



TECHNICAL ANALYSIS REPORT

Non-Resident Property Leasing - SPC Structure,
Arm's Length Analysis and Deduction Entitlements

Prepared for:	Instructing Accountant / Client
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Client Query

Background

The client is domiciled overseas and subject to foreign tax rates. The client owns a residential property 100% and is planning to demolish the existing building, which has Development Approval (DA) for a childcare centre. The client proposes to establish an intermediate Special Purpose Company (SPC) to lease the property to a third party.

Scenario 1 - SPC Receives Rent Directly

The client does not receive rent directly. The client holds 100% of the shares (or 50%/50% with the client's wife) in the SPC. The SPC leases the property to a third party, receives the rent, and claims rent-related deductions.

Scenario 1 Query

Query: Is this structure considered to be within arm's length?

Scenario 2 - Client Receives Market Rent from SPC

The client receives market rent from the SPC (which has shares issued 100% to the client or 50%/50% with wife). The SPC then sub-leases the property to a third party.

Scenario 2 Queries

Query: Would this structure and the transactions be considered within arm's length?

Additional Query: Is the SPC eligible for full rent-related deductions (rates, land tax, etc.), or must the client individually claim the full deductions along with the market rent?

1. Summary

Scenario 1 - SPC Leases Directly to Third Party

Scenario 1: Significant Arm's Length Risk

The structure raises significant arm's length and anti-avoidance concerns. The client (non-resident) owns the property but the SPC (Australian resident company) leases the property and receives the rent. The core issue is: what consideration does the SPC provide to the client for the right to lease the client's property?

If the SPC does not pay the client market rent for the right to occupy and sub-lease the property, the arrangement is not at arm's length. The ATO will ask: would an independent party grant a company the right to lease their property to a third party, collect all the rent, and claim the deductions, without receiving any payment?

Transfer pricing (Subdiv 815-B ITAA 1997) applies because this is a cross-border dealing between related entities. Part IVA (s 177D ITAA 1936) is also a risk if the dominant purpose is to shift Australian-source rental income from the non-resident (taxed at non-resident rates with no tax-free threshold) to the company (taxed at 25-30% with deductions).

Scenario 2 - Client Receives Market Rent from SPC

Scenario 2: More Defensible - If Market Rent Applied

This structure is more commercially defensible, provided the rent between the client and the SPC, and the sub-lease rent between the SPC and the third party, are both at genuine market rates.

Under Scenario 2, the client receives market rent from the SPC and is assessable on that rental income as Australian-source income (s 6-5 ITAA 1997). The client claims deductions directly attributable to the property (rates, land tax, insurance, depreciation on the building, interest on any mortgage). The SPC claims the sub-lease rent as income and claims the head-lease rent paid to the client as a deduction, plus any additional expenses it incurs in managing the sub-lease.

The SPC is entitled to deductions for expenses it actually incurs - principally the rent it pays to the client under the head lease. The client claims deductions for expenses it incurs as the property owner. Deductions follow the entity that incurs them.

2. Facts & Assumptions

Facts Provided

Client is domiciled overseas (non-resident for Australian tax purposes).

Client owns a residential property in Australia 100%.

The existing building will be demolished; the site has DA for a childcare centre.

Client proposes to establish an Australian Special Purpose Company (SPC).

SPC shares: 100% client, or 50%/50% client and wife.

Two scenarios: (1) SPC leases directly to third party; (2) Client leases to SPC at market rent, SPC sub-leases to third party.

Assumptions Made

Assumption [ASSUMED]	Affects
The client is a "non-resident" for Australian income tax purposes (s 6(1) ITAA 1936). [ASSUMED]	Determines tax rates (non-resident rates, no tax-free threshold), CGT restrictions (from 9 May 2017 for non-residents), and transfer pricing applicability (cross-border dealing).
The SPC will be an Australian-resident private company (Pty Ltd) incorporated in Australia. [ASSUMED]	Determines the SPC's tax rate (25% or 30%), deduction entitlements, and PAYG/franking obligations.
The property will be used as a childcare centre (commercial property) after demolition and construction. [ASSUMED]	Affects GST treatment (commercial lease = taxable supply), land tax classification, and income characterisation.
The SPC and the client are "associated entities" for transfer pricing purposes because the client controls the SPC. [ASSUMED]	Subdiv 815-B applies to cross-border dealings between associated entities. Arm's length conditions must be applied.
The client's country of residence has a double tax agreement (DTA) with Australia. [ASSUMED]	DTAs typically preserve Australia's right to tax real property income under Article 6 (Income from Immovable Property). The DTA may provide relief from double taxation via foreign tax credits.
The construction of the childcare centre will be funded by the client (not the SPC). [ASSUMED]	Determines who claims Div 43 capital works deductions (2.5% on construction cost) and who holds the depreciating assets.

Information Needed

Missing Information [NEEDED]	Impact if Different
The client's country of tax residence. [NEEDED]	Determines: applicable DTA, foreign tax credit availability, withholding tax rates on dividends from SPC, and whether the foreign jurisdiction taxes the Australian income.
Whether the client will fund the construction of the childcare centre and at what cost. [NEEDED]	Determines who claims Div 43 capital works deductions and Div 40 depreciation on fitout/plant.

Missing Information [NEEDED]	Impact if Different
The expected market rent for the property (both head lease and sub-lease). [NEEDED]	Critical for arm's length analysis. The rent between the client and SPC, and the SPC and third party, must be independently valued.
Whether the SPC will have any genuine commercial function beyond holding the lease. [NEEDED]	If the SPC adds no value (no management services, no capital contribution, no risk assumption), the ATO may treat it as a conduit with no substance.
The client's marginal tax rate in the foreign jurisdiction. [NEEDED]	Determines the net tax benefit of the proposed structure and whether the arrangement has a tax avoidance purpose.

3. Related Areas & Cross-Over Analysis

Area	Relevance	Key Provision	Impact
Non-Resident Taxation	Client's Australian-source rental income is assessable.	s 6-5 ITAA 1997; s 6(1) ITAA 1936	Non-resident taxed at non-resident rates (no tax-free threshold). Rental income from Australian property is Australian-source.
Transfer Pricing	Cross-border dealing between related entities (client and SPC).	Subdiv 815-B ITAA 1997	Arm's length conditions must apply. ATO can substitute arm's length terms if actual terms differ.
Part IVA	Anti-avoidance - if dominant purpose is tax benefit.	s 177D ITAA 1936	If the SPC is interposed solely to shift income/deductions, Part IVA may apply to negate the tax benefit.
Withholding Tax - Dividends	SPC distributing profits to non-resident shareholder.	s 128B ITAA 1936	Unfranked dividends to non-resident subject to withholding tax (typically 15% under DTAs, 30% without DTA).
Division 7A	SPC is a private company - loans/payments to shareholder.	Div 7A ITAA 1936	Any payments from SPC to non-resident client (other than dividends or arm's length rent) may trigger Div 7A.
GST	Commercial lease is a taxable supply.	s 9-5 GST Act	SPC must register for GST if turnover >= \$75K. Both head lease and sub-lease are taxable supplies.
Capital Works Deduction	Construction of childcare centre on the site.	Div 43 ITAA 1997	2.5% p.a. on construction cost. Claimed by the entity that incurs the expenditure and holds the asset.
Land Tax	State land tax on property held by non-resident.	Land Tax Act (QLD)	Non-resident/absentee surcharges may apply depending on state. QLD imposes an absentee surcharge of 2%.
DTA - Immovable Property	Most DTAs preserve source country (Australia) taxing right on real property income.	Article 6 OECD Model; applicable DTA	Australia retains the right to tax rental income from Australian property regardless of the DTA.

4. Analysis

4.1 Scenario 1 - SPC Leases Property Directly to Third Party

Structure Description

Under Scenario 1, the client (non-resident, property owner) grants the SPC the right to lease the property to a third party. The SPC collects the rent and claims the deductions. The client does not receive rent directly.

Arm's Length Analysis - Subdiv 815-B

Subdivision 815-B ITAA 1997 applies to cross-border dealings between entities where the actual conditions differ from arm's length conditions and an entity gets a transfer pricing benefit (s 815-115).

The critical question is: would independent parties enter into an arrangement where the property owner (the client) allows a company to lease their property to a third party, collect 100% of the rent, and claim 100% of the deductions, without the property owner receiving any consideration?

The answer is clearly no. An independent property owner would not grant a third party the right to lease their property without receiving market rent or a fee. The arrangement lacks arm's length consideration flowing from the SPC to the client for the use of the client's property.

Specific Issues

Issue 1 - No consideration to client: The SPC receives the benefit of the rental income stream. The client receives nothing (other than potentially retaining shares in the SPC). An arm's length arrangement would require the SPC to pay market rent or a licence fee to the client for the right to lease the property.

Issue 2 - Income shifting: The effect of the arrangement is to shift Australian-source rental income from the non-resident client (taxed at non-resident marginal rates without a tax-free threshold) to the SPC (taxed at 25% company rate with access to deductions). The ATO will view this as profit shifting.

Issue 3 - Part IVA: If the dominant purpose of interposing the SPC is to obtain a tax benefit (lower tax on rental income, or shifting income to a lower-taxed entity), Part IVA (s 177D ITAA 1936) may apply. The Commissioner could make a determination to negate the tax benefit by assessing the rental income directly to the client.

Issue 4 - No commercial substance: If the SPC has no employees, no capital, no business premises, and performs no genuine commercial function (e.g., property management, tenant sourcing, capital investment), it lacks commercial substance. It is merely a conduit. Independent parties would not interpose a company with no substance into a leasing arrangement.

Conclusion: Scenario 1 - NOT Arm's Length

Scenario 1 is NOT within arm's length as described. The SPC receives the entire rental income without paying any consideration to the property owner. This arrangement would not occur between independent parties.

The ATO is likely to: (a) apply Subdiv 815-B to substitute arm's length conditions (requiring the SPC to pay market rent to the client); and/or (b) apply Part IVA to negate the tax benefit of the structure.

If Subdiv 815-B applies, the outcome is effectively the same as Scenario 2 - the client would be assessed on market rent.

4.2 Scenario 2 - Client Receives Market Rent from SPC; SPC Sub-Leases

Structure Description

Under Scenario 2, the client (property owner) leases the property to the SPC at market rent. The SPC then sub-leases the property to a third party (the childcare centre operator). The client receives market rent from the SPC; the SPC receives the sub-lease rent from the third party.

Arm's Length Analysis

This structure is more commercially defensible, provided two conditions are met:

Condition 1 - Market rent between client and SPC (head lease): The rent the SPC pays to the client must be a genuine market rate. This should be supported by an independent valuation. The rent should reflect what an arm's length tenant would pay for a head lease of the property.

Condition 2 - Market rent between SPC and third party (sub-lease): The sub-lease rent should also be at market rates. If the sub-lease rent equals the head-lease rent (i.e., the SPC earns zero margin), the ATO may question the commercial rationale for the SPC's existence. An arm's length sub-lessor would charge a margin above the head-lease rent to cover its costs and earn a profit.

Commercial Substance of the SPC

For Scenario 2 to withstand ATO scrutiny, the SPC must have genuine commercial substance. Consider whether the SPC:

- Provides property management services (tenant liaison, maintenance coordination, lease administration);
- Bears genuine commercial risk (tenant default risk, vacancy risk, maintenance obligations under the sub-lease);
- Has adequate capital and resources to perform its functions;
- Earns a margin that reflects the value it adds and the risks it assumes.

If the SPC simply passes through the rent with no value-add and no risk assumption, it is a conduit - not a genuine commercial intermediary.

Conclusion: Scenario 2 - Defensible if Properly Structured

Scenario 2 is more defensible than Scenario 1, provided: (a) both the head-lease and sub-lease rents are at genuine market rates supported by independent valuations; (b) the SPC has genuine commercial substance (management services, risk assumption, adequate resources); and (c) the SPC earns a margin that reflects its commercial function.

If the SPC is a mere pass-through with no substance, the ATO may still apply Part IVA or Subdiv 815-B to reconstruct the arrangement.

4.3 Additional Query - Who Claims the Deductions?

Relevant Law

Under s 8-1 ITAA 1997, a deduction is available to the entity that incurs the expense, to the extent it is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business.

The general principle is: deductions follow the entity that incurs the expenditure. The entity that pays the expense claims the deduction - not the entity that benefits from it.

Application to Scenario 2

Expense	Who Incurs It?	Who Claims Deduction?	Notes
Council rates	Property owner (client) - levied on the registered owner	Client	Client claims as deduction against rental income received from SPC.
Land tax	Property owner (client) - levied on landowner	Client	Client claims. Note: QLD absentee surcharge of 2% may apply to non-resident.
Insurance (building)	Depends on lease terms - typically property owner	Client (if client pays)	Or SPC if the sub-lease obliges the SPC to insure.
Div 43 capital works (2.5%)	Entity that incurs the construction expenditure	Client (if client funds construction)	If SPC funds construction on the client's land, complex legal and tax issues arise (tenant's fixtures, improvements).
Div 40 depreciation (fitout/plant)	Entity that owns the depreciating asset	Depends on ownership	If third party tenant installs fitout, neither client nor SPC claims.
Head-lease rent (SPC pays to client)	SPC - the SPC incurs this as its cost of obtaining the right to sub-lease	SPC	Deductible to SPC under s 8-1 against the sub-lease rental income.
Property management fees	Entity that engages the property manager	Whoever engages and pays the manager	If SPC manages, SPC claims. If client engages manager, client claims.
Interest on mortgage	Property owner (client) - if the client has a mortgage	Client	Client claims interest against the rental income from SPC. Purpose test applies (s 8-1).
Repairs and maintenance	Depends on lease obligations	Whoever is contractually obligated and pays	Typically the property owner for structural repairs; tenant for non-structural.

Answer: Deduction Allocation

The SPC is entitled to deductions for expenses it actually incurs - principally the head-lease rent it pays to the client, plus any additional expenses it bears under the sub-lease (e.g., management costs, repairs if contractually obligated).

The client claims deductions for expenses it incurs as the property owner - rates, land tax, insurance, mortgage interest, Div 43 capital works, and any repairs it is obligated to make.

Deductions cannot be "allocated" between entities by agreement. Each entity claims deductions for expenses it genuinely incurs. The SPC cannot claim the client's rates or land tax unless the SPC contractually assumes and pays those costs.

4.4 Tax Consequences for the Non-Resident Client

Rental Income

Under both scenarios, the client's Australian-source rental income is assessable in Australia. As a non-resident:

- No tax-free threshold (\$0 threshold for non-residents);
- Non-resident tax rates apply: 32.5c in the dollar on the first \$120,000, 37c on \$120,001-\$180,000, 45c on \$180,001+ (2024-25 rates);
- No Medicare levy (non-residents are exempt);
- The client must lodge an Australian income tax return reporting the rental income and claiming applicable deductions.

Dividends from SPC

If the SPC earns a profit (sub-lease rent minus head-lease rent minus expenses) and distributes dividends to the non-resident client:

- Unfranked dividends: subject to dividend withholding tax (typically 15% under most DTAs, or 30% without a DTA) under s 128B ITAA 1936;
- Franked dividends: non-resident shareholders are generally not entitled to a refund of franking credits (s 207-115 ITAA 1997). The franked portion is exempt from withholding tax under s 128B(3)(ga);
- Retained earnings in the SPC are taxed at the company rate (25% or 30%) and not distributed until the client decides - this provides a deferral mechanism.

Division 7A Risks

Any payments from the SPC to the client (other than arm's length rent, dividends, or salary for services) may trigger Division 7A. If the SPC pays the client's personal expenses or lends money to the client, the usual Div 7A deemed dividend rules apply. The SPC should maintain strict corporate governance and ensure all transactions with the client are documented and at arm's length.

5. Worked Example Tables

5.1 Scenario 2 - Tax Flow Comparison

Assumes: Sub-lease rent from third party = \$200,000 p.a. Head-lease rent (SPC to client) = \$170,000 p.a. Client's property expenses (rates, land tax, insurance, interest, Div 43) = \$80,000 p.a.

Item	Client (Non-Resident)	SPC (Aust Resident Company)
Income	\$170,000 (head-lease rent from SPC)	\$200,000 (sub-lease rent from third party)
Less: Deductions	(\$80,000) (rates, land tax, insurance, interest, Div 43)	(\$170,000) (head-lease rent to client) + (\$10,000) (SPC management costs)
Taxable income	\$90,000	\$20,000
Tax rate	Non-resident: 32.5%	Company: 25% (if BRE)
Tax payable	\$29,250	\$5,000
Total Australian tax	\$34,250 combined	

5.2 Comparison - Direct Ownership (No SPC)

Item	Client Direct (No SPC)
Income	\$200,000 (rent from third party directly)
Less: Deductions	(\$80,000) (rates, land tax, insurance, interest, Div 43)
Taxable income	\$120,000
Tax rate	Non-resident: 32.5%
Tax payable	\$39,000

Tax Comparison

With the SPC structure (Scenario 2), total Australian tax is \$34,250 vs \$39,000 without the SPC - a saving of \$4,750.

However, the saving arises because \$20,000 of profit is taxed in the SPC at 25% instead of in the client's hands at 32.5%. The ATO will scrutinise whether the SPC's \$30,000 margin (sub-lease \$200K minus head-lease \$170K) is commercially justified.

If the SPC performs genuine management/leasing functions, the margin is defensible. If the SPC is a mere conduit, the ATO may apply Part IVA or Subdiv 815-B to eliminate the benefit.

Additional compliance costs (SPC tax return, ASIC fees, governance) must also be factored in.

6. Case Law Support

Primary Authority

Case / Reference	Source	Principle	Application
TR 2014/6	ATO (Binding Ruling)	Transfer pricing rules - application of Subdiv 815-B. Arm's length conditions must reflect what independent parties would do. Consideration of economic substance and commercial rationality.	Core guidance on whether the SPC arrangement satisfies arm's length conditions. The ATO will test whether independent parties would enter into this arrangement.
<i>FCT v Spotless Services (1996) 186 CLR 404</i>	HCA	Part IVA: dominant purpose assessed objectively. Tax benefit can be one of several purposes - only needs to be dominant.	If the dominant purpose of interposing the SPC is to reduce Australian tax on the rental income, Part IVA applies. Commercial substance must outweigh the tax benefit purpose.
<i>FCT v Peabody (1994) 181 CLR 359</i>	HCA	Part IVA: the scheme must be identified, and the tax benefit must arise under or in connection with the scheme.	Relevant to identifying the "scheme" (interposing the SPC into the leasing chain) and the tax benefit (shifting income to a lower-taxed entity).

Supporting Authority

Reference	Source	Principle	Relevance
PS LA 2015/4	ATO (Practice Statement)	ATO's compliance approach to transfer pricing - simplified record keeping for low-risk dealings.	Relevant to documentation requirements. The SPC arrangement may not qualify for simplified treatment given the non-resident element.
s 26-50 ITAA 1997	Legislation	Limits deductions for payments to related entities on non-arm's length terms.	If the head-lease rent from SPC to client is above market rate, the excess may be non-deductible to the SPC.

7. Conclusion

Scenario 1: is NOT within arm's length. The SPC receives the entire rental income without paying consideration to the property owner. This would not occur between independent parties. The ATO is likely to apply Subdiv 815-B and/or Part IVA to reconstruct the arrangement.

Scenario 2: is more defensible, provided: (a) both the head-lease and sub-lease rents are at genuine market rates supported by independent valuations; (b) the SPC has genuine commercial substance (management services, risk assumption, resources); and (c) the SPC earns a margin that reflects its commercial function and risk.

Deductions: follow the entity that incurs the expense. The SPC claims deductions for the head-lease rent it pays to the client and any expenses it bears under the sub-lease. The client claims deductions for property owner expenses (rates, land tax, insurance, mortgage interest, Div 43). Deductions cannot be "shifted" by agreement.

We recommend: (a) obtaining an independent property valuation to support the head-lease rent; (b) ensuring the SPC has genuine commercial substance and documented functions; (c) maintaining comprehensive transfer pricing documentation under Subdiv 284-E TAA 1953; and (d) considering whether the net tax benefit justifies the compliance complexity and ATO scrutiny risk.

8. Risks & Caveats

Transfer pricing - Subdiv 815-B: **[High (Scenario 1); Medium (Scenario 2)]** Cross-border dealing between related entities. The ATO can substitute arm's length conditions for the actual conditions. Both the head-lease and sub-lease rents must be at market rates. Independent valuation is essential.

Part IVA anti-avoidance: **[High (Scenario 1); Medium (Scenario 2)]** If the dominant purpose of interposing the SPC is to obtain a tax benefit (shifting income to a lower-taxed entity), Part IVA applies. The SPC must have genuine commercial substance and a non-tax business rationale. Document the commercial reasons for the structure contemporaneously.

ATO Private Wealth focus: **[High]** Non-resident property structures are a stated ATO compliance focus area under the Private Wealth International Program. The ATO actively audits arrangements involving non-residents, SPCs, and Australian property.

Dividend withholding tax: **[Information]** Profits distributed from the SPC to the non-resident client are subject to dividend withholding tax (15% under most DTAs, 30% without). Franked dividends are exempt from WHT but non-residents cannot claim refunds of excess franking credits.

Division 7A: **[Monitor]** Any non-arm's length payments, loans, or benefits from the SPC to the client trigger Div 7A deemed dividends. Strict corporate governance required.

GST registration: **[Procedural]** The SPC must register for GST if turnover exceeds \$75,000. Both the head-lease (client to SPC) and sub-lease (SPC to third party) of commercial property are taxable supplies. The client may also need to register for GST if the head-lease rent exceeds \$75,000.

QLD land tax - absentee surcharge: **[Financial]** Queensland imposes a 2% absentee surcharge on land owned by non-residents (Land Tax Act 2010 (Qld), Part 4A). This applies regardless of the SPC interposition. The surcharge is levied on the registered owner (the client).

Compliance cost-benefit: **[Commercial]** The SPC creates additional compliance costs: ASIC registration (\$576), annual review (\$316), company tax return preparation, transfer pricing documentation, GST obligations, and corporate governance. The tax saving may not justify these costs.

9. Rulings & References

Legislation

Provision	Relevance
ITAA 1997, Subdiv 815-B (ss 815-115 to 815-145)	Transfer pricing - arm's length principle for cross-border dealings
ITAA 1997, s 815-130	Relevance of actual commercial relations to arm's length conditions
ITAA 1997, s 8-1	General deduction provision - deductions follow the entity that incurs the expense
ITAA 1997, s 26-50	Limit on deductions for payments to related entities on non-arm's length terms
ITAA 1997, Div 43	Capital works deduction (2.5% p.a. for commercial building construction)
ITAA 1997, Div 40	Depreciation of plant and equipment
ITAA 1936, s 6(1)	Definition of resident and non-resident
ITAA 1936, s 177D (Part IVA)	Anti-avoidance - dominant purpose test
ITAA 1936, s 128B	Withholding tax on dividends paid to non-residents
ITAA 1936, Div 7A	Deemed dividends for payments/loans from private company to shareholders
GST Act, s 9-5	Taxable supplies - commercial lease of real property
Land Tax Act 2010 (Qld), Part 4A	Absentee surcharge for non-resident landowners
Taxation Administration Act 1953, Subdiv 284-E	Transfer pricing documentation requirements

ATO Rulings & Guidance

Reference	Topic	Binding Status
TR 2014/6	Transfer pricing - application of Subdiv 815-B, arm's length conditions	Binding (Public Ruling)
PS LA 2015/4	ATO compliance approach to transfer pricing record keeping	Non-binding (Practice Statement)
PCG 2017/1	Transfer pricing - simplified record keeping for low-risk dealings	Non-binding (Practical Compliance Guideline)

Case Law

Case	Court	Principle
<i>FCT v Spotless Services (1996) 186 CLR 404</i>	HCA	Part IVA dominant purpose test - objective assessment
<i>FCT v Peabody (1994) 181 CLR 359</i>	HCA	Part IVA - identification of scheme and tax benefit
<i>FCT v Hart (2004) 217 CLR 216</i>	HCA	Part IVA applies to individual steps in a wider arrangement

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