was analysed at 7.3.3.

The requirements for partnerships to be members of MEC groups was analysed at 7.4. The eligibility for a partnership to qualify as a top company of a MEC group was analysed at 7.4.1. The eligibility of a partnership to qualify as a tier-1 company of a MEC group was analysed at 7.4.2. The eligibility of a partnership to qualify as a wholly-owned subsidiary of a tier-1 company was analysed at 7.4.3.

Issues arising from the analysis undertaken in this chapter were analysed at 7.5.

Chapter 8 - Consequences of Trusts Joining and Exiting Consolidated Groups and MEC Groups

8.1 Introduction

This chapter at 8.2 sets out and analyses the tax cost setting process on the formation of a consolidated group and entities joining an existing consolidated group.

At 8.3 the cost setting rules upon the exit of subsidiary members from a consolidated group are analysed.

At 8.4 the transfer of losses to the head company by a joining entity (including the loss transfer rules for trusts at 8.4.2) and their utilisation by the head company are analysed.

At 8.5 the joining and exiting of a consolidated group by a trust as head company of a consolidated group is analysed.

At 8.6 the joining and exiting of a consolidated group by a trust as a subsidiary member of a consolidated group is analysed.

At 8.7 the joining and exiting of a MEC group by a trust as a tier-1 company is analysed and, at 8.8, the joining and exiting of a MEC group by a trust as subsidiary member of a MEC group is analysed.

At 8.9 various issues are analysed arising from the analysis undertaken in this chapter 8.

8.2 Overview of Tax Cost Setting on Formation and Joining a Consolidated Group

As discussed in 3.5,[962] the basis of the design of Australia's tax consolidation regime was an asset-based model that disregards an entity's separate existence whilst in consolidation. Upon an entity's entry into consolidation, the sum of the cost bases for the assets of the entity is reset equal to the consolidated group's cost base for the equity of the entity. The assets of the head company retain their tax values upon formation of a consolidated group. Conversely, when an entity leaves or exits the group, a cost base for its equity, that is the membership interests in the entity, is reconstructed which is equal to the sum of the cost bases of the entity's assets.

[962] See above nn 371-381 and accompanying text.

8.2.1 Tax Cost Setting - Entity becoming a subsidiary member of an existing consolidated group

At the time an entity becomes a subsidiary member of a consolidated group each asset[963] of that entity ('joining entity') at that time has its tax cost set at the asset's 'tax cost setting amount' ('TCSA').[964] This recognises the cost to the head company of the asset as an amount reflecting the group's cost of acquiring the joining entity.[965]

The TCSA of an asset of a joining entity is the amount worked out in accordance with Division 705 of the *ITAA 97*.[966] Subdivision 705-A applies in working out the TSCA for an asset, the tax cost of which is set at the time the joining entity becomes a member of the consolidated group ('joined group').[967]

In working out the TCSA of assets of the joining entity it is first necessary to determine what assets are 'retained cost base assets'.[968] The TCSA for retained cost base assets is set out in sections 705-25(2) – (4B). In certain circumstances, the TCSA of a retained cost base asset may be reduced where it exceeds the market value of the asset.[969]

Assets that are not retained cost base assets are 'reset cost base assets'.[970] The TCSA of a reset cost base asset is determined by first working out the joined group's 'allocable cost amount' for the joining entity in accordance with s 705-60 and then reducing that amount by

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963 An asset for these purposes is a 'CGT asset', a 'revenue asset', a 'depreciating asset', 'trading stock' and 'a thing that is part of a Division 230 financial arrangement': *ITAA 97* (n 7) s 701-67. A 'CGT asset' has the meaning given by s 108-5 of the *ITAA 97*: s 995-1(1) (definition of 'CGT asset'); a 'revenue asset' has the meaning given by s 977-50 of the *ITAA 97* which, broadly, means an asset that is neither trading stock nor a depreciating asset and in respect of which the profit or loss from its realisation forms part of the entity's assessable income other than a capital gain or loss : s 995-1(1) (definition of 'revenue asset'); a 'depreciating asset' has the meaning given by s 40-30 of the *ITAA 97*: s 995-1(1) (definition of 'depreciating asset'); and 'trading stock' has the meaning given by s 70-10 as modified by s 70-12 of the *ITAA 97* and sections 124ZO and 124ZQ of the *ITAA 36* (n 40): s 995-1(1) (definition of 'trading stock').

964 *ITAA 97* ss 701-10(2) and (4).

965 Ibid s 701-10(3)

966 Ibid s 701-60 item 1 of the table.

967 Ibid s 705-20.

968 Section 705-25(5) of the *ITAA 97* sets out the definition of a 'retained cost base asset' which, broadly, includes, inter alia, Australian currency, other than trading stock or collectables of the joining entity (para (a)); a right to receive a specified amount of Australian currency (para (b)), a unit in a cash management trust if the redemption value is expressed in Australian dollars and the redemption value cannot increase (para (ba)); a 'right to future income' (defined in s 701-63(5) other than a 'WIP amount asset' (defined in s 701-63(6)) (para (d)).

969 Ibid s 705-27.

970 Ibid s 705-35(1).

the total of the TCSAs for the retained cost base assets and, finally, allocating the resulting amount to each of the entity's reset cost base assets in proportion to their market values.[971]

The TCSA allocated to a reset cost base asset on the basis of the above method may, however, be reduced where the TCSA exceeds a cap for certain assets.[972] If a reduction occurs in the TCSA of an asset, the amount of the reduction is allocated amongst other reset cost base assets to increase their TCSAs.[973] However, the increased amount cannot exceed the greater of the asset's market value or the joining entity's terminating value for the asset.[974] Where the reduction cannot be allocated, the unallocated amount is treated as a capital loss of the head company under CGT event L8.[975]

The allocable cost amount ('ACA') for a joining entity is determined by the calculation set out in s 705-60 as follows:

Step 1	Start with the cost of the membership interests in the joining entity held by the members of the joined group.[976]
Step 2	Add the value of the joining entity's liabilities.[977]
Step 3	Add certain undistributed taxed profits accruing to the joined group before the joining time, or if the joining entity is a trust, add undistributed realised profits accruing to the joined group before the joining time if they could be distributed tax free.[978]

[971] The Guide to Subdivision-S of the *ITAA 97* (n 7) indicates that the expression 'market value' is used in its ordinary sense for the purposes of the *ITAA 97* unless the provisions of the Subdivision have application. Those provisions have no application to Part 3-90 and therefore 'market value' as used in the consolidation provisions is to be interpreted according to its ordinary meaning. The High Court in *Commissioner of State Revenue (WA) v Placer Dome Inc* (2018) 265 CLR 585, referring to the decision of the High Court in *Spencer v Commonwealth* (1906) 5 CLR 418, indicated that under ordinary valuation principles 'value is the price which a hypothetical willing but not anxious seller could reasonably expect to obtain and a hypothetical willing but not anxious buyer could reasonably expected to pay after proper negotiations between them have concluded and without overlooking any ordinary business consideration' : 593 [17] (Kiefel CJ, Bell Nettle and Gordon JJ). The Commissioner allows certain 'valuation shortcuts' for tax consolidation purposes: see Australian Taxation Office, *Consolidation Valuation Shortcuts* (Web Page) <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/consolidation/in-detail/consolidation-valuation-shortcuts>.

[972] Section 705-40(1) of the *ITAA 97* provides that the TCSA of a reset cost base asset that is trading stock, a depreciating asset, a registered emissions unit or a revenue asset must not exceed the greater of the asset's market value and the joining entity's 'terminating value' for the asset. A joining entity's' terminating value' for an asset is set out in s 705-30 for varying types of assets.

[973] *ITAA 97* s 705-40(2).

[974] Ibid s 705-40(3).

[975] Ibid s 104-535.

[976] Step 1 ensures that the ACA includes the cost of acquiring the membership interests. The cost of membership interests is determined under s 705-65. Where the joining entity is a discretionary trust, the step 1 amount may be increased by an amount determined under s 713-20 for settled capital that could have been distributed tax free to the objects of the discretionary trust.

[977] Step 2 ensures that certain accounting liabilities of the joining entity at the joining time are part of the joined group's cost of acquiring the joining entity. The amount of the liabilities is determined by the application, where relevant, of ss 705-70, 705-75, 705-76, 705-80 and 705-85.

[978] Step 3 increases the ACA to reflect the undistributed taxed profits and to prevent double taxation. If the joining entity is a trust, to reflect, undistributed realised profits that could be distributed tax free. The step 3 amount is determined under s 705-90 unless the joining entity is a trust in which case s 713-25 applies. The meaning of a 'profit that accrues

Step 3A	Add/subtract a loss/gain disregarded by a foreign company or the head company as a result of a CGT rollover previously claimed on an asset owned by the joining entity at the joining time.[979]
Step 4	Subtract distributions of profits not accruing to the joined group and those accruing to the group that recouped losses.[980]
Step 5	Subtract unused losses that accrued to the group, except those losses that reduced step 3.[981]
Step 5A	Subtract 'FRT disallowed amounts' accruing to the joined group before the joining time.[982]
Step 6	Subtract an amount equal to transferred losses that did not accrue to the group, multiplied by the general company tax rate.[983]
Step 6A	Subtract 'FRT disallowed amounts' that the joining entity transferred to the head company'.[984]
Step 7	Subtract certain inherited deductions to which the head company is entitled.[985]
Step 8	If the remaining amount is positive, it is the joining entity's ACA. Otherwise, the ACA is nil.

Pursuant to s 705-315, the head company of a consolidated group is required to notify the Commissioner of Taxation if it has made one or more errors in working out the TCSA for a reset cost base asset and those errors have caused the TCSA to differ from the correct amount

to the joined group before the joining time' is contained in s 705-90(7) and refers to profit that, if it had been distributed as it accrued to holders of memberships interests and that entities interposed between the head entity and the joining entity successively distributed any of it immediately upon receiving it, it would have been received by the head company in respect of interests that it held continuously until the joining time either directly, or indirectly through the interposed entities.

979 Step 3A makes adjustments for certain roll-overs before the joining time affecting deferred gains and losses. The step 3A amount is determined under s 705-93.

980 Step 4 prevents the ACA reflecting return of part of the amount paid to acquire the membership interests in the joining entity. The step 4 amount is determined under s 705-95.

981 Step 5 requires the subtraction of carry forward tax losses and net capital losses of the joining entity to the extent that those losses accrued to membership interests that were directly or indirectly owned by the head company and were continuously held by the head company until the joining time. The step 5 amount is determined under s 705-100.

982 Step 5A amount is worked out under s 705-102 and requires the subtraction of each 'fixed ratio test disallowed amount' (within s 820-57) in the same way as tax losses and net capital losses under step 5. Broadly, the thin capitalisation rules (contained in *ITAA 97* div 820) allow a special deduction for debt deductions under the fixed ratio test in certain circumstances.

983 Step 6 prevents the joined group obtaining benefits through higher TCSAs for the joining group's assets and through losses transferred to the head company. In the absence of an adjustment under step 6 the joined group may receive a doble benefit by reason of an uplift in the terminating value of the assets of the joining entity at the joining time and the ability of the head company to use losses against the joined group's assessable income after the joining time. The step 6 amount is determined under s 705-110.

984 Step 6A amount is worked out under s 705-112 and its purpose, similar to step 6, is to prevent the joined group obtaining benefits through higher TCSAs for the joining entity's assets and through a 'fixed ratio test disallowed amount' (within s 820-57) transferred to the head company.

985 Step 7 prevents the joined group from obtaining benefits through higher TCSAs for the joining group's assets and through certain tax deductions inherited by the head company under the inherited history rule in s 701-5 of the *ITAA 97*. The step 7 amount is determined under s 705-115.

and it is unreasonable, having regard to certain factors,[986] to require a recalculation of the amounts involved.[987]

Where the errors caused the TCSA of a reset cost base asset to be more than the correct amount, the difference is the 'overstated amount' and, if the TCSA is less than the correct amount, it is an 'understated amount'. The notice by the head company, in the approved form, to the Commissioner of Taxation, which should be made as soon as practicable after the head company becomes aware of the errors, must indicate that the head company has made the errors and of the amount of the overstated amount or understated amount.[988]

Where the conditions in s 705-315 are met, the TCSA worked out by the head company is taken to be correct and CGT event L6 happens.[989] Broadly, CGT event L6, which occurs at the start of the income year in which the Commissioner becomes aware of the errors, requires that a 'net overstated amount' (which is the amount by which overstated amounts exceeds understated amounts for the income year) is a capital gain of the head company and a 'net understated amount' (which is the amount by which understated amounts exceeds overstated amounts for the income year) is a capital loss of the head company.[990]

8.2.2 Cost Setting on Formation of a Consolidated Group

The tax cost setting rules on the formation of a consolidated group are materially the same as the cost setting rules that apply under Subdivision 705-A when an entity joins an existing consolidated group. Subdivision 705-B modifies certain provisions of Subdivision 705-A but otherwise Subdivision 705-A has effect in relation to each entity becoming a subsidiary member of a consolidated group at the formation time in the same way as it applies to an entity becoming a subsidiary of an existing tax consolidated group.[991]

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986 The factors are the net size of the error compared to the ACA for the joining entity; the number of TCSAs that would have to be recalculated and the difficulty of making the recalculations; the number of adjustments, in assessments that could be amended and in future income tax returns, that would be necessary to correct the errors; and the difficulty in obtaining any necessary information: *ITAA 97* (n 7) s 705-315(4).

987 *ITAA 97* ss 705-315(1)-(4).

988 Ibid s 703-315(6).

989 Ibid s 705-320(1).

990 Ibid s 104-525 (1)-(3).

991 Ibid s 705-140.

Broadly, upon formation of a consolidated group the head company retains its existing tax values and the tax cost setting process as discussed in 8.1.1 applies separately to each subsidiary member of the consolidated group.

If a subsidiary member is wholly owned by the head company and no other subsidiary member holds membership interests in the first-mentioned subsidiary member, the TCSA in respect of the first-mentioned subsidiary member's assets can be worked out in any order in relation to the TCSAs of other subsidiary members.[992]

If, however, on becoming a subsidiary member that subsidiary member holds membership interests in other entities that become subsidiary members, it is necessary to work out the TCSAs of the assets of each the subsidiary members on a 'top down' basis.[993] Accordingly, for example, where a subsidiary member ('first subsidiary') owns membership interests in a subsidiary member ('second subsidiary'), the first subsidiary determines the TCSA for its assets which will include a TCSA for its membership interests in the second subsidiary. That TCSA for the membership interests in the second subsidiary is then used in working out the ACA for the assets of the second subsidiary.[994] This process will continue if the second subsidiary has membership interests in another subsidiary member.

Depending on the circumstances, there may be modifications to the calculation of the ACA in respect of subsidiary members to which Subdivision 705-B applies.[995]

8.3 Cost Setting Upon Exit of Subsidiary Members from a Consolidated Group

Where a subsidiary member ('leaving entity') of a tax consolidated group ceases[996] to be a member of a consolidated group ('old group') at a particular time ('leaving time') Division 711 of the ITAA 1997 applies to recognise the head company's tax cost for membership interests in the leaving entity which had not been recognised whilst the leaving entity was part of the consolidated group.[997] The head company's costs for those membership interests, just before

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992 Ibid s 705-145(2) Note.

993 Ibid s 705-145(2).

994 Ibid s 705-145(3).

995 Step 3A may be modified by s 705-147 and step 4 may be modified by s 705-155. See also s 705-160 for further modifications to the ACA calculation and working out the TCSA.

996 The cessation may occur if membership interests in the leaving entity are sold outside the consolidated group or the leaving entity is ineligible to be a subsidiary member by reason of it not satisfying one or more of the eligibility requirements in s 703-15(2) item 2 of the table.

997 *ITAA 97* (n 7) ss 711-5(1)-(2) and 701-15.

the leaving time, is an amount equal to the cost of the leaving entity's assets at the leaving time reduced by the amount of its liabilities.[998]

The TCSA for each membership interest in the leaving entity that members of the old group held, where there is no multiple exits,[999] is worked out under s 711-15(1). That section works out the TCSA for each membership interest by, first, working out the old group's allocable cost amount ('ACA') for the leaving entity under s 711-20 and, secondly, if there is more than one class of membership interests in the leaving entity, allocating the ACA to each class in proportion to the market value of all the membership interests on issue.[1000] Next, the ACA of each class is allocated to each membership interest in each class which results in the TCSA for each membership interest. If a leaving entity is a trust, the ACA for each membership (other than a unit or other interest in the trust) may be reduced to nil in certain circumstances. [1001]

The ACA of the old group in the leaving entity is worked out as follows:

Step 1	Start with the amount worked out under s 711-25 for the terminating values of the leaving entity's assets just before the leaving time.[1002]
Step 2	Add the step 2 amount worked out under s 711-35 which is about the deductions inherited by the leaving entity that are not reflected in the terminating values of the leaving entity's assets just before the leaving time.[1003]
Step 3	Add the amount of the liabilities owed by members of the old group to the leaving entity at the leaving time worked out under s 711-40.[1004]
Step 4	Subtract the amount worked out under s 711-45 of the leaving entity's accounting liabilities just before the laving time and membership interests in the leaving entity that are not held by members of the old group.[1005]
Step 5	If the amount after step 4 is positive, it is the old group's ACA in the leaving entity. Otherwise, the ACA is nil.

998 Ibid s 711-5(3).

999 Where a leaving entity holds membership interests in another subsidiary member of the group, that other subsidiary will also cease to be a member(s) at the leaving time, the cost of those membership interests is worked out on a bottom up basis: s 711-55.

1000 Where a member of the old group holds a 'non-membership equity interest' (broadly, 'a non-membership equity interest is an interest in the leaving entity that is not an accounting liability and is not a membership interest in the leaving entity and is not a debt interest in the leaving entity (s 995-1 *ITAA 97* (n 7) (definition of 'non-membership equity interest')) in the leaving entity, that interest is treated as a membership interest and of a different class than any other membership interest for the purposes of s 711-15(1).

1001 *ITAA 97* s 711-15(1)(d). See below nn 1044-45 and accompanying text.

1002 Step 1 ensures that the ACA includes the cost of the leaving entity's assets.

1003 Step 2 ensures that the value of the deductions is reflected in the ACA.

1004 Step 3 ensures that the intra-group liabilities that were not recognised while the leaving entity was a member of the consolidated group are reflected in the ACA.

1005 Step 4 ensures that the ACA is reduced to reflect the accounting liabilities and the value of certain membership interests worked out under s 711-45.

8.4 Losses in Tax Consolidated Groups

8.4.1 Overview

The tax consolidation provisions allow, subject to various requirements, the transfer of a loss of any sort[1006] of an entity ('joining entity'), including a trust, that at a time ('joining time') becomes a member of a consolidated group ('joined group') to the head company of the joined group and the utilisation of those transferred losses by the head company.[1007] Unlike companies and trusts, since tax losses of partnerships are shared by the partners individually each income year and not carried forward to future income years, the loss transfer provisions have no application to partnerships.

The joining entity must have made the loss in an income year before the joining time and the loss is transferred at the joining time by the joining entity to the head company subject to the satisfaction of certain transfer tests considered at 8.4.2.[1008]

Upon the transfer of a loss of a joining entity, the head company is treated as having made the loss in the income year in which the transfer occurs[1009] and the head company can utilise the loss[1010] subject to Subdivisions 707-B and 707-C which are discussed in 8.4.3.

The head company may choose to cancel the transfer of a loss and the choice is irrevocable.[1011] The choice to cancel a loss transfer may be made, for example, where the available fraction (discussed in 8.4.3) associated with those losses is negligible and recoupment therefore practically worthless. A consequence of the cancellation is that those losses will not be deducted at step 6 of the ACA calculation. The result of the cancellation is that the loss is taken not to have been transferred.[1012] Where a loss is not transferred by the joining entity, the loss cannot be utilised by any entity for any income year ending after the joining time.[1013]

8.4.2 Loss Transfer Tests

[1006] The 'sorts' of losses are a 'tax loss', a 'film loss' and a 'net capital loss': *ITAA 97* s701-1(4). Each expression is defined in s 995-1(1) of the *ITAA 97*.
[1007] *ITAA 97* div 707.
[1008] Ibid ss 705-115, 705-120(1) and (1A).
[1009] Ibid s 707-140(1)(a).
[1010] Ibid s 707-105(1).
[1011] Ibid ss 707-145 (1) and (3).
[1012] Ibid s 707-145(2).
[1013] Ibid s 707-150.

As discussed in 8.4.1, the ability of a joining entity to transfer losses is subject to certain transfer tests which are, broadly, modified versions of the recoupment tests that apply where an entity is seeking to utilise carry-forward losses in determining its taxable income outside tax consolidation. The transfer tests vary according to the nature of the entity. The following considers the transfer tests applicable to trusts.

The transfer tests apply on the assumptions, first, that the trust had sought to claim the loss for an income year ('trial year'), which generally starts 12 months before, and ends immediately after the trust joined the group,[1014] secondly, the amount of the loss that could be utilised for the trial year is not limited by the trusts income or gains for the trial year, and, thirdly, that the trust had not become a member of the joined group but had been a wholly-owned subsidiary of the head company.[1015]

For joining entities that are fixed trusts,[1016] and not widely held unit trusts[1017] or excepted trusts,[1018] the relevant transfer test is the '50% stake test'[1019] or, if that cannot be met, the 'non-fixed trust stake test'.[1020]

[1014] Ibid s 707-120(2).

[1015] Ibid s 707-120(1A).

[1016] A fixed trust is a trust where persons hold 'fixed entitlements' to all of the income and capital of the trust: *ITAA 36* (n 40) sch 2F s 272-70. Broadly, a 'fixed entitlement' to a share of income or capital of a trust is a vested and indefeasible interest in the income or capital of the trust held by a beneficiary of the trust: s 272-5.

[1017] *ITAA 36* sch 2F s 272-105.

[1018] Ibid s 272-100. Examples of excepted trusts are family trusts, complying superannuation funds and the trust of a deceased estate.

[1019] Ibid ss 266-25, 266-40. Broadly, the 50% stake test is passed if during a period or two times during the period the same individuals own, directly or indirectly, for their own benefit, fixed entitlements to a greater than 50% share of the capital of the trust and during the period or two times during the period the same individuals own, directly or indirectly, for their own benefit, fixed entitlements to a greater than 50% share of the income of the trust: *ITAA 36* sch 2F ss 269-50, 269-55. Although it is only individuals that can satisfy the 50% stake test, the legislation provides for tracing through certain interposed trusts, companies and partnerships to individuals: ss 272-20, 272-25.

[1020] Ibid ss 266-25, 266-45. The 'non-fixed trust stake test' is an alternative test where the 50% stake test cannot be met because half or more of the interests in the fixed trust are held directly or indirectly by a non-fixed trust with no or insufficient fixed entitlements – this may occur where a discretionary trust holds interests in the fixed trust but there are no fixed entitlements held in the discretionary trust. The test applies if there are fixed entitlements to 50% or more of the income or capital of a fixed trust held by a non-fixed trust(s) (s 266-45(2)(a)), or all the fixed entitlements are held, directly or indirectly, by another fixed trust or a company ('holding entity') and a non-fixed trust(s) hold fixed entitlements to a 50% or greater share of the income or capital of the holding entity (s 266-45(2)(b)). The test will be met and a loss can be deducted by the fixed trust if, first, where the fixed trust is held directly by a non-fixed trust, there is no change in the persons directly holding fixed entitlements to shares of the income or capital of the fixed trust nor the percentage of their shares and, where the fixed trust is held, directly or indirectly, by a holding entity, this requirement is applied to the holding entity (s 266-45(3)). Secondly, each non-fixed trust that holds fixed entitlements in the fixed trust, directly or indirectly, must satisfy the relevant tests that apply to non-fixed trusts if they stood in place of the fixed trust (s 266-45(5)). See, generally, Explanatory Memorandum, Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997 (Cth) [6.18] –[6.24].

For joining entities that are not fixed trusts, which are referred to as 'non-fixed trusts', the conditions which govern the transfer of the losses are

1. The pattern of distributions test[1021] must be passed for the income year ('joining year') in which the joining time occurs (not the trial year) if:

   - the trust has distributed income in the joining year or in at least one of the six earlier income years; or

   - the trust has distributed capital in the joining year or in at least one of six earlier income years.[1022]

2. The trust must not have been prevented from deducting the tax loss in an earlier income year because of a failure to meet the pattern of distributions test.[1023]

3. If at any time ('test time') in the trial year there are individuals with more than a 50% stake in income or capital of the trust, more than a 50% stake in income or capital must be maintained from the test time until the end of the trial year.[1024]

4. A group must not in the trial year begin to 'control' the trust directly or indirectly.[1025] Matters that are required to be taken into account in considering whether there is a group[1026] that 'controls' are set out in Subdivision 269-E of Schedule 2F and include, the group's power to remove or appoint the trustee,[1027] the trustee is accustomed, or under an obligation, or might reasonably be expected, to act in accordance with the

[1021] Broadly, the pattern of distributions test is passed if the trust has distributed, directly or indirectly, more than 50% of every 'test year distribution' of income and capital to the same individuals for their own benefit: *ITAA 36* sch 2F s 269-60. Broadly, a test year distribution of capital and income is the total of all distributions of capital and income in the trial year, the year of income of the loss and years of income between the trial year and the loss year provided that no period should begin earlier than 6 years prior to the beginning of the trial year: s 269-65. For an analysis of perceived defects in the pattern of distributions test see Dale Boccabella, 'Patterns of Distributions Test for Discretionary Trusts: Defects Reveal Questionable Policy Design and implementation' (2015) 30(2) *Australian Tax Forum* 411.

[1022] *ITAA 36* (n 40) sch 2F ss 267-20(2), 267-30(2) and *ITAA 97* (n 7) s 707-130(2).

[1023] *ITAA 36* sch 2F ss 267-20(2), 267-35 and *ITAA 97* s 707-130(3).

[1024] Ibid ss 267-20(2), 267-40(1) and (2).

[1025] Ibid ss 267-20(2), 267-45.

[1026] A 'group' includes a person, a person and one or more associates, and 2 or more associates of a person: *ITAA 36* sch 2F s 269-95(4).

[1027] *ITAA 36* sch 2F s 269-95(1)(e).

wishes of the group,[1028] and the group is able (directly or indirectly) to control the application of the income or capital of the trust.[1029]

8.4.3 Utilisation of Transferred Losses by Head Company

Subdivision 707-B contains provisions which 're-instate' the continuity of ownership test ('COT') rules where a company has transferred COT losses to the head company.[1030] This is necessary to overcome the provision[1031] that losses transferred to the head company are taken to have been made by the head company for the income year in which the transfer occurred. The Explanatory Memorandum ('2002 EM')[1032] to the legislation explained that this is an inappropriate outcome where the original loss entity is a company and the loss is transferred because COT is passed. It would allow a faster or greater use of losses than would occur outside consolidation. Accordingly, Subdivision 707-B has the effect of preserving pre-consolidation changes in ownership in determining whether COT is passed in respect of the loss post-consolidation.

For the transfer of losses other than COT losses, Subdivision 707-B has no application and therefore things that occurred before a loss is transferred to a head company are ignored in determining whether the head company can use the loss.[1033]

Subdivision 707-C limits the use of transferred loss by the head company of a consolidated group. The 2002 EM explained that transferred losses would be used by the group 'at approximately the same rate they would have been used by the joining entity had it remained outside the group. The aim is to ensure that the treatment of transferred losses is not a motive in deciding to consolidate a group or in a consolidated group deciding to acquire a loss entity'.[1034]

A head company has two categories of losses, those losses generated by the consolidated group ('group losses') and losses of an entity before it became a member of the consolidated group and transferred them to the head company at the joining time ('transferred losses').

[1028] Ibid s 269-95(1)(d).
[1029] Ibid s 269-95(1)(b).
[1030] *ITAA 97* s 707-210.
[1031] Ibid s 707-140(1)(a).
[1032] 2002 Consolidation EM (n 21) [7.3]-[7.5].
[1033] Ibid [7.6].
[1034] Ibid [8.2].

So-called 'loss bundles' come into existence when transferred losses of any sort are transferred to the head company at the joining time and constitute a single bundle of losses.[1035] A single available fraction is worked out for each loss bundle and is used to limit the annual rate at which the bundle's losses can be recouped by the head company.[1036] The available fraction for a bundle of losses is worked out, broadly, by dividing the market value of the joining entity at the loss transfer time by the consolidated group's market value at the transfer time.[1037] Broadly, the available fraction is applied to each category of the income and gains of the head company for the income year which is used as the basis for determining the amount of losses of each sort that the head company can use from the bundle.[1038] The available fraction may be maintained or reduced on the happening of certain events.[1039]

Group losses are deducted by the head company in accordance with the rules[1040] outside consolidation for the recoupment of company losses.[1041] Group losses of a sort are required to be used before transferred losses of the same sort.[1042]

8.4.4 MEC Group Losses

As indicated at 6.1.2, the tax consolidation provisions contained in Part 3-90 of the *ITAA 97*, other than Division 703 and subject to Division 719, have effect in relation to a MEC group in the same way that they have effect in relation to a consolidated group.[1043] The loss transfer provisions discussed above in respect of a trust that joins a consolidated group as a subsidiary member will apply in the same way to a trust that becomes a subsidiary member of a MEC group. There are amendments in Subdivision 719-F that modify the consolidation group rules for transferring and utilising losses in respect of losses in MEC groups due to the special characteristics of MEC groups. These relate mainly to maintaining same ownership for loss utilisation and how much of a loss can be utilised by references to bundles of losses and their available fractions.[1044]

1035 *ITAA 97* (n 7) s 707-315(1)-(2).
1036 Ibid s 707-310.
1037 Ibid s 707-320. The available fraction is worked out to 3 decimal places: s 707-320(4).
1038 Ibid s 707-310.
1039 Ibid s 707-320(2).
1040 Ibid divs 165, 166.
1041 Ibid s 707-345.
1042 Ibid s 707-310(3)(b).
1043 Ibid s 719-2.
1044 Ibid s 719-250.

8.5 Trust as Head Company of a Consolidated Group - Joining and Exiting a Consolidated Group

The conclusion was reached at 6.3 that a trust other than a public trading trust ('PTT") is ineligible to be the head company of a consolidatable group or consolidated group since the company requirement is not satisfied by a trust.[1045]

It was noted at 6.3 that Subdivision 713-C permits a PTT, subject to certain requirements, to make a choice to consolidate a consolidatable group as if the PTT were a company.[1046] As discussed in 6.3,[1047] the PTT will have certain income tax law ('applied law') applied to it in the same way that it applies to a company subject to the modifications set out in s 713-140.

8.5.1 Formation of a Consolidated Group by a PTT

On the formation of a consolidated group by a PTT, as noted at 8.2.2, the PTT retains the existing tax values for the assets it owns except for intra-group debt and intra-group membership interests that it owns which are not recognised during the period of consolidation.

The process for setting the TCSA of the assets of the subsidiary members of the group at the formation time is that as discussed in 8.2.2.

The PTT, as head company, must give a notice to the Commissioner of Taxation, in the approved form, of the choice to form a consolidated group from a consolidatable group and the date from which the consolidated group is in existence.[1048]

8.5.2 PTT Exits a Consolidated Group

Where a PTT ceases to be the head company of a consolidated group, for example, by reason that it does not satisfy one or more of the eligibility requirements in item 1 of s 705-15(2), the consolidated group will cease to exist.[1049] At that the cessation time, membership interests in the subsidiary members of the consolidated group will have their tax cost set at their TCSA in accordance with the process set out in 8.3.

[1045] Ibid s 703-15(2)(a) item 1 column 2 of the table.
[1046] Ibid s 713-130.
[1047] See above nn 685-9 and accompanying text.
[1048] *ITAA 97* (n 7) s 703-50. The notice must also contain the information required by s 703-58(1) and by the relevant day mentioned in s 703-58(2).
[1049] Ibid s 703-5(2)(a).

The assets of the PTT are not reset, however, it will begin to recognise just after the cessation time any intra-group assets and liabilities that had not been recognised whilst the consolidated group existed.

The PTT, as head company, must notify, in the approved form, the Commissioner of Taxation that the consolidated group has ceased to exist.[1050]

8.6 Trust as a Subsidiary Member of a Consolidated Group upon Joining and Exiting a Consolidated group

8.6.1 Formation of a consolidated group

Where a trust becomes a subsidiary member of a consolidated group at the time of formation of the consolidated group, the process for determining the TCSA of the assets of the trust will be that as discussed in 8.2.2 subject to the modifications made by Subdivision 713-A to steps 1 and 3 of the method statement in s 705-65. Those modifications are discussed in 8.6.2.

The head company must give a notice to the Commissioner of Taxation, in the approved form, of the choice to form a consolidated group from a consolidatable group and the date from which the consolidated group is in existence.[1051]

8.6.2 Joining an existing consolidated group

Where a trust becomes a subsidiary member of an existing consolidated group, the process for determining the TCSA of the assets of the trust will be that as discussed in 8.2.1 with certain modifications.

Subdivision 713-A makes modifications to step 1[1052] and step 3[1053] of the method statement in s 705-65 that works out the ACA of a joining entity that is a discretionary trust in certain circumstances.

[1050] Ibid s 703-60(1) item 3 of the table.

[1051] *ITAA 97* (n 7) s 703-50. The notice must also contain the information required by s 703-58(1) and by the relevant day mentioned in s 703-58(2).

[1052] Ibid s 713-20.

[1053] Ibid s 713-25.

As explained in the explanatory memorandum ('713-A EM') to the Bill introducing Subdivision 713-A,[1054] the modification to step 1 deals with the circumstance where an amount has been settled on a discretionary trust by a third party and the discretionary objects have not paid for their membership interest in the discretionary trust being their rights as an object of the trust. In the absence of consolidation, the amount of the capital could have been distributed tax free to the objects as CGT event E4[1055] would not have happened and no capital gain would arise since the objects do not have an 'interest in the trust' for the purposes of s 104-70(1)(a).[1056] If the discretionary trust were to join a consolidated group, the step 1 amount (that is, the cost of the membership interests in the trust) would be nil as the objects would not have paid an amount for their membership interest in the trust. Since the assets under the normal cost setting provisions would have a low tax cost setting amount due step 1 being nil, a capital gain would be expected upon the sale of the assets by the head company. To overcome this outcome, step 1 of the ACA for the trust is increased by the amount that was settled on the discretionary trust independently of the group and that could have been distributed tax free if the trust had not joined the group. This increase in the step 1 amount increases the amount allocated to the assets of the trusts. The method statement in s 713-20 applies to determine the step 1 amount.

The amendment made to step 3 by s 713-25, as explained in the 713-A EM, overcomes the fact that, unlike a company, a trust cannot frank dividends and therefore does not have undistributed, but frankable, profits that had previously accrued to the group for the purposes of the unamended step 3. To achieve a similar position for trusts, the amendment provides for an amount to be added to the step 3 amount in s 705-65 for a trust of the realised, but undistributed, profits that accrued to the group before the joining time, except to the extent that they would have been covered by CGT event E4 if they had been distributed as they accrued (that is, they would have reduced the cost base of the membership interest concerned or produced a capital gain), or they recouped losses that accrued to the group

[1054] Explanatory Memorandum, New Business Tax System (Consolidation and Other Measures) Bill (No 1) 2002 (Cth) ('713-A EM') [1.47]-[1.49].

[1055] Ibid s 104-70.

[1056] The Commissioner of Taxation accepted this conclusion in Taxation Determination TD 97/15 in respect of repealed section 160ZM(1) of the *ITAA 36* (n 40) which was materially the same as s 104-70(1)(a).

before the joining time.[1057] Section 713-25(1) does not apply to PTTs as they can frank distributions.[1058]

8.6.3 Exiting a Consolidated Group

Where a trust that is a subsidiary member of a consolidated group leaves the consolidated group, the TCSA for each membership interest in the trust that members of the old group hold is worked out under s 711-15(1) as discussed in 8.3. However, where a membership interest in a trust is neither a unit nor an interest in the trust, the member of the old group that held the interest began to hold it only because money or property was settled on the trust, and the interest had no cost base[1059] or it had a cost base of nil, the TCSA of that interest is nil.[1060] This circumstance may occur, for example, in the case of a discretionary trust where an object of the discretionary has no cost base in their membership interest in the trust which is their right as an object of the discretionary trust.

8.7 Trust as a Tier-1 Company of a MEC Group upon Joining and Exiting a MEC Group

It was noted in 6.4.2 that a trust does not meet the requirements to be a tier-1 company since a trust does not meet the company requirement[1061] for the reasons set out in 6.2.1 in relation to a trust not being a company for the purposes of the *ITAA 97*. Also, noted in 6.4.2 is that since there is no equivalent in Division 719 to Subdivision 713-C for PTTs in tax consolidated groups, a PTT cannot be a tier-1 company.

8.8 Trust as a Subsidiary Member of a MEC Group upon Joining and Exiting a MEC Group

8.8.1 Joining an Existing MEC Group

The cost setting rules for trusts that join an existing MEC group as a subsidiary member are the same as for trusts that join a consolidated group which were discussed in 8.2.1 and 8.6.2. Subdivision 719-C of the *ITAA 97* makes Subdivision 705-A (which relates to cost setting in consolidated groups upon joining an existing consolidated group) applicable to entities that join an existing MEC group as a subsidiary member.[1062] It also makes ' any other provision of

[1057] 713-A EM (n 1054) [1.62]-[1.65].
[1058] *ITAA 97* (n 7) s 713-25(2).
[1059] Ibid s 110-25.
[1060] Ibid s 711-15(1)(d).
[1061] Ibid s 719-20(1)(b) item 2 column 2.
[1062] Ibid s 719-160(3)(b).

the *ITAA 97* or *ITAA 36* giving Subdivision 705-A a modified effect in circumstances other than those covered by Subdivision 705-A.[1063] This would include, for example, Subdivision 713-A in respect of trusts.

8.8.2 Joining upon formation of a MEC Group

The cost setting rules for trusts that become subsidiary members of a MEC group upon its formation are the same as those for trusts that join a consolidated group upon formation which were discussed in 8.2.2 and 8.6.1. Similar to Subdivision 705-A, Subdivision 719-C makes Subdivision 705-B (which relates to cost setting in consolidate groups upon formation of the consolidate group) applicable to entities that join a MEC group as a subsidiary member upon formation of the MEC group.[1064]

8.8.3 Exiting a MEC Group

The tax cost setting amount for the membership interests in a trust that is a subsidiary member of a MEC Group that leaves the MEC Group is determined under the leaving rules in Divisions 701 and 711 of the ITAA in the same way as trusts leaving a consolidated group[1065] which are discussed in 8.3.

8.9 Analysis of Issues Arising

The following analyses certain issues that arise from the analysis in this chapter of trusts joining and exiting consolidated groups and MEC groups.

8.9.1 Part Year Joining and Exiting a Consolidated Group

The 'part year issue' was discussed in detail in 2.4 as part of the literature review and it is unnecessary to repeat it here. The issue has been examined and discussed in a variety of forums, including by the Board of Taxation as outlined in 2.4, and it remains disappointing that it has not been resolved by legislative amendment as recommended by the Board[1066] and recognised as an issue by the Government in December 2013.[1067]

[1063] Ibid s 719-160(3)(c).
[1064] Ibid.
[1065] Ibid sub-div 719-J.
[1066] See above (n 162).
[1067] See above n 165 and accompanying text.

It is submitted that the uncertainty regarding the issue still remains and should be resolved by legislative amendment so that certainty is achieved in relation to the calculation of the trust's net income in the membership period and non-membership period and in relation to the liability to tax of the beneficiaries on their appropriate share of the net income.

8.9.2 Loss Transfer Testing and Utilisation of Losses

In 8.4 the legislative provisions in relation to the transfer of losses to the head company of a consolidated group by a trust that joins the group as a subsidiary member were analysed. These provisions are detailed, technical, complex and not always easy to understand.[1068] The loss transfer rules mostly adopt, with modifications, the trust loss recoupment measures and concepts in Schedule 2F to the *ITAA 1936* in relation to fixed and non-fixed trusts. PSLA 2002/11[1069] sets out the multiples provisions in the *ITAA 36* and *ITAA 97* that utilises the fixed trust and fixed entitlement concepts in Schedule 2F.

It is understandable that the Government wished to ensure that the losses which were to be transferred to the head company should have been able to be used by the entity seeking to transfer the losses to the group. These losses are tested at the transfer time. The 2002 EM[1070] indicated that although it was intended in the design of the consolidation regime to allow the transfer of losses, due to the large store of unused losses in the taxation system, allowing all losses to be automatically transferred and used against group income would be too costly to the revenue.[1071] Accordingly, as well as loss transfer testing, the legislation also provided for the use of an available fraction, discussed in 8.4.3, to limit the utilisation of the losses by the head company to a rate that the joining entity would have used the loss if it had remained outside the group.

The necessary detail and complexity of the loss transfer tests and the use of the available fraction to limit the utilisation of losses can be understood against the

[1068] Rooke has considered the meaning of 'fixed trust', 'fixed entitlement' and 'vested and indefeasible interest': see Karen Rooke, 'How Fixed Is Your Trust?' *Australian Tax Forum* (2006) 21 465

[1069] Practice Statement Law Administration PS LA 2002/11 'Fixed vs Non-Fixed Trusts and Consideration Whether a Beneficiary has a Fixed Entitlement to a Share of Income or Capital under Subsection 272-5(1) of Schedule 2F of the *Income Tax Assessment Act 1936* including Requests to Exercise the Commissioner's Discretion under subsection 272-5(3)'.

[1070] See above (n 1032).

[1071] Ibid [6.5]-[6.10].

background of the policy design of the consolidation regime not to provide immediate utilisation of substantial unused losses in the system against group income. It is, however, submitted that to more readily understand the tests and their place in the consolidation loss rules and to create greater certainty, the transfer of loss provisions in Subdivision 707-A should be amended to incorporate (including with relevant amendments for their use as a transfer test) the relevant trust loss rules presently contained in Schedule 2F. This amendment would also be relevant for trusts in MEC groups as the amended rules would also have application to Division 719 pursuant to s 719-2 of the *ITAA 97*.

8.9.3 Determination of Tax Cost Setting Amount

The tax cost setting process, the calculation of the allocable cost amount ('ACA') and its allocation, subject to legislative caps, to varying asset types to determine their tax cost setting amount ('TCSA') at the time a trust (and any linked entities) joins a consolidated group or MEC group, is complex and requires detailed information in order to calculate both the ACA and the TCSA. Ting has suggested that the 'high price' paid for Australia's adoption of an asset-based model as a part of the design of the tax consolidation regime is in the form of 'complex and problematic [tax cost setting rules] which occupy over 100 pages of legislation'.[1072] Moreover, the statutory acknowledgement of the complexity and difficulty of the tax cost setting process is the existence of s 705-315 of the *ITAA 97* which allows errors in the TCSA of assets in certain circumstances to be taken to be correct and introduces a CGT event L6 which may result in a capital gain or loss to the head company depending on whether the errors in aggregate are an understatement or overstatement of the correct amount.[1073]

It can be readily accepted that the tax cost setting process is necessarily complex since the purpose of the process is to establish and recognise for the head entity the tax cost of the assets that a trust or another joining entity brings into the group. The legislation does seek, by way of notes and objects clauses, to explain the process, but this is not always helpful.

[1072] Ting, 'Key Design Issues' (n 27) 586.
[1073] See above nn 986-8 and accompanying text.

The establishing of the basic case in Subdivision 705-A for the tax cost setting process where an entity joins an existing consolidated group with modifications to that Subdivision by Subdivision 705-B in the case of the formation of a consolidate group, by Subdivision 705-C in the case of a consolidated group being acquired by another consolidated group, by Subdivision 713-A in respect of trusts joining a consolidated group, and by Division 719 in respect of subsidiary members joining a MEC group is a better way of setting out the rules that apply in those varying scenarios rather than wholly contained separate divisions where considerable overlap and repetition would exist. Ultimately, it must be accepted that the tax cost setting rules are complex and their understanding and application can only be undertaken by close and detailed analysis. Nevertheless, the legislature should make amendments to the provisions with a view to providing, so far as possible, clarity which aids an understanding of the meaning and purpose of the provisions, which more easily permits an understanding of their application to the facts and circumstances and which minimises the uncertainty that can occur with their interaction with other areas of the income tax law.

8.10 Conclusion

This chapter at 8.2 set out and analysed the tax cost setting process on the formation of a consolidated group and entities joining an existing consolidated group which process sets the head company's tax cost setting amount for each of the joining entity's assets.

The tax cost setting rules upon the exit of subsidiary members form a consolidated group, which set the head company's tax cost in the membership interests of a leaving entity, were analysed at 8.3.

At 8.4 the transfer of losses to the head company by a joining entity (including the loss transfer for trusts at 8.4.2) and the utilisation of transferred losses, including the determination of an available fraction for loss bundles, by the head company were analysed. Also, the rules relating to the transfer of losses to a MEC Group by a subsidiary member (other than an eligible tier-1 company) were noted at 8.4.4

The cost setting process in relation to the joining and exiting of a consolidated group by a trust as head company of a consolidated group was analysed at 8.5 and at 8.6 for the joining and exiting of a consolidated group by a trust as a subsidiary member of a consolidated group.

At 8.7 the joining and exiting of a MEC group by a trust as a tier-1 company was analysed and, at 8.8, the joining and exiting of a MEC group by a trust as subsidiary member of a MEC group was analysed.

At 8.9 various issues were analysed arising from the analysis undertaken in this chapter.

Chapter 9 - Consequences of Partnerships Joining and Exiting Consolidated Groups and MEC Groups

9.1 Introduction

This chapter at 9.2 analyses the tax cost setting rules where a partner in a partnership joins a consolidated group as a subsidiary member including explaining the concept of 'partnership cost setting interests' held by partners in a partnership.

At 9.3 the eligibility of a partnership to be a head company of a consolidated group is discussed and the tax cost setting implications.

At 9.4.1 the tax cost setting implications of a partnership joining an existing consolidated group as a subsidiary member is analysed and at 9.4.2 the tax cost setting implications are analysed for a partnership that joins a consolidated group as a subsidiary member upon formation of the consolidated group. The tax cost setting implications of a partnership leaving the consolidated group as a subsidiary member are analysed at 9.4.3.

At 9.5.1 the tax cost setting implications of a partnership joining a MEC group as a subsidiary member upon formation of the MEC group are analysed and at 9.5.2 the tax cost setting implications are analysed for a partnership that joins an existing MEC group as a subsidiary member.

At 9.5.3 the tax cost setting implication are analysed for a partnership that leaves an MEC group as a subsidiary member.

At 9.6 there is an analysis of various issues that arise from the analysis undertaken in this chapter 9.

9.2 Overview

Subdivision 713-E of the *ITAA 97* modifies the tax cost setting rules in Divisions 701, 705 and 711 in their application to partners and partnerships in consolidated groups. The modifications deal with a partner in a partnership (but not the partnership) joining a consolidated group as a subsidiary member, a partnership joining a consolidated group as a subsidiary member and the leaving of a consolidated group by a partnership.

Since, as discussed in 7.2, a corporate limited partnership ('CLP') is treated as a company for income tax law purposes, Subdivision 713-E has no application to CLPs. The tax cost setting rules for CLPs upon joining a consolidated group and leaving a consolidate group are those applicable to companies are set out in Divisions 705 and 711.

9.2.1 Tax Cost Setting where a partner joins a consolidated group

The explanatory memorandum[1074] ('2003 EM') to the Bill that introduced Subdivision 713-E explained that the general cost setting rules in Division 705-A that apply when an entity joins a consolidated group are modified by Subdivision 713-E to ensure they apply appropriately where that entity is a partner in a partnership.[1075]

When an entity that is a partner in a partnership joins a consolidated group, s 701-10, Subdivision 705-A and other provisions giving Subdivision 705-A a modified effect (for example, Subdivision 705-B which applies on the formation of a consolidated group) (collectively hereinafter referred to as 'the general cost setting rules') apply as if the 'partnership cost setting interests' of the entity in the partnership were the entity's only assets relating to the partnership.[1076]

The expression 'partnership cost setting interest' ('PCSI') is defined in s 713-210 as follows:

> A ***partnership cost setting interest*** in a partnership is the asset that is comprised of:
>
> (a) an interest in an asset of the partnership; or
>
> (b) an interest in the partnership that is not covered by paragraph (a);
>
> but does not include an asset that is comprised of a * membership interest in the partnership.
>
> Note 1: A partner may have more than one partnership cost setting interest that relates to an asset of the partnership (see section 106-5).
>
> Note 2: A partnership cost setting interest may relate to an asset of the partnership, but the asset of the partnership is not a partnership cost setting interest in the partnership.

The 2003 EM explained that:

> 3.56 A partnership is not treated as an entity for the purposes of the cost setting rules and consequently no tax cost is set for membership interests in the partnership. This is consistent with the CGT

[1074] Explanatory Memorandum, Taxation Laws Amendment Bill (No 6) 2003 (Cth) ('2003 EM').
[1075] Ibid [3.53].
[1076] *ITAA 97* (n 7) ss 713-205(1) and (3).

> approach to the taxation of partnerships. By not treating the partnership as an entity for the purposes of the cost setting rules, the ACA calculated for an entity (being the partner) is allocated to the entity's individual share in the assets of the partnership as well as any other assets of the entity.
>
> ……..
>
> 3.60 The concept of 'partnership cost setting interest' draws upon the recognition for CGT purposes of CGT assets in paragraphs 108–5(2)(c) and 108-5(2)(d). However, the assets referred to in the definition of 'partnership cost setting interest' are not limited to CGT assets and can therefore comprise assets consisting of anything of economic value (as per the general cost setting rules).

If an entity ('joining entity') that is a partner in a partnership becomes a subsidiary member of a consolidated group at a time ('joining time'), the general cost setting rules are modified by s 713-220 to set the tax cost for each PCSI that the joining entity holds at the joining time.[1077]

Section 713-220 provides that, in applying the general cost setting rules at the joining time, it is necessary to work out the tax cost setting amount ('TCSA') for each PCSI in the partnership that the joining entity holds at the joining time in accordance with s 713-225[1078] but do not work out TCSAs for the assets of the partnership,[1079] and do not work out TCSAs for the membership interests in the partnership held by the joining entity.[1080] Accordingly, no amount of ACA for the joining entity is allocated to the partnership assets or to the membership interests[1081] held by the joining entity in the partnership.[1082]

Pursuant to s 713-225(1), the ACA for the joining entity is allocated amongst its assets, including its PCSIs, under Division 705 and modified in accordance with the provisions of s 713-225. The modifications are:

1. The TCSAs for PCSIs in the partnership are worked out as if any PCSI that relates to an asset were an asset of the same kind as the underlying partnership asset.[1083] In this regard, the kinds of assets include retained cost base assets, reset cost base assets

[1077] Ibid s 713-220(1).
[1078] Ibid s 713-220(2)(a).
[1079] Ibid s 713-220(2)(b).
[1080] Ibid s 713-220(2)(c).
[1081] See above n 895 and accompanying text.
[1082] *ITAA 97* (n 7) s 713-220(2) Note 1.
[1083] Ibid s 713-225(2).

that are held on revenue account[1084] or on capital account, excluded assets[1085] and current assets (within s 705-125(2)).[1086]

2. Step 2 of the ACA calculation in s 705-70 is modified to include the joining entity's share of the liabilities of the partnership.[1087]

3. Step 7 of the ACA calculation in s 705-115 is modified where the consolidated group, in effect, becomes entitled to deductions of the partnership through its share of the partnership net income or loss.[1088] Step 7 reduces the ACA by the joined group's owned deductions and the tax benefit attaching to its 'acquired deductions'.

9.3 Partnership as a Head Company upon Joining and Exiting a Consolidated Group

The conclusion was reached at 7.2.1 that a partnership within the partnership definition in s 995–1(1) of the *ITAA 97* does not satisfy the company requirement[1089] and therefore is ineligible to qualify as a head company of a consolidatable group or consolidated group.

Accordingly, since a partnership cannot be a head company, no joining and leaving issues arise.

9.4 Partnership as a Subsidiary Member of a Consolidated Group upon Joining and Exiting a Consolidated Group

9.4.1 Joining an Existing Consolidated Group

The eligibility requirements for a partnership to join a consolidated group as a subsidiary member were discussed in 7.3. The partnership requirement[1090] was discussed in 7.3.1 and the wholly-owned requirement[1091] was discussed in 7.3.2.

[1084] Revenue assets that are trading stock, a depreciating asset or a 'registered emissions unit' (defined in *ITAA 97* (n 7) s 420-10) have their TCSAs set as if they were a retained cost base asset and their TCSAs equal to their terminating value worked out under s 713-215: s 713-225(4).

[1085] The reference to 'excluded assets' in s 713-225(1)(c) are to those referred to in s 713-225(3), however, this provision has no current operation as the reference to an 'excluded asset' in s 713-225(3) is a reference to an 'excluded asset' within s 705-35 which was contained in s 705-35(2) and repealed by *Tax Laws Amendment (2012 Measures No 2) Act 2012* (Cth) s 3 sch 3 item 39.

[1086] *ITAA 97* s 713-225(2) Note.

[1087] Ibid s 713-225(6). The 2003 EM (n 1074) explained that '[a]s a partnership will not be treated as a joining entity, each partner therefore must add their share of the partnership liabilities to their ACA calculation. As it is possible for partnership liabilities to be reflected in either the books of account of the partners or the partnership (depending on the circumstances), subsection 713-225(6) only adds an appropriate share of those liabilities that would otherwise be recognised in the partnership's books of account at step 2 of the ACA calculation for the partner' (at [3.84]).

[1088] Ibid s 713-225(7). See 2003 EM (n 1072) [3.85]-[3.87] which explained this adjustment.

[1089] Ibid s 703-15(2)(a) item 1 column 2 of the table.

[1090] *ITAA 97* s 703-15(2) item 2 column 2 para (a).

[1091] Ibid column 4.

Subdivision 713-E of the *ITAA 97* ensures that where a partnership becomes a subsidiary member of a consolidated group the general tax cost setting rules apply as if the consolidated group became the holder of the assets of the partnership and apply to set the tax cost base of assets of the partnership at an appropriate amount, taking into account the taxation treatment of partnerships.[1092]

Pursuant to ss 713-235(1) and (2), if a partnership becomes a subsidiary member of a consolidated group at a time ('joining time'), in applying the general tax cost setting rules, an allocable cost amount ('ACA') is not worked out for the partnership, rather, the tax cost setting amount ('TCSA') for each asset of the partnership covered by s 713-235(3)[1093] is worked out in accordance with s 713-240.

Where a partner joins a consolidated group at the same time as the partnership joins the consolidated group (for example, where the head company acquires the entity that is a partner in the partnership), the TCSAs for the assets of the partner (including the PCSIs) are worked out (in accordance with process set out in 9.2.1) before the TCSAs for the assets of the partnership.[1094]

Section 713-240(1) sets out the following method statement for working out the TCSA of the assets of a partnership that joins a consolidated group as a subsidiary member.

1. First, add up the amounts in s 713-240(2)[1095] for all the PCSIs in the partnership at the joining time (the result is the 'partnership cost pool'('PCP')).[1096]
2. Secondly, work out the TCSAs for the partnership assets that are retained cost base assets within s 705-25.[1097]

[1092] Ibid s 713-205(2).

[1093] Section 713-235(3) provides that each asset of the partnership is covered by this subsection unless it would be an 'excluded asset' under s 705-35. As discussed above at (n 1085), s 705-35(2), which formerly contained the meaning of 'excluded asset', has been repealed and therefore there is currently no asset that is an 'excluded asset' within s 713-235(3).

[1094] Section 713-235(2) Note.

[1095] The amounts in s 713-240(2) for a PCSI is, first, equal to its 'cost base' (the meaning of 'cost base' is given in *ITAA 97* sub-div 110-A) s 110 if the market value of the PCSI is equal to or greater than its cost base, secondly, is equal to its market value if the market value of the PCSI is less than its cost base but greater than its 'reduced cost' (the meaning of 'reduced cost base' is given in *ITAA 97* sub-div 110-B) and, thirdly, equal to its reduced cost base if its market value is less than or equal to its reduced cost base.

[1096] Section 713-240(1)(a). The PCSIs held by a partner that becomes a subsidiary member of the consolidated group at the joining time are included under s 713-240(1)(a): s 713-240(1)(a) Note 1. Also, include PCSIs even if the cost setting rules had not applied in relation to those interests (for example, if the interests were acquired directly acquired by the head company): s 713-240(1)(a) Note 2.

[1097] Section 713-240(1)(b).

3. Thirdly, work out the TCSAs for the remainder of the partnership assets in accordance with s 713-240(3).

Section 713-240(3) provides that in working out the TCSA for the assets mentioned in paragraph 3 above, apply sections 705-35, 705-40, 705-45 and 705-47 to those assets as if, first, the partnership were, at the joining time, the joining entity mentioned in those sections, secondly, the assets of the partnership were those within s 713-235(3) and, thirdly, the allocable cost amount referred to in s 705-135(1)(a) were the PCP.

The result, therefore, is that the TCSA of assets of a partnership that joins a consolidated group are set by reference to the tax costs of the PCSIs which are aggregated in the PCP.

9.4.2 Joining upon Formation of a Consolidated Group

Where a partnership becomes a subsidiary member of a consolidated group at the time of formation of the consolidated group, the process for determining the TCSA of the assets of the partnership will be the same as that discussed in 9.4.1.

9.4.3 Exiting a Consolidated Group

Where a partnership ceases to be a subsidiary member of a consolidated group at a time ('leaving time'), the provisions in sections 701-15 and 701-50 (that relate to the tax cost setting of membership intertest in an entity that leaves the group), in sections 701-20 and 701-45 (that relate to the cost of assets consisting of certain liabilities owed by or to an entity that leaves the group) and Division 711 (hereinafter collectively referred to as the 'leaving rules'), operate as if the group's PCSIs were the group's only assets relating to the partnership and set the tax cost of the PCSIs at an appropriate amount, taking into account the fact that the group ceases to be the holder of the assets of the partnership.[1098]

A partnership may cease to be a subsidiary member of a consolidated group if a partner leaves the group (for example, because the head company has disposed of its membership interests in the partner) or if the head company disposes of some or all of its PCSIs in the partnership. In this latter case, there is no leaving of the group by a partner that is a subsidiary member of the consolidated group. In either case, the partnership will cease to be a 'wholly-owned

[1098] *ITAA 97* (n 7) s 713-205(4).

subsidiary' and no longer eligible to be a member of the group.[1099] The leaving rules are modified by the special rules in Subdivision 713-E that apply if a partnership leaves the consolidated group, whether or not any partner also ceases to be a subsidiary member at the leaving time.[1100]

Section 713-255 provides that no tax cost setting amount is worked out for membership interests in the partnership,[1101] rather PCSIs in the partnership are worked out. However, where other entities cease to be members at the leaving time, the usual leaving rules apply except that a special rule applies for PCSIs in the partnership.[1102]

Where a partnership that is a subsidiary member of a consolidated group is the only entity that exits a consolidated group (that is, entities that are partners do not also exit at the leaving time), the TCSA just before the leaving time is set for each PCSI in the partnership that is held by a partner that is a member of the consolidated group just before the leaving time.[1103] The TCSA is equal to the partner's individual share of the terminating value of the partnership asset to which the PCSI relates.[1104] For income tax purposes, there is no disposal by the head company of any of the assets of the partnership when the partnership ceases to be a subsidiary member of the group.[1105] However, the head company will have set the tax cost of its PCSIs which will be taken into account in determining a capital gain or loss upon the future disposal of those interests by the head company.

Where a partnership is one of two or more entities that cease to be subsidiary members of the consolidated group at the same time, there is a modified application of s 711-55 which deals with tax cost setting for membership interests where there are multiple exits from a consolidated group at the same time. The modifications, by s 713-255(5), are necessary since Division 711 relies on a concept of membership interests which are ignored in the case of partnerships under Subdivision 713-E.

Accordingly, where the entity is a partnership, a reference in s 711-55(3)(a) to 'membership interests' in an entity, or to the 'tax cost setting amount for such interests in the entity', are

[1099] See Explanatory Memorandum, Tax Laws Amendment (2004 Measures No 2) Bill 2004 (Cth) ('2004 EM') [2.69].
[1100] *ITAA 97* (n 7) s 713-250.
[1101] Ibid s 713-255(2).
[1102] Ibid s 713-255(1).
[1103] Ibid s 713-255(3).
[1104] Ibid s 713-255(4). The 'terminating value' of an asset is worked out under ss 711-30 and 705-30.
[1105] Ibid Note.

taken to be a reference to 'partnership cost setting interests in the partnership' and to the 'tax cost setting amount for such interests', respectively.[1106] Also, s 711-55(3)(a) is applied by replacing it with a requirement that where the entity in which the membership interests mentioned in s 711-55(3) are held is a partnership, s 713-255(4) is applied to work out the TCSA of the PCSIs in the partnership.[1107]

Section 713-260 relates to the recognition of intra-group assets at the time a partnership leaves the consolidated group which had been ignored in consolidation under the single entity rule.[1108] If, first, a partnership ceases to be a subsidiary member of a consolidated group and a partner remains a member of the group, secondly, an asset becomes an asset of the head company because the single entity rule ceases to apply, and thirdly, the asset is either a partner's interest in an asset of the partnership consisting of a liability of a member of the group owed to the partnership or the partner's share of a liability of the partnership owed to a member of the group, the asset's tax cost is equal to the market value of the asset at the leaving time.[1109]

The explanatory memorandum to the Tax Laws Amendment (2004 Measures No 2) Bill 2004 (Cth) ('2004 EM') that introduced provisions in the *ITAA 97* relating to the leaving of partners and partnerships from tax consolidated groups explained that special rules were required to ensure that the leaving partner's allocable cost amount ('ACA') included the partner's share of certain partnership attributes.[1110] Section 713-265 adjusts the ACA where a partner leaves a consolidated group ('old group') by including in the ACA of the partner its share of certain partnership deductions to which the partnership becomes entitled,[1111] its share of liabilities

[1106] Ibid s 713-255(5)(a).
[1107] Ibid s 713-255(5)(b).
[1108] Ibid s 701-1.
[1109] Ibid s 713-260.
[1110] See 2004 EM (n 1099) [2.83].
[1111] *ITAA 97* (n 7) s 713-265(2). Section 713-265(2) modifies s 711-35 (which includes the value of deductions inherited by the leaving entity in the ACA) so that it operates as if a deduction to which the partnership becomes entitled were a deduction to which the partner becomes entitled (to the extent of the partner's share) and is the same kind of deduction as the partnership deduction. This ensures that the value of the partnership deduction is reflected in the ACA of the partner as the deduction will flow to the partner through its entitlement to the net income of the partnership which is calculated by taking into account the deduction: see 2004 EM (n 1099) [2.85].

that the partnership owes to the old group,[1112] and its share of liabilities owed to the partnership by the old group.[1113]

9.5 Partnership as a Subsidiary Member of a MEC Group upon Joining and Exiting a MEC Group

9.5.1 Formation of a MEC Group

The cost setting rules for partnerships that become subsidiary members of a MEC group upon its formation are the same as those for partnerships that join a consolidated group upon formation which were discussed in 9.4.2. Subdivision 719-C makes Subdivision 705-A (which relates to cost setting in consolidated groups upon an entity joining an existing consolidate group), and any other provision of the *ITAA 97* or *ITAA 36* giving Subdivision 705-A a modified effect in circumstances other than those covered by Subdivision 705-A, applicable to entities that join a MEC group as a subsidiary member of the MEC group.[1114] Subdivision 705-B (which relates to cost setting in consolidated groups upon formation of the consolidate group) and 713-E (which relates to tax cost setting of partnerships) are examples of provisions that give Subdivision 705-A a modified effect and therefore they also have application to MEC groups.

9.5.2 Joining an Existing MEC Group

The cost setting rules for partnerships that join an existing MEC group as a subsidiary member are the same as for partnerships that join a consolidated group which are discussed in 9.4.1. Subdivision 719-C of the *ITAA 97* makes Subdivision 705-A (which relates to cost setting in consolidated groups upon entities joining an existing consolidated group) applicable to entities that join an existing MEC group as a subsidiary member.[1115] Subdivision 719-C also makes 'any other provision of the *ITAA 97* or *ITAA 36* giving Subdivision 705-A a modified effect in circumstances other than those covered by Subdivision 705-A' applicable to entities

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[1112] Ibid s 713-265(3). Section 713-265(3) modifies s 711-40 (which includes amounts in the ACA which represent liabilities that the old group owed by the old group to the leaving entity) to treat a partner's share of partnership assets that consist of liabilities owed by members of the old group to the partnership as being assets of the partner and not the partnership. That is, the liability is treated as if it is owed to the partner and not the partnership, to the extent of the partner's share of the liability: see 2004 EM (n 1099) [2.86]-[2.87].

[1113] Ibid s 713-265(4). Section 713-265(4) modifies s 711-45 (which reduces a leaving entity's ACA by the amount of liabilities owed by the leaving entity to the group) so that where a partnership liability is recognised in the partnership's statement of financial position and for that reason is not also included in the partner's statement of financial position, it is treated as if it was a liability of the partner and not the partnership to the extent of the partner's share of the partnership liability. This allows the partner's share of the partnership liability to be included in step 4 when working out the leaving partner's ACA: 2004 EM (n 1099) [2.88]-[2.89].

[1114] Ibid s 719-160(3)(b) and (c).

[1115] Ibid s 719-160(3)(b).

that join an existing MEC group as a subsidiary member.[1116] This last-mentioned modification would include, for example, Subdivision 713-E in respect of partnerships.

9.5.3 Exiting an MEC Group

The leaving rules for partnerships that cease to be a subsidiary of a MEC group are the same as for partnerships that cease to be members of a consolidated group which are discussed in 9.4.3. Section 719-2(1) provides that Part 3-90 of the *ITAA 97* (other than Division 703 and Division 719) has effect in relation to a MEC group in the same way in which it has effect in relation to a consolidated group. Accordingly, the provisions relating to partnerships leaving a consolidated group in Subdivision 713-E have equal effect in relation to MEC groups.

9.6 Analysis of Issues Arising

The following analyses certain issues that arise from the analysis in this chapter of partnerships joining and exiting consolidated groups and MEC groups.

9.6.1 Foreign Hybrids

As discussed in 2.5 and 7.3.1, a foreign hybrid is treated as a partnership for the purposes of the income tax law and, where the ownership requirement is satisfied, is eligible to be a member of a consolidated group and MEC group. Under the SER, a foreign hybrid that is a subsidiary member of a consolidated group or MEC group will be treated as a part of the head company with the result that the income tax consequences for the head company of the activities of the foreign hybrid will be determined under the general income tax provisions.

Whilst the foreign hybrid is a subsidiary member of the group, the foreign hybrid regime in Division 830 of the *ITAA 97* has no application and therefore the loss limitation rules for foreign hybrids[1117] and the 'asset-based income tax regime' for assets of foreign hybrids will have no application.[1118] Accordingly, transactions between the foreign hybrid and other group members including the head company are ignored and foreign income earned is assessable to the head company although foreign tax offsets may be available for foreign tax paid. However, depending on the circumstances, s 23AH of the *ITAA 36* may have application, to the extent that the head company is carrying on a business at or through a permanent

[1116] Ibid s 719-160(3)(c).
[1117] *ITAA 97* (n 7) sub-div 830-C.
[1118] Ibid sub-div 830-D.

establishment (constituted by the activities undertaken by the foreign hybrid) in a foreign country, to treat certain foreign 'active' income as not assessable and not exempt income and to disregard certain capital gains and losses.

As discussed in 7.5.2, it is important to monitor ownership changes in a foreign hybrid since the failure to meet the wholly-owned requirement will result in the exit of the foreign hybrid from the consolidated group (with the tax cost setting consequences set out in 9.4.3 and 9.5.3). Following exit from the group, it may be the case that the foreign hybrid remains a foreign hybrid under Division 830, or it may no longer qualify as a foreign hybrid. In either case, there can be complex issues as to its on-going income tax treatment, for example, the application of the loss limitation rules and the asset based income tax regime mentioned above are not straightforward.[1119]

A further issue, as discussed in 7.5.2, is that where a foreign hybrid ceases to satisfy the requirements of Division 830 during an income year such that it is no longer eligible to be regarded as partnership for the purposes of the taxation law, it is not treated as a foreign hybrid for the whole of that income year as it ceases to be a member of the consolidated group or MEC group at the previous 30 June. Such a retrospective character change seems inequitable since it is not until the disqualifying event happens, which could be on 29 June of an income year, that the hybrid status changes but it is retrospective to the prior 30 June. Fulton[1120] has referred to the unsatisfactory consequences of this 'whole-of-year' requirement and recommended that legislative changes should be considered in accommodating part-year changes to foreign hybrid status 'such as through closing of the books or apportionment methods, which may assist with a number of practical difficulties [and potential costs]'.[1121]

[1119] The extent of the complexity can be gauged by the following examples which may occur in practice for multi-national groups. Where a US LLC that is a foreign hybrid issues shares outside the consolidated group, the result is that the US LLC will leave the group and the consequences noted in 9.4.3 will apply. The hybrid provisions in Division 830 will, however, be relevant in respect of the head company's PCSIs in the US LLC and the tax implications. If the shares issued are debt interests (for example, redeemable preference shares classified as debt interests and not equity interests), the US LLC will not leave the consolidated group as debt interests are not membership interests (s 960-130(3)) and therefore the US LLC remains wholly owned. If subsequently, there is a further change in ownership such that the US LLC ceases to be a foreign hybrid, the hybrid provisions will apply to determine the tax consequences. The cessation of foreign hybrid status will occur on the last day of the prior income year. If, subsequently, transactions occur whereby the US LLC again becomes a foreign hybrid and wholly owned by the head company, the US LLC will join the consolidated group and the consequences noted in 9.4.1 will apply.

[1120] See above (n 202).

[1121] Ibid 116.

Similar to Fulton, it is recommended that legislative amendments should be made such that the date of cessation of foreign hybrid status should be the date ('cessation date') on which the foreign hybrid is taken not to be a partnership, rather than at the end of the prior year of income, and, accordingly, the foreign hybrid will leave a consolidated group or MEC group at the cessation date.

9.6.2 Part Year Joining and Exiting by a Partnership

Where a partnership joins or exits a consolidated group or MEC group part way through an income year, it is necessary to work out the net income of the partnership for the time the partnership was not a subsidiary member of the group. Section 701-30 of the *ITAA 97*, as amended by s 701-65 in relation to its application to partnerships, applies where a partnership is a subsidiary member of a consolidated group for some but not all of the income year and there is a period ('non-membership period)' where it is not a subsidiary member of a consolidated group or MEC group. For a non-membership period, the net income of the partnership is worked out on the basis that the start and end of that period is the start and end of an income year and 'items' of assessable income or deductions are allocated to the non-membership period and the other period in the income year or apportioned among such periods.[1122] The partnership will be required to file a partnership return for the non-membership period[1123] and the partners (including the head company if it is a partner) will be assessable on their share of the net income as determined above under the partnership tax provisions.[1124]

The difficult issues discussed in 2.4 in relation to trusts and the part year issue do not arise for partnerships since a partner in a partnership is subject to tax on their share of the net income as worked out under s 701-30 (as modified by s 701-65) whereas a beneficiary's tax liability in respect of the net income depends on their present entitlement to trust income which is not dealt with in s 701-30 as amended by s 701-65.

For the period of the income year that the partnership is a subsidiary member of the group, the single entity rule treats the partnership as a part of the head company and the head

[1122] An apportionment may be required under sections 716-15 and 716-70 for certain assessable income, deductions and capital expenditure.
[1123] *ITAA 36* (n 40) s 91.
[1124] Ibid s 92.

company is taken to derive all assessable income and incur expenses in relation to the partnership activities and intra-group dealings will be ignored.

Where, as discussed in 9.6.1, a partnership that is a foreign hybrid ceases to be a foreign hybrid within the relevant requirements in Division 830, and therefore is not regarded as a partnership for the purposes of the taxation law, it will cease to be a subsidiary member of the consolidated group or MEC group. No part year issues arise such that there is a non-membership period in an income year for the partnership since a foreign hybrid ceases to be a foreign hybrid at the end of the prior income year as discussed in 9.6.1.

9.6.3 Partnership Cost Setting Interests and Partnership Cost Pool

The provisions of Subdivision 713-E relating to the cost setting of interests in a partnership (that is, the PCSIs), the tax cost setting of assets of a partnership that joins a group and the tax cost setting of PCSIs upon a partnership leaving a group are, despite their brevity, complex.

Much of the complexity is due to the need to accommodate the 'look-through' treatment of partnerships for Australian capital gains tax purposes such that partners are taken to have an interest (equal to their proportionate interest in the partnership) in the assets of the partnership.[1125] This is in contrast to the general law position that a partner's interest in a partnership is an equitable interest consisting of right to a proportion of the surplus after the realisation of the assets and the payment of the debts and liabilities of the partnership.[1126] Difficult issues can arise, for example, where a head company sells PCSIs it holds in a partnership that is not a member of the group and the appropriate basis for the determination of a taxable gain or loss on that sale. To what extent is it taken into account that the head company, say a bank, holds all its assets on revenue account and how this affects the tax treatment of its PCSIs in partnership assets where the partnership is outside the consolidated group.

Following on from the above tax treatment of assets of partnerships, the consolidation provisions in relation to partnerships set the tax cost of the PCSIs of a partner in the assets of the partnership at the time the partner joins a consolidated group or MEC group. Upon a partnership joining a group, an ACA for the partnership is not calculated but a partnership

[1125] See above (n 182).
[1126] See above (n 180).

cost pool (being the tax costs of all the PCSIs in the assets of the partnership) which is allocated to the assets of the partnership. Upon a partnership leaving a group, the tax cost of the PCSIs (ignored whilst the partnership was a subsidiary member of the group) need to be set.

It is submitted that the tax cost setting provisions in relation to PCSIs upon a partner joining, or a partnership leaving, a consolidated group or MEC group, and the tax cost setting of assets upon a partnership joining a group, work appropriately and are sufficiently drafted to achieve their purpose without undue complexity.

9.7 Conclusion

This chapter at 9.2 analysed the tax cost setting rules where a partner in a partnership joins a consolidated group as a subsidiary member and introduced and explained the concept of 'partnership cost setting interests' that are held by partners in a partnership for the purposes of the tax consolidation rules.

At 9.3 the eligibility of a partnership to be a head company was discussed and its tax cost setting implications noted.

At 9.4.1 the tax cost setting implications of a partnership joining an existing consolidated group as a subsidiary member were analysed and at 9.4.2 the tax cost setting implications were analysed for a partnership joining a consolidated group upon formation of the consolidated group.

The tax cost setting implications of a partnership leaving a consolidated group as a subsidiary member were analysed at 9.4.3.

At 9.5.1 the tax cost setting implications of a partnership joining a MEC group as a subsidiary member upon formation of the MEC group were analysed and at 9.5.2 the tax cost setting implications of a partnership joining an existing MEC group as subsidiary member were analysed.

At 9.5.3 the tax cost setting implications of a partnership leaving a MEC group as a subsidiary member were analysed.

At 9.6 various issues that arose from the analysis undertaken in this chapter were analysed.

Chapter 10 - Analysis of whether the Inclusion of Trusts and Partnerships within Consolidated Groups in Australia's Tax Consolidation Regime Promotes a Stronger Enterprise Doctrine and Represents Good Tax Policy

10.1 Introduction

This chapter analyses at 10.2 whether Australia's tax policy decision to include trusts and partnerships in tax consolidated groups promotes a stronger enterprise doctrine.

Whether the inclusion of trusts and partnerships within tax consolidated groups represents good tax policy is analysed at 10.3 by reference to long-standing accepted criteria that are regarded as the hallmarks of a 'good' tax system.

10.2 Whether Trusts and Partnerships within Tax Consolidated Groups Promotes a Stronger Enterprise Doctrine

10.2.1 Overview of Enterprise Doctrine

At 1.2 and 3.2 it was noted that the enterprise doctrine refers to the feature of the modern business economy that medium to large businesses are carried on by corporate groups or enterprises under the common control of a parent entity rather than being conducted by a group of separate legal entities.

At 3.4 it was noted that the rise of corporate groups and the emergence of the enterprise doctrine has led to the introduction of tax consolidation regimes in many countries with varying eligibility requirements and effects.[1127] It was concluded in 3.5 that Australia's tax consolidation regime represented a strong application of the enterprise doctrine as it treats for income tax purposes a group of wholly owned entities (comprising companies, trusts and partnerships) as parts of a single Australian resident company with those entities having no separate existence for income tax purposes.

10.2.2 Analysis of Whether Trusts and Partnership within Australian Tax Consolidated Groups Promotes a Stronger Enterprise Doctrine

[1127] See above nn 334-5 and accompanying text.

From a theoretical perspective, the Australian tax consolidation regime in allowing trusts and partnerships to be members of a consolidated group or a MEC group results in a business enterprise or group being able to form a consolidated group that includes eligible partnerships and trusts within that consolidated group that would not have been included if the design of the consolidation rules did not allow their inclusion. It follows, therefore, that an enterprise doctrine that consists of companies, trusts and partnerships under which all are treated as a single entity for tax purposes as compared to an enterprise doctrine that does not allow the inclusion of trusts and partnerships, is a stronger enterprise doctrine than the latter enterprise doctrine. On this basis, the inclusion of trusts and partnerships within Australian tax consolidated groups does promote a stronger enterprise doctrine.

Whether this theoretical conclusion is borne out in practice is considered below using statistics provided by the ATO.

10.2.2.1 Trusts

At 1.3, it was indicated that from tax statistics provided by the ATO,[1128] the number of trusts in Australian tax consolidated groups and MEC groups ('consolidation groups') as at 30 June 2024 was 7,187 in 20,054 consolidation groups. Also, as at 30 June 2024, there were 108,126 companies and 200 partnerships in those 20,054 consolidation groups. Therefore, trusts represented approximately 6.6% of total members in those 20,054 consolidation groups.

The number of trusts in consolidation had been 759 as at 30 June 2003 (representing approximately 4.7% of total members in 1,702 consolidation groups) and 4,012 as at 30 June 2015 (representing approximately 5.7% of total members in 12,684 consolidation groups).

From the above empirical data, it can be concluded that the percentage of trusts in consolidation groups is not insignificant and in absolute terms as at 30 June 2024 there were 7,187 trusts within consolidation groups that but for the policy to include trusts in consolidated groups would not have been included. It is submitted that on the basis of that empirical data, the inclusion of trusts in consolidation groups does promote a stronger enterprise doctrine.

[1128] See above (n 13).

10.2.2.2 Partnerships

From the tax statistics provide by the ATO, the number of partnerships in Australian tax consolidated groups and MEC groups as at 30 June 2024 was 200 in 20,054 consolidation groups. As at 30 June 2024, partnerships represented approximately 0.17% of total members in those 20,054 consolidation groups.

The number of partnerships in consolidation groups had been 55 as at 30 June 2003 (representing approximately 0.32% of total members in 1,702 consolidation groups) and 201 as at 30 June 2015 (representing approximately 0.27% of total members in 12,684 consolidation groups).

For income years from 30 June 2003 to 30 June 2024, the range of the number of partnerships in consolidation groups was 55 (as at 30 June 2003) to 224 (as at 30 June 2020).

Australian Bureau of Statistics data indicates that as at 30 June 2024 there were 213,919 operating partnerships in Australia.[1129]

The relatively small incidence of partnerships in tax consolidated groups, in both percentage terms and absolute terms, indicates that business enterprises that enter into consolidation contain few eligible partnerships. This may be due in part to the fact that a wholly owned partnership within business groups is not a common feature of such groups in Australia. It is more probable that partnerships form a part of small business and family groups where income splitting is a motive amongst individuals. Trad et al[1130] found that 98% of professional business advisors interviewed in the small to medium business sector recommended a combination of business structure in which a discretionary trust was predominant either as a trading trust or as a shareholder in a trading entity. None recommended a partnership.

It is not known to what extent partnerships in tax consolidation constitute foreign hybrid partnerships. It is understood that for each of the last 10 income tax years the ATO has received less than 100 income tax returns for foreign hybrid partnerships.[1131] None of these

[1129] Australian Bureau of Statistics, *Counts of Australian Businesses, Including Entries and Exits, June 2020 to June 2024*, (Catalogue No 8165.0, Table 10, (2024)) <https://www.abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/latest-release>.

[1130] Barbara Trad, et al, 'Choice of Australian Business Structures in the SME Sector: What Do Advisors Recommend?' (2023) 52(3) *Australian Tax Review* 177, 204.

[1131] The statistic was provided to the author by a Director in the Taxation Statistics Division of the Revenue Analysis Branch of the Australian Taxation Office by email dated 16 April 2025.

foreign hybrid partnerships would have been in tax consolidated groups as they would have had no obligation to lodge an income tax return if they had been a member of a consolidated group. It can be inferred, therefore, that there is a low level of foreign hybrids within Australian tax consolidated groups (for example, less than 200 as at 30 June 2024).

It is submitted that, on the basis of the empirical data analysed above, which evidences a small and insignificant incidence of partnerships in Australian tax consolidated groups for the period that Australia has had a tax consolidation regime, the inclusion of partnerships in Australian consolidated groups and MEC groups does not promote a stronger enterprise doctrine.

10.2.3 Conclusion

From a theoretical standpoint, as discussed in 10.2.2, and on the basis of the empirical evidence in 10.2.2.1, it can be concluded that the inclusion of trusts in consolidated groups does promote a stronger enterprise doctrine.

Although from a theoretical standpoint, as discussed in 10.2.2, the inclusion of partnerships in consolidated groups does promote a stronger enterprise doctrine, the empirical evidence in 10.2.2.2 shows that there has been in fact a very low incidence of partnerships in tax consolidated groups. Accordingly, it can be concluded that the inclusion of partnership in tax consolidated groups does not promote a stronger enterprise doctrine.

10.3 Whether Trusts and Partnerships within Tax Consolidated Groups Represents Good Tax Policy

10.3.1 Good Tax Policy Principles

At 4.3.2.3, in relation to research question 3 as it relates to considering whether the inclusion of trusts and partnerships within tax consolidated groups represents good tax policy, it was indicated that the accepted and well-established tax policy design principles would be examined and applied to answer this aspect of research question 3.

As indicated in 4.3.2.2, simplicity, neutrality, fairness, competitiveness and efficiency are well-accepted features of a ‘good’ tax system. These features can be used to analyse whether the design of the tax system, or particular part of the tax system, represents a ‘good’ tax system or part. The meaning and content of these features are considered below.

10.3.1.1 Simplicity

Simplicity (or non-complexity) is a long-standing and keenly sought feature of tax system design. The Asprey Report noted that '[a]fter equity simplicity is perhaps the most universally sought after of qualities in individual taxes and tax systems as a whole ...'.[1132]

Evans and Tran-Nam indicated that tax complexity 'is itself a complex concept' being 'a multi-faceted concept that cannot be simultaneously and adequately characterized by a single definition or measure'.[1133] Cooper indicated that the notion of simplicity involved: 'predictability' (the rule chosen and its intended and actual scope are easily understood by taxpayers and their advisers); 'proportionality' (a rule is not simple where the degree of complexity of the solution is more than necessary to achieve the stated policy); 'consistency' (the rule deals with similar issues in the same way avoiding distinctions which are arbitrary); 'compliance' (the rule is not simple if it is difficult and excessively costly for taxpayers to comply with); 'administration' (a rule is simple if it is easy for the revenue authority to administer); 'co-ordination' (a rule is simple if is meshes comfortably with other rules but is complex if the interaction with other rules is obscure); and 'expression' (the rule is clearly expressed).[1134] Cooper also noted that, taking into account these attributes, 'a complex tax system would result where neither taxpayers nor the revenue authority could identify a taxpayer's liability with an appropriate degree of certainty at a reasonable cost, nor could that liability be cheaply and easily satisfied, nor enforced.[1135]

Memon concluded that the distinct facets of a simple tax system should be one which is 'clear, certain, consistent, stable, flexible and entails low compliance and administration costs'.[1136]

A Tax System Redesigned indicated that '[c]omplexity is one consequence of continually building the tax system upon a foundation deficient in tax policy design principle.'[1137] The Report also noted that complexity had a 'technical dimension' that was 'more than a matter of statutory volume or opaque language' and had a 'structural dimension that 'is reflected in

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[1132] Asprey Report (n 430) 15 [3.19].

[1133] Evans, Chris, and Binh Tran-Nam, 'Managing Tax System Complexity: Building Bridges Though Pre-Filled Tax Returns' (2010) 25(2) *Australian Tax Forum* 245, 248.

[1134] Cooper, 'Themes and Issues' (n 434) 424.

[1135] Ibid 424-5.

[1136] Najeeb Memon, 'Prioritizing Principles of a Good Tax System for Small Business in Informal Economies' (2010) 25(1) *Australian Tax Forum* 57, 70.

[1137] See above (n 508) 106.

unintended or inconsistent interactions as well as excessively specialised provisions which lack general application and adaptability'.[1138] The conclusion in *A Tax System Redesigned* was that complexity should be minimised by adopting 'a principles-based approach to policy development and its legislative expression and administration'.[1139]

In relation to drafting clear and understandable legislation, the Australian Office of Parliamentary Counsel has indicated that in producing a legally effective Bill, one way in which the policy can be drafted clearly and concisely is by adopting a 'coherent principles drafting approach' under which the law is stated in general principles and the details are left to be filled by the Courts or by delegated legislation. Also, it can be used when there are a wide range of alternatives or where all alternatives are not known with a simple general statement covering most of the alternatives.[1140]

Cooper has indicated that in principles-based drafting, a principle is an operative rule and is not a statement of the object or purpose that is to be accomplished by another rule nor is it an aid to interpreting the operative provision.[1141] Secondly, a principle is a statement about an intended outcome rather than a provision which sets out the means for accomplishing the outcome.[1142] Thirdly, a principle is intended to be comprehensive, applying to a wide range of facts and circumstances. The idea is that generality can capture and express a rule with sufficient, if not complete precision.[1143]

Cooper analysed the single entity rule ('SER')[1144] in relation to whether it, as the guiding bedrock principle in tax consolidation, has resulted in a satisfactory outcome. Cooper indicated that the SER 'does most of the work of the entire consolidation edifice for an established group — the vast bulk of legislative detail is about entries and exits'.[1145] Cooper indicated that legislative history was clear that the intention of the drafters was for the SER 'to undo the fact of incorporation and thus the separate existence of the related entities' and therefore 'intra-group provision of services, sales and purchases of inventory, depreciables or

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1138 Ibid.

1139 Ibid.

1140 Australian Government, Office of Parliamentary Counsel, *Reducing Complexity in Legislation* (Guide, June 2016) 3 [2.2.2]. <https://www.opc.gov.au/sites/default/files/2023-01/reducingcomplexity.pdf>.

1141 Cooper, 'Legislating Principles' (n 434) 341.

1142 Ibid 342.

1143 Ibid.

1144 See above (n 18).

1145 Graeme S Cooper, 'Fixing the Defective Jigsaw' (2021) 45(1) *Melbourne University Law Review* 362, 379

capital assets does not give rise to income or gain or cost or loss; no income, deduction or franking consequences attach to intra-group flows of interest, dividends or royalties'.[1146] However, Cooper indicated that the Australian Taxation Office had taken 'matters further and expanded the domain where implications of the SER arise to include aspects of tax administration and procedure and to carry implications about characterizing transactions for members of corporate group'.[1147]

Ultimately, Cooper concluded that [p]rinciples are not easy to capture and the attempt to find them can be just wrongheaded….even if they appear to have a confined domain, it is not obvious their implications will be restricted to just that domain'.[1148]

From the above, it can be concluded that the mere statement of principles in legislation does not of itself make the legislation simple and easy to apply. The domain in which a principle operates can be unclear and there may be differing views as to its application in circumstances with 'principle creep' occurring into areas beyond its original intended domain. The SER is a good example, demonstrated by Cooper, where it has gone from having effect for the determination of the taxable income of the head entity of a consolidated group (the 'head company core purposes')[1149] and of a subsidiary member of the group (the 'entity core purposes')[1150] to having application, in the view of the ATO, to recharacterise transactions.

10.3.1.2 Neutrality and Efficiency

The Asprey Report indicated that an objective of public policy was the 'economic and efficient use of national resources'.[1151] Villios et al have commented that 'within the aim of efficiency, all government tax reviews have focused on the additional aim of achieving a neutral tax system'.[1152]

The Asprey Report noted that efficiency required that the resources available for public use should be as nearly as possible equal to the resources withdrawn from the private sector: that is, that the process by which resources are transferred should involve minimal 'waste'.

1146 Ibid.
1147 Ibid 380.
1148 Ibid 381.
1149 *ITAA 97* (n 7) s 701-1(2).
1150 Ibid s 701-1(3)
1151 Asprey Report (n 430) 16 [3.23].
1152 Sylvia Villios, Michael Blissenden and Paul Kenny, 'Australia's Tax Law Policy of the Past and That of the Post Digital Revolution' (2021) 28 *Revenue Law Journal* 1, 8.

Further, the minimisation of waste requires that the tax system should not influence the individuals and businesses choices on resource allocations – this is the requirement that the tax system should be neutral.[1153] Therefore, efficiency relates to the objective of maximizing the efficiency with which national resources are used with tax administration costs and taxpayer compliance costs minimised.

Trad et al noted[1154] that the concept of neutrality requires that the tax burden should be equivalent regardless of the business structure adopted and that a tax system should not affect the choice of business structure adopted. Also, from a tax policy perspective, an objective is that the tax system should neither distort commercial decisions concerning the choice of business structures nor permit similar economic activities to be taxed differently.[1155]

10.3.1.3 Fairness

Fairness, or equity, in tax system design usually refers to the concepts of 'horizontal equity' and 'vertical equity' in relation to individuals. Under horizontal equity, individuals with similar circumstances should be taxed in an equal manner. Whereas under vertical equity, individuals with differing circumstances should be taxed fairly.[1156]

A Tax System Redesigned[1157] indicated that in the context of the business tax system, horizontal equity was 'primarily about ensuring the like treatment for like transactions'. This involved the formal application of the law being equitable and limiting the scope for tax avoidance.[1158]

A Tax System Redesigned set out a Charter of Business Taxation,[1159] which provided a framework within which Australian taxation policy affecting the business sector should be formulated. Included in the framework was the need to promote equity or fairness. In relation to the business tax system, it was noted that that the concept of equity was primarily related

[1153] Asprey Report (n 430) 16 [3.24]
[1154] See above (n 1130) 184.
[1155] Ibid.
[1156] Asprey Report (n 430) 12 [3.7]; Alley and Bentley (n 430) 601.
[1157] See above (n 508).
[1158] Ibid 15 [33].
[1159] Ibid 104-18.

to horizontal equity and that business income earned in similar circumstances should be taxed in similar ways.[1160]

10.3.1.4 Competitiveness

Ting indicated that 'competitiveness' relates to the policy objective of a tax system to enhance the competitiveness of a country's businesses and to promote economic growth.[1161]

A Tax System Redesigned provided that Australian taxation policy formulation in the business sector should ensure that the business tax system interferes to the least possible extent with, and should promote, the best use of existing national resources, efficient allocation of risk, and long-term economic growth. Poorly designed tax systems can inhibit growth by distorting business decisions.[1162]

10.3.2 Analysis of Trusts and Partnerships in Tax Consolidated Groups in Relation to Good Tax Policy Principles

Before analysing whether the inclusion of trusts and partnerships in tax consolidated groups represents good tax policy with reference to the principles outlined in 10.3.1 above, it is useful to first consider the tax policy reasons to include the tax consolidation regime in the Australian income tax law.

It was noted in 5.2 that the ANTS White Paper[1163] had proposed consultation on allowing groups of companies, trust and co-operatives to consolidate their position on the basis that there were growing complexities in the then current law facing company groups and associated high compliance costs as well as the ability of group companies to gain unintended tax advantages from the then existing group concessions and dealing between themselves.[1164]

As indicated in 5.4, *A Platform for Consultation*[1165] contained a framework for the proposal contained in the ANTS White Paper of taxing groups as a single entity.[1166] *A Platform for Consultation* indicated that a tax consolidation regime would simplify the tax system and

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1160 Ibid 105.
1161 Ting (n 1) 21.
1162 See above (n 508) 105.
1163 See above (n 444).
1164 See above nn 467-8 and accompanying text.
1165 See above (n 480).
1166 See above nn 500-7 and accompanying text.

reduce compliance costs, promote economic growth by providing a taxation framework that allows Australian businesses to adopt organisational structures based more on commercial rather than tax considerations and promoting equity by improving the integrity of the tax system. Accordingly, the proposals for the tax consolidation regime were claimed as being anchored by the tax design principles of simplicity, competitiveness (that is, promoting economic growth), and equity.[1167]

A Tax System Redesigned,[1168] consistent with *A Platform for Consultation*, regarded the proposed tax consolidation regime as 'offering major advantages to entity groups — in terms of both reduced complexity and increased flexibility in commercial operations (driven by intra-group transactions being ignored for tax purposes).. [although] short-term transitional costs are well worth the long-term benefits'. [1169]

The Consolidation Bill No 1 EM[1170] indicated that the tax consolidation regime would assist in the simplification of the tax system, reduce both tax compliance costs and tax revenue costs associated with the existing tax treatment of company groups, improve the efficiency of business restructuring and strengthen the integrity of the tax system. Therefore, explicit stated policy aims in the explanatory memorandum were simplicity and efficiency. The competitiveness or economic growth policy aim relating to permitting Australian businesses to adopt organisational structures based on commercial considerations rather than tax considerations, as stated in *A Platform for Consultation*, can also be implied.

The Board of Taxation in its Report[1171] to the Government relating to its post-implementation review into certain aspects of the tax consolidation regime indicated that the consolidation regime had 'delivered substantial improvements to the Australian tax system in providing a set of rules for the taxation of wholly-owned corporate groups'.[1172] The Report noted that the consolidation rules provide greater simplicity and transparency for groups by more closely aligning their income tax position with the group's position from a business and accounting perspective.[1173]

1167 See above (n 480) 534 [25.7].
1168 See above (n 508).
1169 Ibid 518 [15.1].
1170 See above (n 29).
1171 See above (n 9).
1172 Ibid 16 [2.29].
1173 Ibid [2.31].

The Report also noted that increased operational efficiencies had arisen and substantially reduced compliance costs by reason of the significant reduction in tax analysis required where groups undertake corporate restructures and intra-group asset transfers.[1174] Also, the consolidation pooling of tax attributes such as tax losses, franking credits and foreign income tax offsets have been instrumental in generating sensible, simple and appropriate tax outcomes as compared to the pre-consolidation environment where significant complexity reigned.[1175]

Notwithstanding the above articulated benefits of the tax consolidation regime, the Report also noted there were concerns in relation to the compliance costs associated with the regime, and in relation to the complexity and uncertainty of certain aspects of the regime including the tax cost setting rules on entry and exit and the interaction of the regime with the rest of the general tax law.[1176] Some of these issues have been discussed in 6.5, 7.5, 8.9 and 9.6.

The above analysis has indicated that the tax policy reasons for the adoption of a tax consolidation regime were based, first, on simplicity, that is, the existing rules governing the taxation of wholly owned groups albeit as single entities were complex, costly to comply with and resulted in outcomes that were unfair in certain circumstance and too favourable in others. Although the consolidation regime carries its own level of complexity, compliance costs and some uncertainty in its interaction with other parts of the income tax law, it replaced a complex, high compliance costs wholly-owned group company regime that had provided unintended benefits to some taxpayers, with a far simpler regime that ignored intra-company dealings and eliminated unfairness and unintended tax advantages.

Secondly, the tax policy principle of competitiveness, or promoting economic growth, was seen as being achieved since the tax consolidation regime established a taxation framework that allowed Australian businesses to adopt organisational structures based more on commercial rather than tax considerations. Thirdly, the tax consolidation regime promoted efficiency, integrity and equity by improving the integrity of the tax system.

1174 Ibid 16-17 [2.32].
1175 Ibid 17 [2.33].
1176 Ibid 17-19 [2.36]-[2.49].

Ting indicated that in relation to the neutrality principle, the taxation of consolidated groups as one single taxable entity is functionally equivalent to the tax outcome for a company with branches and consistent with the neutrality principle under which the tax system should not affect the business decisions of taxpayers.[1177]

Also, on the basis that all of the business income of a tax consolidated group or MEC group is taxed in the hands of the head entity at the company tax rate which is the same rate as that of other non-consolidated companies earning business income, implies that the requirement of fairness or equity is satisfied.

From the above, it can be concluded that Australia's decision to implement the tax consolidation regime in the form that was enacted represented good tax policy.

It is submitted that the feature of the enacted 'good' tax consolidation regime that permitted trusts and partnerships to be included in consolidated groups, which, as concluded in 10.2.2, on a theoretical basis for partnerships and a theoretical and actual basis for trusts, promotes a stronger enterprise doctrine, should also be regarded as good tax policy. The inclusion of trusts and partnerships in Australian tax consolidated groups is an integral albeit unique feature of Australia's tax consolidation regime that results in a stronger enterprise doctrine that assists Australian businesses to adopt organisational structures, consisting of companies, trusts and partnerships, based on commercial considerations and not tax considerations which enhances economic growth and achieves neutrality.

Although there are issues of complexity and uncertainty of certain legislative provisions that arise in relation to trusts and partnerships as discussed in 6.5, 7.5, 8.9 and 9.6, which should be addressed, these do not affect the conclusion that the policy decisions to implement Australia's tax consolidation regime and to include trusts and partnerships as group members represents good tax policy.

Accordingly, the decision to include trusts and partnerships in Australian tax consolidate groups should be regarded as good tax policy.

[1177] Ting (n 1) 25-6.

10.3.3 Conclusion

The tax policy decision to include trusts and partnerships within tax consolidated groups represents good tax policy.

Trusts and partnerships were seen as an integral part of the tax consolidation regime as they, together with companies, comprise the entities that, subject to eligibility requirements, can be included in consolidated groups and MEC groups. On the basis that the policy decision to include a tax consolidation regime in Australian taxation law represents good tax policy, it is submitted that the inclusion of trusts and partnerships, which promote a stronger enterprise doctrine, within tax consolidated groups should also be regarded as good tax policy.

10.4 Conclusion

This chapter at 10.2 analysed whether trusts and partnerships within Australian tax consolidated groups promotes a stronger enterprise doctrine.

After an overview of the enterprise doctrine in 10.2.1, 10.2.2 analysed whether trusts and partnerships, in theory and practice, promoted a stronger enterprise doctrine.

Although both trust and partnerships were regarded as promoting a stronger enterprise doctrine in theory, in practice, based on empirical data, trusts were found to promote a stronger enterprise doctrine whereas partnerships were not as there has been since the commencement of the tax consolidation regime a small number of partnerships in tax consolidated groups.

The 'good ' tax principles (simplicity, neutrality and efficiency, fairness and competitiveness) of tax system design were analysed in 10.3.1 and considered in 10.3.2 in relation to the decision to introduce Australia's tax consolidation regime and the decision to include trusts and partnerships in Australia tax consolidated groups.

It was concluded in 10.3.2 that the tax policy decisions to introduce Australia's tax consolidation regime and to include trusts and partnerships in Australian tax consolidated groups represents good tax policy.

Chapter 11 - Summary and Conclusion

Australia's income tax legislation provides for the taxation of consolidated groups and MEC groups (collectively, 'tax consolidated groups') under which a head entity and its wholly owned subsidiaries are subject to income tax as a single group rather than as separate entities. A unique feature of Australia's tax consolidation regime is the inclusion of trusts and partnerships within tax consolidated groups.

The aim of this thesis was to extensively analyse the inclusion of trusts and partnerships as members of tax consolidated groups. The literature review (in chapter 2) concluded that there was little academic literature that had extensively analysed the issues associated with trusts and partnerships as members of Australian tax consolidation groups. The research undertaken in this thesis has filled that gap and made an original contribution to knowledge in the area of the inclusion of trusts and partnership in Australian tax consolidated groups. The research undertaken in this thesis in relation to the three research questions (summarised below) has resulted in findings relating to the meaning and adequacy of the legislative provisions and what legislative reforms may improve the efficacy and clarity of the legislation, the extent to which the inclusion of trusts and partnerships in tax consolidated groups represented good tax policy, and whether the inclusion of trusts and partnerships in tax consolidated groups promotes a stronger enterprise doctrine which refers to the phenomenon that modern large business enterprises comprise a group of companies, with a parent company owning or controlling subsidiary entities, which carry on business as a group or enterprise rather than as a collection of separate individual legal entities.

Research Questions and Findings

Research Questions 1 and 2

Research Question 1 asked whether the Australian tax legislation adequately and effectively provides for the inclusion of trusts and partnerships in tax consolidated groups?

Research Question 2 asked what legislative reforms are required to better achieve the policy intent of the inclusion of trusts and partnerships in the Australian tax consolidation regime?

The research methodology used to answer research question 1 was 'doctrinal research' which is a legal research methodology that involves a high level of analysis and critique of the relevant legislative provisions and involves interpreting the legislation to ascertain its legal meaning. The approach to statutory interpretation begins with the words of the statute having regard to their context and purpose.

The results of the doctrinal research undertaken in research question 1 were also used to answer research question 2 which addressed what legislative reforms would better achieve the policy intent of including trusts and partnerships in Australian tax consolidate groups.

Although research question 1 and research question 2 were separate and distinct questions, in extensively analysing the legislative provisions to determine whether they adequately and effectively provided for the inclusion of trusts and partnerships in tax consolidated groups for the purposes of answering research question 1, any deficiencies or incomplete or inadequate legislative drafting that arose from that analysis was utilised in considering what legislative amendments or reforms were necessary to better achieve the policy intent of the inclusion of trusts and partnerships in tax consolidated groups.

The doctrinal research relevant to research question 1 was undertaken in chapters 5 to 9. Initially (in chapter 5) the business tax reform process in Australia and the development and enactment of legislation that culminated in trusts and partnerships being included as members in tax consolidated groups from the commencement of Australia's tax consolidation regime was outlined. The detailing of the enactment history of the legislation that provided for trusts and partnerships in Australian tax consolidated groups was important as it provided, in part, the 'context' and 'purpose' for their inclusion in the consolidation legislation which is relevant in ascertaining the legal meaning of those legislative provisions and necessary for the doctrinal research undertaken.

The legislative eligibility requirements for trusts to qualify as members of a consolidated group and an MEC group were outlined and analysed in chapter 6 and certain issues that arose from that analysis were outlined and analysed, some of which were recommended as requiring legislative amendments (noted below in relation to research question 2). Similarly, the legislative eligibility requirements for partnerships to qualify as members of a consolidated group and a MEC group were outlined and analysed in chapter 7 and certain issues that arose from that analysis were outlined and analysed .

The tax consequences of trusts joining and leaving consolidated groups and MEC groups were analysed in chapter 8 and certain issues that arose from that analysis were outlined and analysed. The tax consequences of partnerships joining and leaving consolidated groups and MEC groups were analysed in chapter 9 and certain issues that arose from that analysis were outlined and analysed.

It was concluded from the detailed analysis undertaken of the legislative provisions in chapters 6 to 9 that, subject to the analysis of the issues identified in 6.5, 7.5, 8.9 and 9.6, the legislative provisions adequately and effectively provide for the inclusion of trusts and partnerships in consolidated groups and MEC groups. Although some of the legislative provisions are complex and can give rise to interaction issues with other parts of the income tax law, much of the complexity arises from Australia's decision to implement an asset based tax consolidation regime which requires a tax cost setting of assets held by the head entity at the time a partnership or trust joins a group and a re-setting of the equity owned in a trust or partnership at the time the trust or partnership leaves the group.

It can also be observed that some of the complexity and detail of the legislative provisions is necessary to take into account the legal nature of trusts and partnerships and their particular features. Also, certain statutory regimes outside of the consolidation regime relating to 'foreign hybrid' entities (which are treated as partnerships), corporate limited partnerships (which are treated as companies), and public trading trusts (which are treated as companies) impact the classification and treatment of those trusts and partnerships under tax consolidation which can cause complexity and requires on-going monitoring by taxpayers and

tax practitioners to ensure the eligibility requirements (for, example, the residence requirement) are continuously met.

In addressing research question 2, from the results of the doctrinal research undertaken in relation to research question 1, certain issues arising from that analysis were identified for which legislative reform was recommended.

The recommended areas of legislative reform were in respect of the following issues:

1. The 'trust and not trustee' issue and whether it is necessary for a trustee of a trust to be a member of the consolidated group of which the trust is a member – analysed at 6.5.1.1.
2. The group liability issue relating to trusts as members of consolidated groups – analysed at 6.5.1.2
3. The 'nominee' issue relating to interposed entities in s 703-45(2) – analysed at 6.5.3.
4. The 'part-year' joining and exiting of consolidated groups by trusts issue – analysed at 8.9.1 and 2.4.
5. The re-writing of Schedule 2F to the *ITAA 1936* re trust losses into the consolidation provisions to achieve clarity in their application to consolidated groups – analysed at 8.9.2.
6. Tax cost setting rules upon a trust joining a consolidated group to ensure greater clarity and understanding given their inherent complexity – analysed at 8.9.3.
7. The retrospective date of cessation of foreign hybrid status issue – analysed at 9.6.1.

Although, ideally, each of the seven issues referred to above should be examined by the Government and appropriate legislative amendments developed and enacted, there are some issues which require more urgent reform and should be addressed before other issues.

The 'part-year' issue (relating to the interaction between the consolidation legislation and the general taxation of trusts legislative provisions) has been known for over 20 years with the Board of Taxation examining the issue in 2009 and recommending legislative amendments and subsequent Governments from time to time acknowledging that legislative amendments are required to address the issue but no amendments have been enacted to date. The issue requires immediate action as current legislation is ineffective to deal appropriately and fairly with the interaction and the tax return positions adopted by taxpayers are often not in accordance with the law which, unfairly, potentially exposes those taxpayers to the risk of further tax and penalties.

Although the 'trust and not trustee' issue relating to trusts which are members of consolidated groups with no legislative requirement for a trustee of the trust to also be a member of the group, has also been known since at least 2009 when it was examined by the Board of Taxation, the recommended amendment has not been made to date. The amendment is less important than the 'part-year' issue as the conclusion has been made that although the legislation works adequately it is nevertheless worthwhile to clarify and make explicit the legislative position that assets and liabilities of the trustee of a trust are brought into consolidation notwithstanding that the trustee is not a member of the group.

The group liability issue relates to a trust that is a member of a consolidated group having joint and several liability for group liabilities as a member of the group under existing legislation. However, as the trust is not a legal person and the legislation does not make the trustee liable for the group liability of the trust, it has been concluded that it is likely that no group liability can arise for a trust that is a member of the consolidated group. This is not a desirable outcome since there is no mechanism by which the group liability can be satisfied from assets of the trust. This issue should be a priority for legislators to address as it impairs the ability of the Australian Taxation Office to seek recovery of a group liability in respect of a trust that is a member of a consolidated group.

Each of the remaining four issues mentioned above has no particular priority in terms of the timing of an appropriate legislative amendment but should be addressed as soon as practicably possible.

Research Question 3

Research Question 3 asked whether the inclusion of trusts and partnerships in Australia's tax consolidation regime promotes a stronger enterprise doctrine and represents good tax policy?

The first part of research question 3 related to the enterprise doctrine which refers to the feature of the modern business economy that medium to large businesses are carried on by corporate groups or enterprises under the common control of a parent entity rather than being conducted by a group of separate legal entities. That is, the corporate group or enterprise is recognised as a single economic unit. It was concluded that an Australian tax

consolidated group which is treated as a single entity (of which the subsidiary members are taken to be a part) reflects a strong application of the enterprise doctrine.

It was concluded that, from a theoretical standpoint, as discussed in 10.2.2, the inclusion of trusts and partnerships in tax consolidated groups promotes a stronger enterprise doctrine as compared to a tax consolidated group regime that did not allow under its formation rules the inclusion of trusts and partnerships. Also, on the basis of the empirical evidence presented in 10.2.2.1, the inclusion of trusts in consolidated groups promotes a stronger enterprise doctrine.

Although from a theoretical standpoint, the inclusion of partnerships in consolidated groups does promote a stronger enterprise doctrine, the empirical evidence presented in 10.2.2.2, however, discloses that there has been in fact a very low incidence of partnerships in tax consolidated groups. Accordingly, it was concluded that on the basis of that empirical evidence that the inclusion of partnerships in tax consolidated groups has not promoted a stronger enterprise doctrine.

Although, from the empirical evidence, the very low incidence of partnerships in tax consolidated groups was a surprising revelation, the inference is that partnerships are an uncommon feature of medium and large sized businesses carried on as a single enterprise. It is likely, as discussed in 10.2.2.2, they are co-owned by unrelated parties (such as mining or petroleum joint ventures) or are entered into by individuals in the small business sector for income splitting motives. Perhaps the Government and its advisers should re-consider whether the continued inclusion of partnerships in tax consolidated groups is necessary or worthwhile given their continued (from the commencement of the tax consolidation legislation to the present) very low incidence and that some partnerships are only included in tax consolidated groups by reason of them being wholly owned foreign hybrids that are treated as partnerships under the taxation law.

It can be concluded, therefore, that the Australian taxation law does reflect a strong enterprise doctrine or theory by reason of its adoption of a strong form of tax consolidation regime that includes not only companies but also, uniquely, trusts and partnerships. In practice, however, unlike trusts, partnerships have been shown to in fact feature infrequently in Australian tax consolidated groups.

It was concluded in 10.3.2 that the decision to implement Australia's tax consolidation regime represented good tax policy based on a consideration of the accepted principles of good tax policy of simplicity, competitiveness or economic growth, fairness (or equity) and efficiency and neutrality in relation to Australia's tax consolidation regime.

Trusts and partnerships were regarded as an integral part of the tax consolidation regime as they, together with companies, comprise the entities that, subject to eligibility requirements, can be included in consolidated groups and MEC groups. On the basis that the policy decision to include a tax consolidation regime in Australian taxation law represented good tax policy, it was concluded at 10.3.2 that the inclusion of trusts and partnerships, which promotes a stronger enterprise doctrine, within tax consolidated groups also represented good tax policy.

Legislators should ensure the principles of good tax policy design are adhered to when amendments are made to the tax consolidation regime including those that deal with trusts and partnerships. An area of particular focus should be ensuring that, to the extent possible, amendments should be drafted that satisfy the simplicity or non-complexity principle. The doctrinal analysis undertaken in relation to research question 1 has revealed certain areas (in 6.7. 7.5, 8.9 and 9.6) in the current law that are complex and unclear and which breach the simplicity principle of good tax design. It is submitted that greater effort on the part of the legislators should be made to meet this principle otherwise higher compliance costs incurred by taxpayers and higher administrative costs in the ATO administering the legislation will result.

This thesis has extensively analysed the inclusion of trusts and partnerships in Australian tax consolidated group by answering the three research questions and has filled the research gap identified in 2.6. The extensive analysis of trusts and partnerships within tax consolidated groups undertaken in this thesis should be of practical benefit to taxpayers, tax practitioners and also to tax administrators as they should now have a better understanding of the meaning, operation and effect of the tax consolidation legislation in respect of trusts and partnerships through the research undertaken and also be aware of some of the issues that arise and were discussed. Also, the Government should now be aware of a range of issues that need addressing by legislative amendment. The thesis concluded that the enterprise doctrine or theory by which modern businesses are conducted by groups of entities as a single

entity is stronger due to tax consolidated groups comprising not only companies but also trusts and partnerships albeit that in practice there is a low incidence of partnerships in tax consolidated groups. Overall, the tax consolidation legislation (including trusts and partnerships being within tax consolidated groups) reflects good tax policy design.

A limitation of the current research is that draft amending legislation relating to the recommended legislative amendments identified by this thesis has not been undertaken as part of this thesis. Also, the complexity of the calculations needed to be made upon the joining or exiting of tax consolidated groups by trust and partnerships could have been demonstrated by developing illustrative examples of various joining/exit scenarios.

Adopting a research method such as the survey (appropriately designed) may have yielded further details of the problems and issues actually experienced and dealt with in practice by taxpayers and tax practitioners in relation to trusts and partnerships in tax consolidated groups.

Future research could be undertaken that further extensively analyses those areas that have been identified in this thesis as requiring amendment and develops draft legislation which addresses those legislative amendments and any others and also addresses interaction issues between the consolidation provisions and other areas of the taxation law. The survey research method could be used to identify what issues have been encountered by taxpayers and tax practitioners that have experience in practice in dealing with trusts and partnerships in tax consolidated groups and how they have dealt with those issues and identify those issues that have proved intractable.

Future research could include illustrative examples of areas (such as joining and exiting of tax consolidated groups by trusts and partnerships, determining available fractions) which may aid an understanding of the complexity of various calculations required by the legislation.

A suggested future research question is what legislative amendments (including recommended draft legislation) need to be made to the income tax legislation that relates to trusts and partnerships in tax consolidated groups that improves the efficacy and clarity of the legislation? Alternatively, what legislative amendments (including recommended draft legislation) need to be made to the income tax legislation that relates to trusts and

partnerships in tax consolidated groups that reduces the complexity of the legislation and promotes simplicity?

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