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Corporate Essentials
Tax Smart Australia

Issue
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Tax Essentials
Capital Gains Tax Minimisation Strategies 2022

APRIL	2022

THE NEWSLETTER
Tax Planning Update

MICHAEL'S CORNER
Article No.16
Dealing with difficult behaviours

SPECIAL ISSUE
Capital Gains Tax (CGT)- Minimisation Strategies

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The Newsletter

TAX-DEDUCTIBLE COVID-19 PCR AND RAPID ANTIGEN TESTS

The federal government will make COVID-19 tests tax-deductible for Australian individuals and exempt from fringe benefits tax (FBT) for businesses purchased for work-related purposes.

Key points:

- PCR tests and RATs will be tax-deductible, backdated to July 1, 2021
- Australians earning an income taxed at 34.5pc will receive a refund of about $6.90 for every $20 pack of two RATs
- Small businesses will reduce their FBT liability by about $20 for every dual pack of RATs purchased for $20

Initially, the change will see PCR and rapid antigen tests (RATs) become tax-deductible, but the government intends to include future medically approved tests in the scheme.

The legislation will be in effect from the 2021-22 FBT and income years and will be backdated to July 1, 2021.

Australians earning an income taxed at 34.5 per cent (including Medicare levy) will receive a tax refund of about $6.90 for every pack of two RATs purchased for $20.

Small businesses will reduce their FBT liability by about $20 for every dual pack of RATs purchased for $20 and provided to employees.

Treasurer Josh Frydenberg announced the changes to tax legislation in a speech to the Australian Industry Group on 7.2.2022. .

BAS DURING COVID

If you lodge your business activity statement (BAS) quarterly, the last one is due on 28 February 2022.

Like many small businesses that continue to be affected by COVID, you may be having trouble meeting your BAS lodgement obligations. If that's the case, these tips may help prepare your next BAS.

- Even if you have nothing to report, you still need to lodge your BAS as 'nil'.
- Lodge online, and you may receive an extra two weeks to lodge and pay.
- If you're reporting and paying pay as you go (PAYG) instalments, you may be able to vary the amount or rate for the current income year. If your business income is reduced, you can lodge a variation on your next BAS or instalment notice.
- Even if you can't pay in full, it's essential to lodge on time and pay what you can. Once you lodge and have up-to-date records, you can understand your tax position and find the best support. If you can't pay in full, payment options are available, and the ATO can assist.

If you're closing or selling your business, you need to cancel your GST registration. Remember to complete your lodgement and payment obligations before cancelling your GST registration.

Remember, your BAS can be lodged through a registered tax or BAS agent, giving you an additional two-week grace. Not dealing with this important lodgement obligation could result in a fine of $222 for each week you are late. It is essential to lodge on time.

VACCINATION INCENTIVES

Many employers have encouraged employees to get COVID-19 vaccinations with incentives and rewards.

In December, the ATO published a fact sheet outlining COVID-19 vaccination incentives and rewards. Employers providing non-cash benefits such as gift cards, vouchers or raffle prizes to employees will likely be subject to FBT unless the minor benefits exemption or in-house reduction applies.

COVID TESTING

Due to the daily case numbers, some employers have provided COVID testing support to employees due to border restrictions or company safety mandates. ATO guidance has confirmed COVID tests will not attract FBT where:

- Testing is carried out by a legally qualified medical practitioner and is available to all employees.

- Provided infrequently and irregularly and the cumulative value of the tests provided to an employee is less than $300; or
- The test is required for an employee travelling to work due to border restrictions.

TRAVEL

Refer to the below recently finalised ATO rulings and guidance when determining FBT treatment of travel expenses:

- TF 2021/1 – Income Tax: when are deductions allowed for employees' transport expenses?
- TR 2021/4 – Income tax and fringe benefits tax: employees: accommodation and food and drink expenses travel allowances and living-away-from-home allowances
- PCG 2021/3 – Determining if allowances or benefits provided to an employee relate to travelling on work or living at a location – ATO compliance approach

Given the finalisation of these rulings and changes brought on by COVID-19, employers with mobile workforces should review their travel policies and arrangements. If you are not applying PCG 2021/3, consider the hiatus in extensive executive travel due to the pandemic. Now might be an opportune time for larger companies to revise protocols concerning executive travel. This could reduce FBT.

The PCG sets a "safe harbour" of an aggregate period of fewer than 90 days in an FBT year for presence at a particular temporary work location to be treated as travelling on work. Provided that this requirement is met, the Guideline allows an employee to have numerous short stints of travel of up to and including 21 continuous days. Notably, Fly-in Fly-out or Drive-in Drive-out are excluded from the PCG, so the safe harbour cannot apply in these scenarios.

ELECTRIC VEHICLES

Some employers consider including electric vehicles in their fleet to achieve emission reduction targets.

The FBT legislation was enacted in 1986 and did not contemplate the use of electric vehicles. The ATO currently considers some practical challenges on how to value the vehicle benefits (including substantiation).

Federal Labor targets 50% of new car sales to be electric vehicles by 2030 and has proposed an FBT exemption for electric cars to encourage increased uptake. The intended result is that purchasing or leasing an electric car for use by employees would result in the same outcome as purchasing a dual cab ute.

SIGNING AND SENDING OF ELECTRONIC DOCUMENTS

Around a million businesses will save around $450 million in red tape each year after the Federal Government passed legislation on 10.2.2022 making permanent the temporary changes introduced at the height of the coronavirus crisis relating to AGMs and the signing and sending of electronic documents.

The *Corporations Amendment (Meetings and Documents) Bill 2021* amends the *Corporations Act 2001*, allowing companies and registered schemes to use technology to meet regulatory requirements to hold meetings, such as annual general meetings, distribute meeting-related materials and validly execute documents.

Specifically, the reforms provide greater certainty and flexibility to companies and registered schemes by:

- allowing them to hold physical and hybrid meetings and wholly virtual meetings if expressly permitted by the entity's constitution.
- ensuring that technology used for virtual meetings will enable members to participate in the meeting orally and writing.
- allowing them to use technology to execute documents electronically, including corporate agreements and deeds.
- allowing them to send documents in hard or soft copy and give members the flexibility to receive documents in their preferred format.

The Federal Government aims to support higher productivity across the economy by ensuring that regulatory settings are fit-for-purpose, providing businesses greater flexibility and utilising technology to meet their regulatory requirements.

HIGH COURT BACKS CONTRACT JOBS

ZG Operations & Anor v Jamsek & Ors [2022] HCA 2

In a landmark decision handed down on 9.2.22, the High Court has backed the right of a business to engage workers outside of minimum wage laws and employment regulations. The decision could result in a surge in independent contracting and support Uber and Deliveroo's claims that their drivers are not employees.

In a unanimous decision, the High Court held that two truck drivers who worked nine-hour days for a lighting company for almost 40 years under a partnership arrangement were not employees entitled to minimum pay and conditions, including superannuation and annual leave.

Led by Chief Justice Susan Kiefel, a majority of the High Court overruled the long-running approach by some courts to look beyond a worker's contract to the social reality of the working relationship. Instead, it relied almost solely on the terms of the contract itself.

To quote the judgement, "The employment relationship with which the common law is concerned must be a legal relationship. It is not a social or psychological concept like friendship."

The decision could effectively mean that if lawyers draft a contract that correctly deals with the key issues, a business can avoid minimum award pay and conditions, workers' compensation, superannuation, redundancy, and other statutory requirements.

It is anticipated that this outcome will entrench existing independent contracting in industries like transport, construction and the gig economy. Other sectors in the long term may be encouraged to engage more contractors.

This ruling may well feature in the federal election, with the court leaving little option but legislation if unions want to protect workers' rights from "sham" contracts.

Here are the facts as taken from the court's summary. The High Court allowed an appeal from a judgment of the Full Court of the Federal Court of Australia. The appeal concerned whether a company engaged two truck drivers as employees or independent contractors.

Between 1977 and 2017, Mr Jamsek and Mr Whitby ("the respondents") were engaged as truck drivers by a business run by the second appellant ("the company"). The respondents were initially engaged as employees of the company and drove the company's trucks. However, in 1985 or 1986, the company offered the respondents the opportunity to "become contractors" and purchase their own trucks. The respondents agreed to the new arrangement and set up partnerships with their respective wives. Each partnership executed written contracts with the company for the provision of delivery services, purchased trucks from the company, paid the maintenance and operational costs of those trucks, invoiced the company for its delivery services, and was paid by the company for those services. Income from work performed for the company was declared as partnership income for income tax purposes and split between each respondent and their wife.

The respondents commenced proceedings in the Federal Court of Australia seeking declarations in respect of certain entitlements alleged to be owed to them pursuant to the Fair Work Act 2009 (Cth), the Superannuation Guarantee (Administration) Act 1992 (Cth) and the Long Service Leave Act 1955 (NSW). The respondents claimed to be owed those entitlements on the basis that they were employees of the company. The primary judge concluded that the respondents were not employees and instead were independent contractors. The Full Court overturned that decision and held that the respondents were employees regarding the "substance and reality" of the relationship.

The High Court unanimously held that the respondents were not employees of the company. A majority of the Court held that consistently with the approach adopted in *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1, where parties have comprehensively committed the terms of their relationship to a written contract, the efficacy of which is not challenged on the basis that it is a sham or is otherwise ineffective under general law or statute, the characterisation of that relationship as one of employment or otherwise must proceed by reference to the rights and obligations of the parties under that contract.

After 1985 or 1986, the contracting parties were the partnerships and the company. The contracts between the partnerships and the company involved the provision by the partnerships of both the use of the trucks owned by the partnerships and the services of a driver to drive those trucks. The context in which the first contract was entered into involving the company's refusal to continue to employ the drivers and the company's insistence that the only relationship between the drivers and the company be a contract for the carriage of goods. This relationship was not a relationship of employment.

THE COST OF TAX CONCESSIONS EXPLODES

A recent article in the SMH outlined how record low interest rates and government stimulus have helped save the economy from the COVID-19 recession. However, the flip side to this is an explosion in the cost of federal tax concessions.

While this gives the Government something to think about ahead of the 2022/23 budget on 29 March, there is no suggestion of the concessions discussed are under immediate threat.

Figures released by Treasury show the exemption of the family home from capital gains tax (CGT) will in 2021/22 cost a record $64 billion in forgone revenue. It is a $9 billion increase on the forgone revenue estimated for 2020-21, which itself was an $8 billion increase over 2019-20.

The cost of the concessional tax rates on superannuation climbed by $13.5 billion to a record $43.1 billion. The 50 per cent concession on CGT available to individual taxpayers or trusts for assets held longer than 12 months lifted by 21 per cent to cost a record $11.8 billion.

It is hardly surprising property prices and share values have soared due to the various government and Reserve Bank programs put in place to safeguard the economy amid COVID-19. That has driven the large increase in the relative value of the tax concessions around super, the family home and CGT.

The increase in the cost of the superannuation concession can be explained by:

- profit terms in the housing and share markets having more disposable liquid funds to place in superannuation
- the clear incentive for such individuals to maximise concessional (tax-deductible) superannuation contributions, including “catch up” contributions available from 1.7.2018
- Maximising these contributions can lower and, in some cases, eliminate the capital gain tax.

COVID-19 has delivered the largest budget deficits on record. After an $85.3 billion shortfall in 2019-20, it increased to $134.2 billion last financial year and is forecast to edge down to $99.2 billion in 2021-22.

Gross government debt is at $859 billion and is forecast to exceed $1 trillion by the decade.

As always, preparing a Federal Budget is a delicate balancing act, especially with the challenges of COVID-19 and a looming Federal Election.

SUPPORT INVESTMENT AND JOBS

On 10.2.2022, the Morrison Government introduced legislation to create Australia’s first Patent Box to drive more investment, create more jobs and back Australian companies to commercialise their cutting-edge innovations in Australia.

Under Treasury Laws Amendment (Tax Concession for Australian Medical Innovations) Bill 2022, income earned from new patents that have been developed in Australia will only be taxed at a concessional rate of 17 per cent.

The Patent Box is a part of the Government’s economic plan, announced as part of the 2021-22 Budget. It will increase investment by incentivising innovative Australian businesses to commercialise their research and development in Australia.

This new concession, provided through Australia’s patent box regime, will support research and development for decades to come, as well as help retains Australian innovations in Australia during commercialisation. It complements the Government’s additional $2 billion investment in the Research and Development Tax Incentive announced in the 2020-21 Budget.

GETTING IT RIGHT FOR SUPER

Paying super is an integral part of being an employer. While most employers do their best to keep up with paying employees super, things don’t always go to plan.

If you missed or didn’t pay the total amount of your employees’ super guarantee (SG) for the quarter ended 31 December 2021, you’ll need to:

- lodge a *Super Guarantee Charge Statement* to the ATO by 28 February 2022
- pay the SG charge to the ATO.

By law, the ATO cannot extend the due date to pay SG.

How you calculate the SG charge is also different from how much SG you pay to your employees’ funds. The SG charge is calculated on an employee’s total salary and wages (including overtime and some allowances) and includes interest and an administration fee of $20 per employee per quarter.

Even if you can’t pay the full amount, you should still lodge an SG charge statement by the due date to avoid a late lodgement penalty. The ATO will work with you to find a solution tailored to your situation.

ADDITIONAL SUPERANNUATION GUARANTEE CHARGE (SGC)

PS LA 2021/3 – Remission Of Additional Superannuation Guarantee Charge (SGC)

In what are very trying times, some employers place payment of employees’ statutory superannuation well down the list of priorities. The SGC becomes payable if you fail to pay employees within 28 days of the close of a relevant quarter. It includes the shortfall, a 10% admin fee and nominal interest. The SGC and the severe penalties discussed below are not tax-deductible which worsens matters. It all can become a costly exercise, which employers must consider when deciding whether to make payments on time.

When an employer is liable to pay the superannuation guarantee charge (SGC) for a quarter, a penalty ('Part 7 penalty') is payable in addition to the SGC. Generally speaking, The Part 7 penalty equals double the SGC payable by the employer for the quarter (i.e., an additional 200% of the SGC amount).

PS LA 2021/3 provides guidance on the factors ATO staff consider when deciding how much the Part 7 penalty should be remitted. ATO staff must follow the four-step penalty remission process when deciding whether it is appropriate to remit the Part 7 penalty down from 200%. Matters for consideration include the employer's attempts to comply with their payment and lodgement obligations, their general compliance history, and any other mitigation facts or circumstances.

A one-off amnesty was provided for employers who voluntarily disclosed SGC liabilities for quarters from 1.7.1992 to 31.3.2018 ('historical quarters'). As part of the amnesty, no Part 7 penalty was imposed for employers who voluntarily disclosed during the amnesty period, ending on 7.9.2020. Where a historical quarter is assessed for SGC **after** 7.9.2020, ATO staff generally cannot remit the Part 7 penalty below 100% of the SGC **unless** the employer voluntarily came forward to lodge a superannuation guarantee statement before being notified of ATO compliance action. There must be exceptional circumstances for any prospect of remission of penalties.

SUPPORT FOR FIRST HOME BUYERS AND SUPERANNUATION MEASURES

On 10.2.2022, the Federal Government passed through the Parliament the *Treasury Laws Amendment (Enhancing Superannuation Outcomes For Australians and Helping Australian Businesses Invest) Bill 2021*, which will allow businesses to continue investing in their future and help Australians get into their own home.

The passage of the Bill will help more Australians own their first home by increasing the maximum amount of voluntary contributions that could be released under the First Home Super Saver Scheme (FHSSS) from $30,000 to $50,000. Since 1 July 2018, 26,800 new home buyers have released $371 million worth of savings under the FHSSS.

The Bill will also increase the flexibility for older Australians to contribute to their superannuation by reducing the eligibility age for making downsizer contributions into superannuation from 65 to 60 years of age. This will allow more older Australians to consider downsizing to homes that better meet their needs, increasing the supply of larger homes for young families. From 1 July 2018 to the end of January 2022, 36,800 individuals have contributed $8.9 billion to their superannuation under this measure.

The passage of the Bill will also extend the Government's temporary full expensing regime by 12 months to 30 June 2023 to further support businesses to invest, grow and create more jobs.

The temporary full expensing measure announced in the 2020-21 Budget allows businesses with an aggregated turnover of less than $5 billion to deduct the full cost of eligible depreciable assets in the year they are first used or installed. This measure applies to over 99 per cent of businesses, employing approximately 11.5 million workers.

The Government's unprecedented business investment incentives will provide businesses more than $50 billion in tax relief and support around $320 billion worth of investment. This has seen a significant upgrade in the investment outlook, with new business investment forecast to increase 16 per cent over the next two years at its fastest rate since 2011-12 during the height of the mining investment boom.

LEGISLATION TO ENHANCE THE SUPERANNUATION SYSTEM

On 10.2.2022, the Federal Government passed through the Parliament the *Treasury Laws Amendment (Enhancing Superannuation Outcomes For Australians and Helping Australian Businesses Invest) Bill 2021*, which will ensure superannuation continues to work in the best financial interests of all Australians.

The passage of the Bill will provide more flexibility for families and individuals preparing for retirement by allowing individuals aged between 67 and 75 to make non-concessional superannuation contributions under the bring-forward rule. The legislation also supports the repeal of the work test for non-concessional and salary sacrificed contributions made by individuals aged between 67 and 75.

The Bill also delivers on a key commitment in the 2021-22 Women's Budget Statement by removing the $450 per month income threshold under which employees do not have to be paid the superannuation guarantee by their employer. This will remove an outdated structural feature of the superannuation system and, in doing so, will improve equity in the system.

These superannuation measures will take effect from 1 July 2022.

The Bill will also reduce costs and simplify reporting for superannuation funds by allowing trustees to use their preferred method of calculating exempt current pension income where the fund is fully in the retirement phase for part of the income year but not for the entire income year. This measure will apply for the 2021-22 income year onwards.

The Bill and explanatory material are available on the Parliament of Australia website.

INABILITY TO CLAIM DEDUCTION FOR PERSONAL SUPER CONTRIBUTIONS

Khanna v Coft – No Deduction for Personal Super Contribution – Taxpayer Gave Fund S290-170 Notice Over 1 Year Late

In this AAT case, a taxpayer was unable to claim a deduction for personal super contributions as he was over a year late in giving the required notice to his super fund. To claim a deduction, you need to have given the fund a notice of the amount you wish to deduct and got the fund's written confirmation. The notice has to be given by the earlier of when you lodge your return, or 30 June the following year. If you have not given the notice, matters cannot be rectified after you have lodged your tax return.

Those on tax agent lodgement programs often lodge their tax returns late in the following year. So, failure to attend to this matter can have serious consequences with ripple effects through your superannuation account, the distinction between concession and non-concessional contributions and the $1.7 million limit for tax-free earnings (to pay pensions). The key here is to carefully consider and respond to the notice as soon as you receive it. While claiming a tax deduction will be the optimal decision in most cases, this will not always be the case. In the event you have filled out the required notice automatically stating you wish to claim a tax deduction, then later find out you do not require a tax deduction, this is sometimes not easy to undo.

PATENT BOX

Following consultation, the Government has made two significant expansions to the patent box:

- allowing patents issued by the United States Patent and Trademark Office or granted under the European Patent Convention to access the regime; and
- allowing patents granted after Budget night to be eligible, rather than only those applied for after Budget night.

Patents must link to a therapeutic good entered in the Australian Register of Therapeutic Goods to ensure the patent box concessions are targeted towards relevant medical inventions. In line with internationally accepted standards and best practices, the legislation has been designed to comply with the principles outlined by the Organisation for Economic Co-operation and Development. The Patent Box is part of the Federal Government's economic plan to drive more investment and create more jobs.

bO2 READERS' QUESTIONS AND ANSWERS

Question 1: CGT 15-Year Exemption

Hi, this is a CGT query and whether the respective "partners" are entitled to use the small business 15-year CGT exemption and/or contribute the assessable gain into their respective super funds to gain CGT exemption.

The respective "partners", say A & B via partner A's family trust and B via his private company, each hold 50% of the units in a trading unit trust.

The unit trust operates a stock and real estate agent business and personally utilises sale yards owned by A & B (leasehold property in the ACT).

The rates and taxes relating to the sale yards are paid for by the Unit Trust agency business.

The leasehold property that A & B has "owned" for over 15 years was recently sold to another party for different purposes. So not as a going concern. GST has been charged on the transaction.

The net "gain" on the sale is around $680,000... i.e., $340k each before discount.

I'm assuming that A's net assets, including the share of the Unit Trust and his family trust, would have to be less than $6m. B's share of the Unit Trust and his family company would also have to be less than $6m for each of them to qualify for the small business test and associated CGT exemption...although if one fails the test...this won't impact the other?

Answer

We will confine ourselves to general comments with the strong recommendation you get a legal opinion.

First, the active asset test has to be met – In this case, the sales yard was used exclusively by this business for at least 7.5 years which is a requirement.

If it derived rental income from third parties, then that is an issue.

To establish they were affiliates – you should be able to establish A and B (or immediate family members) were both "significant individuals" of the relevant discretionary trust at the time of sale.

Finally, we confirm the $6 million tests must be met as outlined. If the business turned over less than $2 million per annum, then the $6 million net asset test does not need to be met.

Given we are dealing with a unit trust, CGT event 4 must be considered. In cases such as this, the CGT Small Business Retirement Concession may overcome this.

Question 2: Calculating CGT Liabilities

Can I please get your assistance in this complex matter as my client is considering selling a property he acquired from his father?

In this case, my client, the son, entered an agreement with his father to be added on to his father's principal residency property "title" back in 2011 for $130,000. My client already owned another property at the time, therefore ruling out principal residency exemptions. My client and his father became joint title holders of that property, and the son needed to be on that title to help his dad out with finance.

The value of that property in 2011 was around $220,000.

In 2019, my client bought the property off his father for a further $95,000 and became the sole title holder. As my client owns other property, it still wouldn't be his sole principal residency. The value of the property in 2019 was $360,000.

My client is considering selling that property, and the value has risen to $500,000.

His father bought the house back in 2007 for $195,000.

My two questions are:

Will my client be liable for CGT? I'm guessing he would be, and secondly, how would we calculate it, seeing he was part owner and then became 100% owner?

I would kindly appreciate your help with this to advise correctly.

Answer

We confine our comments to your client's circumstances (the son).

His cost base is as follows:	
2011	$130k
2019	$ 90
Other	$ 30
Total	$ 250k

The other $30k is for purchase and selling costs, but there may be third element additions to the cost base for renovations etc.

If the property is sold for $500k, there is a potential $250k capital gain to consider.

After the application of the 50% discount, $125k remains.

After checking for capital losses, you should check online whether your client can make catch up superannuation contributions.

This could wipe out most capital gain, but we acknowledge the 15% contributions tax.

Question 3: Rural Property - Future Set Up

I intend to purchase 200 acres of rural residential property within two years. Hopefully, the family will sell it off in 20 acre lots in 10 – 15 years.

My idea is to register Ltd Company to our discretionary trust- holding seven-way membership – 10% self, 20% each for my son and daughter and 12.5% each for 4 X grandchildren.

What is the best advice you can give (tax and future for leaving set up for family)? My date of birth is 7.09.37.

Answer:

This sounds like a passive land holding that will not conduct business.

If you want to be certain that each child/grandchild will receive their designated share of the eventual proceeds, it sounds like a company trustee for a unit trust may be necessary.

Question 4: Cost Base Calculation

A married couple purchased a house in Carlton for $481,750 (incl. stamp duty)

On 10/8/2000, this house was their PPR until 10/8/2010. At that time, they sold a 65% share of the Carlton property to their son and his partner for $550,000.

The married couple purchased another property that became their new PPR, which they are still living in. I presume there are no capital gains on the 65% sale transaction.

The son and partner then made this property their PPR.

In November 2020, the Carlton property was sold for $2,388,000 and the agents/legal

Fees were $34,006, making the net sale $2,353,994.

As the married couple only owned 35% of their net proceeds would be $823,988

The married couple spent $145,751 on capital improvements, two-storey extensions etc.

The son and partner paid $53,625 stamp duty on 65% of the market value of the property as at 10/8/20.

According to the council rates and the stamp duty calculator, the market value for the property at the date of sale (10/8/20) was valued at $1,500,000.

What is the cost base for the married couple who owned 35% at the date of sale? (10/8/20)

Answer

The preferred cost base for the married couple is:

Market value at 10.8.2010 35% of $1,500,000 $525,000

The capital improvements are not included because this has already been considered in determining market value.

The total of 35% of the purchase cost…$168,612 plus 35% of the capital improvements being $51,013 gives a cost base of $219,625.

Far better to go with market value.

This assumes there is reliable, objective and independent evidence of the market value being $1.5 million at 10.8.2010.

As the parties to the transaction were associated, OSR Victoria likely determined the market value for stamp duty purposes at 10.8.2010, which should be sufficient evidence.

Question 5: Self-Education Costs

I have a quick question. Can international students on a student visa claim self-education costs or only when their visa status changes to temporary or permanent?

My client has been told by her friends that she can claim her fees, and I said no because she is not working as a nurse, only a personal carer.

Only when she starts working as a nurse can she claim? Please help to explain this.

Answer

You are correct - the studies must directly relate to her current employment.

If their studies are more expansive, as is the case here, there must be the probability that the studies lead to an increase in earnings.

The full facts must be examined: are we dealing with a full-time student who has a part-time, casual position to fund her studies?

If this were the case, the self-education expenditure would be highly unlikely to meet the test and be tax-deductible.

Question 6: Medicare Surcharge

A client has a Medicare levy exemption for 339 days. Being a foreign resident and not entitled to Medicare.

His taxable income is $190,000 for the whole year. He has no private health insurance.

Is he liable for the Medicare levy surcharge?

Answer

If he is subject to the Medicare levy for only 26 days, the same should apply to the Medicare levy surcharge – it should be apportioned.

Question 7: Distribution to Beneficiaries

Family Trust has a Profit of $ 13,824 + Capital Gain $ 4,728 = $ 18,552

Less Cash Flow Boost Non-Accessible ($ 18,908) = ($ 356) L. The Gain is subject to a 50% Discount.

As there is a loss, is there no distribution to Beneficiaries? Or do I have to remove the Gain from the equation and distribute the Gain to the Beneficiaries?

Answer

You are correct – there is no trust distribution for tax purposes.

We take it you have already applied the 50% discount to your calculations.

Question 8: Rural Property Sale/Purchase

Rural property “Carrol” purchased by my father 1924, left to my mother, brother and me not know by me 1976 – left to my two sisters by mother 1983, handled by a solicitor.

I purchased from sister 2002- for $82,000. I am selling the property now – $1.5 mil.

As it has been from one family member to another, are there any capital gains tax or stamp duty issues?

Answer

Given the change in beneficial ownership when you acquired the property, there is no doubt that the property is subject to Capital Gains Tax (CGT).

As you have held the property for longer than 12 months, a 50% reduction applies, meaning only half the capital gain will be assessable.

There are also some further possible exemptions:

1. The principal place of residence exemption if you have lived in the property – the value of the dwelling and the surrounding 5 acres may be exempt from CGT.
2. If the land was used in farming or any associated business for at least 7.5 years in the period of ownership, allowing it to qualify as an active asset, it is also possible that the CGT Small Business Concessions may apply. This could reduce the capital gain by at least 75%, with the possibility of the capital gain being eliminated.

Question 9: Tax Position – Family Trust

I have a client who has a discretionary family trust that owns a large share portfolio that generates fully franked dividends each year.

No Family Tax Election (FTE) has been prepared or lodged. The two beneficiaries are husband and wife.

Since the 2011 financial year, I have allocated $50000 of fully franked income to their wife.

The ATO has issued Notices of Assessment each year, allowing the franking credits in full with no queries.

I just recently became aware that the franking credits above the $5000 exemption may not be claimed unless there is an FTE in place.

I intend to lodge the due 20/21 wife's income tax return soon in the same way as in earlier years.

Can you explain the tax position here for me and what options I have from now on to deal with this matter?

Can I prepare the FTE dated 2 July 2011 (for the 10/11 and subsequent financial years) and merely file it with the work papers and Permanent Document File and not lodge it with the 20/21 coming tax return? Or should I lodge it in the 20/21 next to be lodged trust estate tax return? (I do not want to alert the ATO to a problem if possible?)

Answer

As long as distributions have been in the "family group," it may not be the problem you think.

It would appear that only the husband and wife may have been the only beneficiaries – if this is the case, you can still make an effective FTE.

The income year specified in the FTE must have ended before the FTE is made. An FTE can only be made if the trust passes the family control test at the end of the specified income year.

The FTE can specify an earlier income year from when the election is to commence, provided that from the beginning of the specified income year until 30 June of the income year immediately preceding that in which the election is made, both:

- The trust passes the family control test.
- Any conferrals of present entitlement to income or capital during the period, or actual distributions of such amounts, have been made to the specified individual or members of their family group.

Question 10: Deceased Estate

The company has one shareholder who passed away on 4.6.2018. The shareholder was changed from the deceased to a shareholder, being one of the beneficiaries.

On the advice given, a dividend was declared 26.6.2020 and paid to the Estate 6.8.2020. At the same time, the Estate paid 30% and 40% of the dividend to 2 beneficiaries, and the three beneficiaries left the money in the Estate bank account.

The will state distributions by way of dividends or capital nature to the beneficiaries 40%, 30% and 30%. The beneficiaries decided to change the distribution percentage with a mutual agreement between them.

Is this valid, or do they need a deed of family arrangement?

Estate ITR stated no beneficiaries entitled, and the Estate paid tax. This was done for the Estate to receive concessional income tax treatment.

A further dividend was declared 1.7.2020 by the company and paid 6.10.2020 to the Estate. In the same procedure, two beneficiaries received the distribution from the Estate; the 3rd left his share in the Estate bank account.

As this is the fourth year, the Estate ITR has two beneficiaries receiving the distribution from the Estate; the 3rd beneficiary is entitled to the distribution but decided to leave his share of the distribution in the Estate's bank account.

Does this mean he has no present entitlement? And the Estate pays the tax for him until such time he decides to take the "money".

The Estate is going to pay tax on the 3rd share; the other beneficiaries' distribution is included in their personal ITR.

As mentioned, the company has one shareholder (beneficiaries). When should the company transfer the shares to the Estate, maybe wind up the company?

The deceased shareholder of the company is still the owner of the shares and, in his will states - the shares to be transferred to the Estate. The director/ secretary is acting in his capacity as executor (one of the beneficiaries). If the value of the shares is transferred from the company to the Estate, can the Estate pay out the capital proceeds tax-free to the beneficiaries? Provided the will does not state the beneficiaries have an absolute and indefeasible interest in the capital or income of the Estate.

What are the tax implications? I understand Deceased Estate is very complicated, and your advice would be greatly appreciated.

Answer

It is assumed this beneficiary is a person acting in their capacity as the executor of the Estate.

Regarding the advice, you were given. This can represent a payment of corpus to the beneficiaries with no tax implications as the Estate has already paid the tax.

We agree that this makes sense as for the first three tax returns the Estate lodges, the individual tax-free threshold is available, and the trust is then further taxed at individual marginal rates.

Do they need a deed of family arrangement? You may wish to get legal advice on that, but there should be no problems if a mutual agreement exists.

Purely from a taxation perspective, as long as the correct amount of tax has been paid, these private arrangements are unlikely to concern the Commissioner.

Present entitlement can arise when a valid trust distribution is made by way of a minute prior to 30 June in the relevant tax year - a present entitlement may exist when the trust has booked the distribution by way of a loan account.

We need to be clear that the company has a separate legal identity from the deceased and has its own tax issues. How do you deal with the funds in the company when making payments to the Estate?

- By way of dividend to the estate for the amounts representing retained earnings (franked or unfranked)
- Did the company owe the deceased money by way of a loan account? This is now an asset of the Estate and is a tax-effective way of getting money out of the company by repayment of the loan.
- Are any of the company shares pre- CGT (20.9.1985)? We have already mentioned the Archer Bros principle

Yes, some payments will be tax-free as income retains its character as it flows through a trust, e.g., franked dividends or capital loan repayments as above. It depends on the source of the funds and whether the trustee has already paid the tax liability.

Of course, a member's voluntary liquidation will need to be done for this company.

We are now in the fourth year of the Estate, and below is the relevant tax table to assist you as to the most tax advantageous path to take. This will depend on the beneficiaries' individual tax circumstances – for tax minimisation and also establish whether the company has significant pre-CGT assets and consider the possible application of the Archer Bros Principal. (Refer to tax tip #66-page 28 issue #0115)

There is an effective choice – if a valid trust distribution has been made, there can be a present entitlement. If he does not wish to take the money and pay the tax, then the trustee can pay the tax on his behalf – of course, the actual payment must be debited to his total entitlement under the will.

The following tax rates apply for deceased estates that continue to be administered beyond the third income year.

Deceased estate taxable income (no present entitlement)	Tax rates 2020–21 and 2021–22
\$0 – \$416	Nil
\$417 – \$670	50% of the excess over \$416
\$671 – \$45,000	\$127.30 plus 19% of the excess over \$670 If the deceased estate taxable income exceeds \$670, the entire amount from \$0 will be taxed at the rate of 19%
\$45,001 – \$120,000	\$8,550 plus 32.5 cents for each \$1 over \$45,000
\$120,001 – \$180,000	\$32,925 plus 37 cents for each \$1 over \$120,000
\$180,001 and over	\$55,125 plus 45 cents for each \$1 over \$180,000

Question 11: Personal Services Income

We are a member of your service, and I have a question regarding the attribution of PSI. The PSE is not a PSB, and the attribution rules apply.

If the PSE is a company or a trust, do the payments made to the personal services provider have to be classified as "salary and wages"? Or can it then be accounted for as dividends or trust distributions?

I have reviewed many publications, articles, ATO rulings on PSI; however, I cannot find anything that stipulates the payments must be "salary and wages".

Income tax is not an issue as 100% is payable by the personal services provider. I am only considering the classification of the amounts attributed to him.

I have a client GP who has been required to operate out of a company/trust and can no longer operate as a sole trader. They do not wish to pay SGC or workers' compensation on their income, and hence I'm looking at ways to achieve this.

Answer

As you correctly state, the attribution rules apply.

Therefore, you will be correctly attributing all of the entity's income to the Doctor.

We refer you to old taxation ruling IT 2503 and paras 5-7 where they suggest a bona fide attempt should be made for a medical practice company to "break even."

They mention this should be done by payment of salary and wages.

The ATO's concerns have included using the lower company tax rate to defer or avoid higher personal income tax.

Another concern is that personal services income is alienated from other family members.

In practice, if:
There is a company that pays a fully franked dividend to the Doctor the following year after payment of company tax. The ATO may take exception to this as there has been a deferment of tax.

Paying a director's fee in the year of income without PAYG, which does sometimes occur, is certainly not best practice and frowned upon by the ATO. In any case, if it is a director's fee, it is subject to statutory superannuation (10%).

However, in a trust structure, 100% of the income could be distributed to the Doctor by way of distribution. Here there has been no deferment or alienation of income. This would be extremely unlikely to attract ATO attention. Your client should consider whether they have adequate work cover insurance.

Question 12: Sale of Rental Property

I'm in the process of preparing to sell a rental property and over the years have been claiming depreciation on the building and plant and equipment. It would appear that I need a clause in the sale contract to specify how much of the sales proceeds relate to buildings and plant and equipment in order to calculate a balancing adjustment on these items on disposal.

I need to clarify. For the rental property I am selling I need to dispose the building and Plant and Equipment WDV (written Down Value) in the Depreciation schedule.

How do I determine the sale proceeds for these items to determine a profit/ loss on disposal?

What I am trying to do is have a consideration equal to the WDV of the building and Plant and fixtures so there is no profit and loss on disposal in the depreciation schedule. Hence the reason for the clause. This is really to protect my own interests and minimise tax. This is totally independent from the CGT calculation.

Could you please assist me with a standard clause?

Is there anything else I need to include in the sale contract as I will be liable for capital gains tax on the property? Note I do not have an ABN.

Answer

Balancing adjustments have not been used for some years and they do not serve your best interests.

Since 1.7.1997 any depreciation and/or capital allowance claimed as a tax deduction reduces the cost base of the asset for CGT calculation purposes.

The purchaser is not likely to be interested in a value for claiming depreciation because although they can claim the building capital allowance (2.5%) … they cannot claim any depreciation on fixtures and fittings on pre-owned residential properties.

In the event this is a commercial property and there is separate movable plant and equipment, then scrap this to get the full tax deduction.

In the event the purchaser may want this plant, take legal advice as to its inclusion on the contract.

Although the cost base is diminished by tax deductions, it's still advantageous as individuals being assessed on capital gains have a 50% discount on that capital gain if they have held the asset for longer than 12 months.

With respect, this is not independent of the CGT calculation as the depreciation written off to date along with the Div 43 capital allowance (2.5%) reduces the cost base for CGT calculation purposes.

There will be no contention with the buyers as their accountants will be make it clear to them, that no depreciation claims are available on second hand property on the fixtures and fittings.

With regards to the Div 43 capital allowance, they will continue to claim the 2.5% per annum based either on your Quantity Surveyor's schedule or one they commission.

Question 13: Company Tax Return

The proprietary company (A) is a sole shareholder of another company (B), which runs a retail business.

Company A does not run the business but will receive the dividend from company B in future if B has a profit to distribute. There is no plan for company A to run other business or to earn other income other than future dividends.

Company A has two shareholders, who are the trustee company of two separate trusts.

(i) Company A has a ACN and TFN, however no ABN was applied for yet.

Would you please advise whether ABN is required for the company A in above circumstance?

If yes or no, please provide the link for the information to support it.

(ii) Should we still need to lodge the Company tax return as nil for company A (without ABN) although no dividend was received and no other income during the financial period?

Please note that company A has a TFN but no ABN.

Answer

If company A is not conducting business but is merely a passive investment entity, holding company then there is no need for an ABN as it is not conducting business.

You can lodge a nil return or a "return not necessary" for company A.

Question 14: Division 7a Loan Agreement

A company makes a loan to an associate. Where there is a complying Div 7A loan agreement is the interest expense to the associate tax deductible?

Answer

The fundamental test for deductibility of interest as consistently applied by the Courts is the "use" test... meaning to the use to which the funds have been put.

If the associate has used the funds for personal expenses, then of course a tax deduction cannot be claimed.

If however he has used the funds to fund another business or acquire an income producing asset, then there is the possibility of claiming a tax deduction.

Question 15: Is This Payment Tax-Free?

A client has terminated two builder employees as the next stage of the development is being outsourced to a contracted building company.

One employee was on a fixed-term contract which ended.

The other began with the company on 23/11/15, and the final date is 31/3/2022. This entitles him to pro-rata Long Service Leave.

The company is part of a group with less than 15 employees.

Under the Building and Construction Award 2010, a specific severance/redundancy scheme pays out 8 weeks' pay for 4 or more years of service. Is this payment tax-free? I have had 2 different answers from the ATO using BAS agent number

I understand the other tax treatment of unused annual leave and unused LSL. I need some help.

Answer

From 1.10.2020 The Building Industry Redundancy Scheme Trust (BIRST) has made changes that see most employees terminated by their employer due to genuine redundancy receive their BIRST payment largely tax free provided they are below pension age.

These changes involved amendments to the BIRST trust deed.

This sounds like a genuine bona fide redundancy and the tax-free limit for 2021-22 is $11,341 plus $5,672 for each year of service.

The fact there is less than 15 employees is not relevant in this instance.

Question 16: Div 7a Loans and Deceased Estate

Late in 2020 we were engaged by new clients, a family of three siblings whose mother had recently passed away, to perform their accounting and taxation work.

Their Father had passed away a few years earlier and consequently they inherited various property investment companies. A number of these Companies had Division 7A loans owing, amounting to a substantial sum. Their previous Melbourne Accountant was not forthcoming in providing us with Div 7A Loan principal and interest repayment Schedules, and therefore we have had to reconstruct these various balances. In doing so we find the deceased mother's Div 7A Loan still exists on the Balance Sheet as at 30th June 2020.

Our question to you is how do we treat Div 7A Loans relating to the deceased? Are these loans simply forgiven or do they just sit on the balance sheet? If not, are they taken over by their siblings who have to meet ongoing principal and interest repayments?

Answer

I would be getting them off the balance sheet.

The ideal situation would be that the Estate repays the loan.

If they are unable or unwilling to do so, then I would not forgive the loan but write it off as a bad debt being a capital loss.

It is on capital account because clearly the company was not in the business of money lending.

The journal would be:

Dr	Capital Loss (Share capital accounts)	XXXX
Cr	Loan	XXXX

We do not believe the deceased estate can be burdened with deemed dividends because:

- The entity to whom the private company is taken to have paid the dividend must be the same entity to whom the private company made the amalgamated loan.

Therefore, for subsection 109E(1) to apply, the private company must have made the loan to the executor of the deceased estate.

Accordingly, as the private company made the loan to the shareholder, the executor of the shareholder's deceased estate is not treated as having received a deemed dividend in respect of the amalgamated loan.

This interpretation is contained in ATO I.D. 2002/741.

Your Notes

Michael's Corner

Article No.016
DEALING WITH DIFFICULT BEHAVIOURS

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DEALING WITH DIFFICULT BEHAVIOURS

While HR departments are integral to scoping out values and giving examples of the types of behaviour welcomed by an organisation, too often, they aren't the first port of call if things do go wrong. When a rogue employee is up to no good in an organisation, it will typically be their direct line manager who hears about it first. How they react can prevent wrongdoing from becoming culturally embedded.

Broadly speaking, culture is the glue that binds staff to their employer and guides their actions when hard-and-fast rules are ambiguous, insufficient, or absent. When it doesn't work, you've got a problem. Things get ingrained in the culture at every level, from how you pay people, how you promote people, how you recognise them.

You can push values and encourage people to behave in a certain way, but if values are not linked to behaviour, and you're not walking the walk, they won't have any impact. The result of cultural shortcomings isn't always criminality or misconduct. Often, incompetence and confusion can be every bit as damaging – and the road to recovery just as harrowing.

What are difficult behaviours?

- Aggression/violence
- Passive aggression
- Forceful refusal to co-operate
- Harassment (bullying, racism, stalking)
- Mental health – irrational behaviour
- Alcohol and drug abuse

Other challenging behaviours include:

- Anything that causes offence or distress
- Is life-threatening
- Threatens the emotional well-being of others
- Does not comply with organisational policy or procedure

LIKE IT OR NOT, TOUGH TALKS IN THE WORKPLACE CANNOT BE AVOIDED.

Here are some ways you can prepare for the inevitable:

We have all had these thoughts at some time, like "I don't want to make any waves" or "It was only a minor thing" to avoid confrontation in the workplace.

These are just a few reasons why we don't speak up. None of us enjoys having an uncomfortable conversation. We find it both stressful and difficult to give or receive negative information.

If it's so uncomfortable having hard conversations, why not just avoid them? Because, unless it's a minor matter, the problem doesn't just go away. It festers.

Here are six basic communications tactics to use when dealing with difficult behaviours:

1. Don't react in anger. Express your feelings in a clear and non-threatening way. Creating an open, receptive environment reduces the chances of escalating the conflict.
2. Be specific when describing the offending situation. Just say what you saw or what you heard. But don't state any assumptions about intention. This limits the odds of the person responding defensively.
3. Explain how the situation has affected you. Often people don't ask or even consider how others are affected by their behaviour, so addressing this directly can help people see some of the consequences of their behaviour.
4. Ask what they were thinking at the time of the offending action and how the situation makes them feel. Aim for direct answers. Get clarification if needed. Understanding their point of view is the best way to learn how to work with them.
5. Acknowledge your contribution to the situation. Accepting your share of the responsibility takes away the blame and establishes an even ground.
6. Invite the other person to work with you to improve the situation. This takes the individual off the hot seat and gives them the power to make a change for the better.

In summary, the importance of "focus."

Focus on the most important issue you want to address, avoiding all else. Sometimes this can feel like you are tiptoeing around, so it's important to keep it simple and clear. Here is a guideline for keeping the conversation on topic and ensuring that you say what you need to:

Maintain personal ownership of the problem. When you're upset and frustrated, it's important to recognise that this is your problem, not the other person's. You may feel that your boss or co-worker is the source, but resolving your frustration is your immediate concern. Effective conflict resolution requires accountability for our own actions and feelings.

Succinctly describe your problem in terms of behaviours, consequences, and feelings. A useful model for remembering how to state your concern effectively is: "I have a problem. When you do X, the result is Y, and I feel Z".

Encourage a two-way discussion. It's important to establish a problem-solving climate by inviting the respondent to express their opinions and ask questions. There may be a reasonable explanation for another person's disturbing behaviour. As a rule of thumb, the longer the initiator's opening statement, the longer it will take the two parties to work through their problem.

Manage the schedule. Approach multiple or complex problems incrementally. This is one way of shortening your opening statement. Rather than raising a series of issues all at once, focus initially on a simple or rudimentary problem. Then, as you better appreciate the other party's perspective and share some problem-solving success, you can discuss more challenging issues.

Focus on commonalities as the basis for requesting a change. Most disputants share at least some personal and organisational goals, believe in many of the same fundamental management principles, and operate under similar constraints. These commonalities can serve as a useful starting point for generating solutions.

Give some consideration to the source of your concern. What caused your concern in the first place? If it's personal differences, then address perceptions and expectations. If it's information deficiencies, address misinformation and misrepresentation. If it's role incompatibility, define goals and responsibilities. Or, if it's environmental stress, consider resource scarcity and uncertainty.

Special Issue

CAPITAL GAINS TAX MINIMISATION STRATEGIES 2022

WHAT'S NEW IN 2022?

In the absence of any significant changes to CGT legislation in the last 12 months, we focus on CGT implications departing or returning ex-pats and those becoming Australian tax residents for the first time. This is considered in light of the proposed new residency tests. We examine possibilities for Australians departing to live overseas. We also consider the CGT implications of cryptocurrency sales.

The CGT implications of granny flat arrangements are examined in detail. The Victorian windfall gains tax is also covered.

We also cover in detail the Greensill case, which deals with distributions of taxable capital gains to non-beneficiaries.

LOWERING CAPITAL GAINS TAX

1. Do all you can to preserve your main residence exemption. See Issue #0113- pages 30,34,39.
2. Be aware of the Main Residence 6-year temporary absence. See pages 53,59 of our annual publication.
3. Some people engage in D.I.Y. home renovations to enhance the value of a CGT Exempt Asset, i.e., their main residence then sells for a profit. Note they cannot keep doing this continually.
4. Focus on Superannuation for wealth accumulation. Assets held in a Super Fund for longer than 12 months generally attracts eventual Capital Gains Tax of only 10% on disposal.
5. Assets in a super fund in the pension phase have no tax on earnings or capital gains – see Tax Tip #101-page 33 Issue #115.
6. If this is a viable option, accept shares out of a deceased estate instead of having the Executor liquidate them. This defers the taxing point when you sell them.
7. Fully utilise the CGT small business concessions. See article pages 53-54 of our annual publication.
8. If there are only several parties to a venture, consider using a partnership of Discretionary Trusts used exclusively for that venture. This overcomes capital gains tax event E4, which applies to Unit Trusts.
9. Get the timing right. The key date for CGT events is usually the signing of the contract, so be aware of this for the 50% individual discount. If you have a choice, consider deferring the CGT Event into the next tax year.
10. See 'Halving Tax on Shares' Tax Tip #55-page 27, Issue #0115. This means ceasing to hold shares as trading stock even though you continue to own them.
11. If you are not receiving employer superannuation contributions, it may be possible to reduce capital gain tax by making concessional contributions into a complying super fund.
12. Win the capital versus income argument by careful planning, i.e., if you engage in development approvals (DAs) and large subdivisions, the ATO may argue you are a developer. It may be better to simply sell to a developer. You may wish to calculate the likely receipts and tax implications of both courses of action. You should also carefully assess the business risk of being a developer. Specialist advice should be sought. Also, see pages 24,25 and 38, Issue #0113.
13. Note that Small Business Entities (SBE) turning over less than $2 million, do not have to meet the $6 million asset threshold test to access the CGT Concessions. So, if at all possible, lodge the relevant tax return as an SBE.
14. Where there is a CGT event, fully investigate whether rollover relief is available. See Tax Tip 77, pages 30, Issue #0115, and our annual publication pages 49 and 510.
15. In the wake of the Bamford decision, ensure your Trust Deed allows streaming of various classes of income. See Tax Tip #39-page 25, Issue #0115.

MARKET VALUE OF SHARES IN A PRIVATE COMPANY

Commissioner of Taxation v Miley [2017] FCA 1396

In this Federal Court case, the principles that should be applied in determining the market value of shares in a private company for the purposes of the capital gains tax (CGT) small business concessions were considered.

Those principles are:

- The broadly accepted definition of market value at general law is what a willing and knowledgeable but not anxious buyer would pay a willing and knowledgeable but not anxious seller for the shares.
- If there is no willing, knowledgeable but not anxious buyer for the shares, the valuation method involves a hypothesis that there is such a buyer. The focus is then on what a willing but not anxious seller could reasonably expect to obtain and what amount the hypothetical buyer could reasonably expect to have to pay in the event they got together and agreed on a price.
- Where the shares have been the subject of a recent arm's length sale, it is not necessary to hypothesise about a willing seller and buyer. This is provided the transaction is one between willing but not anxious parties; the price that the parties actually agreed on may generally be taken to be the market price, or at least a reliable indicator, of the market price.
- Suppose it is necessary to apply the hypothesis of a willing seller and buyer. In that case, if there is or likely to be a particular buyer who is willing to pay more for the shares than other buyers because it is in a better position to exploit the shares (for example, it is able to buy all of the issued shares of the company), that buyer should not be excluded in considering the relevant market or market value.
- It is not appropriate to apply a discount for lack of control where the terms of the sale require all of the issued shares of the company to be sold contemporaneously, and the buyer is not required to buy the shares held by one of the shareholders to the exclusion of the shares held by any other shareholder.

It is the last point that is the key issue here, and as have mentioned in past editions, people and their advisers are willing to forward any argument in order to come in under the $6 million threshold. It should be said here the taxpayer had a reasonably arguable position as the A.A.T. had found in his favour, and the Commissioner had appealed the case.

This Federal Court decision provides clarity on how the market value of an asset should be determined.

SIGNIFICANT CHANGES TO SMALL BUSINESS CGT CONCESSIONS

In 2019, legislation was passed that significantly restricts the availability of the small business CGT concessions where shares or units are being sold. It appears the changes take effect from 1.7.2017, which means that some taxpayers have already been affected retrospectively by these measures.

In the May 2017 Federal Budget, the government announced an integrity measure to ensure that the SB concessions were appropriately targeted, namely:

"The Government will amend the small business capital gains tax (CGT) concessions to ensure that the concessions can only be accessed in relation to assets used in a small business or ownership interests in a small business."

Here the focus is on situations where a taxpayer could access the SB concessions for the sale of a stake in a company or unit trust by qualifying as a CGT small business entity for an unrelated business venture. The changes are effective 1.7.2017.

New requirements for share or unit sales

Below are the four new criteria to be satisfied in order to access the SB concessions on the sale of shares or units.

The legislation repeals s 152-10(2) of the Income Tax Assessment Act 1997 (the ITAA 1997). It inserts a new s 152-10(2) in substitution. The conditions of the new subsection are:

1. A stricter active asset test.
2. If a taxpayer relies on the CGT small business entity test to qualify for the sb concessions, they must be carrying on a business just before the relevant CGT event.
3. The company or trust in which the shares or units are being sold (the object entity) must be carrying on a business just before the CGT event, and
4. The object entity must itself either satisfy the CGT small business entity test or a modified $6m maximum net asset value test.

Below we outline a comparison of key features of the new law and current law taken directly from the explanatory memoranda to the draft legislation.

New Law

To be eligible to apply the CGT small business concessions, a taxpayer must satisfy the basic conditions set out in subsection 152-10(1) in relation to the capital gain. Additional basic conditions apply for capital gains relating to shares in a company or interest in a trust. These are either the taxpayer must be a CGT concession stakeholder in the object entity, or unless the taxpayer satisfies the maximum net asset value test, the relevant CGT small business entity must have carried on a business just prior to the CGT event. The object entity must carry on a business just prior to the CGT event; and either be a CGT small business entity for the income year or satisfy the maximum net asset value test; and the shares or interests in the object entity must satisfy a modified active asset test that looks through shares in companies and interests in the trust to the activities and assets of the underlying entities.

Former Law

To be eligible to apply the CGT small business concessions, a taxpayer must satisfy the basic conditions set out in subsection 152-10(1) in relation to the capital gain. Additional basic conditions apply for capital gains relating to shares in a company or interest in a trust – the taxpayer must be a CGT concession stakeholder in the object entity, or at least an interest of 90 per cent of the taxpayer must be held by CGT concession stakeholders.

CHANGES TO SMALL BUSINESS CGT CONCESSIONS – PARTNERSHIPS

There are changes to small business capital gains tax (CGT) concessions to improve the integrity of accessing those concessions. The changes ensure that the CGT concessions are only available for capital gains arising from CGT events that relate to rights or interests that entitle an entity to income or capital of a partnership by making that entity a partner of the partnership.

If you have made a capital gain since 8 May 2018 by assigning a right or interest to the income or capital of a partnership, you will not be able to access the small business CGT concessions unless certain conditions are met.

Those who have entered into these arrangements may need to lodge announced tax returns for 2018 and 2019 in order to ensure no shortfall penalties and interest charges are applied.

AUSTRALIANS RELOCATING OVERSEAS – ISSUES TO CONSIDER

Australian residents relocating overseas or foreign residents who became Australian residents and then moved back to their home countries can trigger unexpected Australian Capital Gains Tax (CGT) issues.

Generally, the assessable income of an Australian tax resident includes income from all sources, whether in or out of Australia. In contrast, the assessable income of a foreign resident generally only includes income with an Australian source.

In the context of CGT, this means that foreign residents disregard capital gains or losses that happen in relation to a CGT asset that is not Taxable Australian Property (TAP).

Taxable Australian Property includes:

- Taxable Australian real property (TARP) – e.g., land or buildings located in Australia.
- Mining, quarrying or prospecting right to minerals, petroleum or quarry materials situated in Australia.
- An asset used in carrying on a business through an Australian permanent establishment.
- An indirect Australian real property.
- An option or right to acquire one of the above assets.

As non-TAP is a unique asset class where the ATO does not levy any CGT on it once you have left the country, a CGT event I1 is triggered when you (an Australian resident) cease your Australian tax residency.

CGT event I1

CGT event I1 occurs when an individual or company stops being an Australian resident.

Under CGT event I1, you are deemed to have disposed of your non-taxable Australian property (TAP) at the time of your departure and stop being a tax resident. Consequently, a capital gain/loss needs to be calculated and declared in your departing year Australian tax return. This is commonly referred to as the "deemed disposal rule".

For an individual taxpayer, this will occur when you no longer satisfy any of the four residency tests – the resides test, the domicile test, the 183-day test and the superannuation test. As new residency tests are being developed, this will need ongoing review as events unfold.

Under CGT Event I1, a capital gain or loss is to be calculated based on the difference between:

- The market value of the asset at the time that you become a non-resident, and
- The asset's cost base.

You make a capital gain if the market value is more than the asset cost base and a capital loss if the market value is less than the reduced cost base.

If you make a capital gain based on the deemed disposal rule, you are required to pay tax at your marginal tax rates on the unrealised capital gain. There may be a cash flow issue given there is no actual sale and no proceeds received.

The potential cash flow issue can be resolved with proper planning. You may seek professional advice to make an estimated CGT calculation for you based on the actual/estimated market value of your non-TAP at the date of your departure. Once you have established your CGT position, you have a period from the date of your departure till the lodgement date of your tax return to decide whether to take the capital gain.

There are, however, exceptions to the “deemed disposal rule”:

- A capital gain or loss is disregarded if the asset was acquired before 20.9.1985 – when CGT was introduced.
- If the taxpayer is an individual, they may choose to disregard the capital gain or loss. This will be evident from whether the capital gain is included or excluded in the relevant tax return.

As an individual, you have a choice to disregard the capital gain or loss which would otherwise arise. This choice applies to all relevant CGT assets – you cannot pick or choose which assets to include.

If this choice is made, the assets are taken to be TAP until you dispose of the asset or you become an Australian resident upon repatriation. This means the assets are kept within the Australian tax system.

The result of deeming a CGT asset to be TAP is that disposal while non-resident will be taxed in Australia even if you are no longer a resident for tax purposes.

Elsewhere we have covered the CGT discount rules from 8.5.2012. From this date, when you dispose of TAP while you are a non-resident, you are no longer entitled to receive the full CGT discount (50%) for a capital gain that would have arisen from the disposal under CGT event I1. For CGT events that occur after 8.5.2012, a CGT discount is dependent on certain criteria, which include:

- Whether the CGT asset was held before or after 8 May 2012.
- The number of days foreign residents had a period of Australian residency;
- The number of days Australian residents had a period of foreign residency.

These are choices that should not be made lightly.

Note that there are special rules for the UK and USA involving Double Tax Agreements (DTA) Article 13 (Alienation of property) of the DTA between Australia and the United Kingdom. The DTA between Australia and the United States of America states that as long as the capital gain is taxable in the new country of residence. There is a suitable provision in the applicable DTA, and it is possible for a capital gain arising on the disposal to be only taxed in the new country of residence.

There needs to be careful thought and planning here, including cash flow, how long you are likely to be overseas, any relevant double tax agreements, the type of non-TAP you hold, and your best assessment of whether the market is going to rise or fall.

FOREIGN TAX CREDITS NOT AVAILABLE FOR DISCOUNT COMPONENT OF CAPITAL GAINS

Burton v Commissioner of Taxation [2019] FCAFC141

Australian resident taxpayers who are entitled to a 50% CGT discount on capital gains on foreign assets stand to lose up to half the benefit of the CGT discount.

Full Federal Court Decision

The Full Federal Court has reaffirmed the Federal Court’s decision to allow only 50% of the foreign income tax offset (FITO) for US tax paid on the sale of long-term investments, as only 50% of the capital gains were taxable in Australia. The problem is the FITO rules do not recognise that while both the US and Australia allow concessions on capital gains made on investments held for more than 12 months, each country has different methods in applying the concessions.

A taxpayer can claim a full credit or offset for foreign income tax paid if 100% of the income (including capital gains) is included in their Australian assessable income. However, if less than 100% of the income or capital gains are assessable in Australia, such as a 50% discounted capital gain, a credit for only the same proportion of foreign tax paid (i.e., 50%) will be allowed against the Australian tax payable.

Burton’s Case

The taxpayer was an Australian resident who owned long term investments in the US which he sold, paying US tax on the capital gains. In the US, he was entitled to concessional treatment (15%) for assets held for more than 12 months, which meant he paid tax at less than half the 35% payable if it was not a long-term investment.

As an Australian tax resident, the taxpayer was also subject to CGT in Australia on the gains from the US long term investments and entitled to the 50% CGT discount resulting in 50% of the capital gain being included in the taxpayer’s assessable income and taxed at his marginal tax rate.

In his tax return, the taxpayer claimed the whole of the US tax paid as a credit against his Australian income tax. However, the ATO allowed only 50% of the US tax paid to be counted toward the FITO because only 50% of the net capital gain was included in the taxpayer's assessable income in Australia.

Both the Federal and Full Federal Courts carefully considered the proper interpretation of the FITO provisions, in particular s 770-10 of the ITAA 1997, which states that '……an amount of foreign tax counts toward the FITO if it is paid in respect of an amount that is all or part of an amount included in assessable income….'

The Full Federal Court held that the words of the provision were concerned with the amounts actually included in Australia's assessable income. This was made clear by the provision that determines what amounts of capital gains are included in assessable income (s102-5 ITAA 1997). Only net capital gains are included in assessable income when applying the provision. A net capital gain is calculated by reducing a capital gain by any capital losses first and then reducing the gain by the discount percentage. The effect of applying the discount percentage to the capital gain was to exclude 50% of the gain from the taxpayer's Australian assessable income. As a result, the taxpayer was entitled to a FITO only in relation to 50% of the US tax paid. This meant only half of the FITO was available to reduce the taxpayer's Australian income tax otherwise payable on the same gain.

The High Court refused special leave to appeal this decision. On 24.7.2020, the ATO released a Decision Impact Statement on this case.

Board of taxation to review CGT rollover provisions

In December 2019, the Federal Government announced the Board of Taxation was to undertake a review into Australia's system of capital gains tax rollovers and associated provisions.

The terms of reference for the review asks the Board to focus on considering practical ways to simplify existing rollovers.

The Board has been asked to report to the Government by 30 November 2020. The terms of reference can be found on the Board of Taxation's website.

CHANGES FOREIGN RESIDENT CAPITAL GAINS WITHHOLDING PAYMENTS

From 1.7.2016, a system was implemented to assist the ATO with the collection of capital gains tax from foreign residents as part of the settlement process when selling or buying real property or interests in real property in Australia.

The procedure which also applies to Australian residents is that unless one of the exceptions applies, a purchaser is required to withhold an amount (12.5% formerly 10%) of the purchase price from the seller and pay it to the ATO (withholding payment). As this system is aimed at the collection of capital gains tax from foreign residents, there are exceptions for sellers who are not foreign residents, subject to the parties following the correct process. Australian residents selling property are required to obtain a clearance certificate from the ATO prior to settlement.

On 9 May 2017, as part of the 2017-2018 Federal Budget, the Government announced two changes to the system – to the threshold and the withholding payment rate. The changes apply to any contracts of sale entered into on or after 1 July 2017.

The two changes to note were:

- The threshold was reduced from $2 million to $750,000 – so the regime now applies all real property disposals where the market value of the property is $750,000 and above; and
- The withholding payment rate was increased to 12.5%

TRUST STREAMING OF FRANKING CREDITS

Commissioner of Taxation v Thomas [2018] HCA 31

The High Court has confirmed the crucial issue in respect of the streaming of distributions with associated franking credits via a trust.

Streaming occurs when a trustee exercises their discretion to allocate a certain type of income to one beneficiary and another type of income to another.

This can have particularly beneficial taxation result in the hands of certain beneficiaries. If a beneficiary has a capital loss from another source, then receives capital gains streamed via the trust, that beneficiary will be able to use those capital losses to offset them against the capital gains, compared to a beneficiary without capital losses paying more tax.

Currently, the nature of the franking credit regime is that it is able to refund money to taxpayers who otherwise have no taxable income and owe no tax.

Nevertheless, a strong incentive exists to stream franking credits via trusts in a tax-effective manner.

Most Trust Deeds permit streaming, and a Trustee distributes the capital gain or franked distribution to a "specifically entitled" beneficiary, allowing the notional allocation system in Subdivision 207-B of the **Income Tax Assessment Act 1997** to generally operate smoothly.

In ***Commissioner of Taxation v Thomas***, the High Court held that franking credits are not an independent source of income that can be distributed or streamed by a trustee. They must remain attached to the franked distribution itself.

Instead of streaming franked distributions, the trustee sought to distribute franking credits as discrete items of income (i.e., separate from the distribution).

The High Court observed (at [12]) that Subdivision 207-B 'creates a system which "notionally allocates" the franking credits in the same proportion as the beneficiaries' share in the franked distributions...'

The High Court held that Division 207 does not treat franking credits as a source of income capable of being dealt with and distributed, separately from the franked distribution to which they are attached. The High Court expressly labelled this argument as "wrong".

The two resolutions made by the trustee (one dealing with the distribution of income and the other dealing with the distribution of franking credits from that income) could not operate together.

The income distribution resolution was effective and carried with the income stream the franking credit. The franking credit resolution had no effect.

ESTATE PLANNING AND CGT EVENT K3

CGT event K3 can occur when a person dies and a certain type of CGT asset they owned just before dying passes to a beneficiary who (among other things) is a foreign resident for tax purposes (non-tax resident). K3 only occurs in this scenario if the asset is not taxable Australian Property ("TAP"). This broadly covers ownership of and interests in real estate, so the relevant assets could be share portfolios, bank accounts and managed investments.

If a capital gain has been made on any assets that are not TAP and passed to a non-tax resident beneficiary, the estate will be liable for the tax to be paid. This can cause further problems if the will has not been drafted to allocate any applicable CGT to a particular asset: the result is that beneficiaries of the estate could be affected by the CGT attached to a gift they are not receiving.

The real sting to the K3 event is that the rule applies to estates structured to include a testamentary trust. A testamentary trust works just like a family or discretionary trust, is contained in the will and is active once the executor has completed the administration of the estate and transferred the estate's assets to the trust. The ultimate transfer of assets from the testamentary trust to a beneficiary, which may be many years on, will attract K3.

K3 will also operate in the circumstances where the trustee of the trust is a non-tax resident and where just one of the beneficiaries or even potential beneficiaries of the trust is a non-tax resident. Given the global labour market, Australians are increasingly likely to live and work overseas at some point, increasing the chances that a future beneficiary could be a non-tax resident and may trigger event K3.

The takeout is that special care should be taken when drafting the terms of the will or testamentary trust to at least allow a trustee to exclude a potential beneficiary if they are a non-resident and ensure the executor has the power of appropriation to sell CGT assets if necessary.

TRUST SPLIT ARRANGEMENTS MAY GIVE RISE TO CAPITAL GAINS TAX

Trustees Should Consider Tax Implications of Trust Splitting in Light of ATO'S TD 2019/14

In December 2019, the ATO issued draft determination TD 2019/14, maintaining that trust split arrangements of the type described in it will cause CGT event E1 in subsection 104-55(1) of the Income Tax Assessment Act 1997 to arise. This occurs when a trust is created over a CGT asset by declaration or settlement. When the draft determination is finalised, the ATO views will apply before and after the date of issue.

The trust split arrangements referred to TD 2019/14 are those where the parties to an existing trust functionally split the operation of the trust so that some assets are controlled by and held for the benefit of some of the beneficiaries, and other assets are controlled and held for the benefit of other beneficiaries. A trust split exhibits all or most of these features:

- The trustee of an existing trust is removed as trustee of some of the assets, and a new trustee is appointed to hold those assets.
- Control of the original trustee is changed so that it passes to some of the beneficiaries, and the new trustee is controlled by other beneficiaries.
- Different appointors are appointed for each trustee.
- The rights of indemnity of the trustees are segregated so that each trustee can only be indemnified out of the assets held by that trustee.
- The expectation is that each trustee will exercise its powers regarding the assets it holds independently of the other trustee to benefit the relevant beneficiaries to the exclusion of the other beneficiaries, regardless of whether the beneficiaries that can benefit from particular assets are expressly limited.

- The rights, obligations and powers of the trustees and beneficiaries remain governed by a single trust deed.
- Each trustee keeps separate books of account.

Many forms of arrangements can be described as a trust split. A trust split usually involves a discretionary trust which is part of a family group. A common reason for splitting the trust is to allow different parts of the family group to have autonomous control of their own part of the trust fund. This often involves asset protection considerations. While a detailed discussion of TD 2019/14 is beyond the scope of this paper, it is essential that you proceed with caution and receive expert advice before contemplating a trust split. Your advisor must be able to demonstrate a detailed knowledge of TD 2019/14 and clearly explain how it does not apply to your proposed arrangements.

BOOSTING AFFORDABLE HOUSING FOR THROUGH INVESTMENT TAX INCENTIVES

Increasing the Capital Gains Tax (CGT) Discount for Investors in Affordable Housing

From 1.1.2018, the Government has provided an additional 10 per cent CGT discount to resident individuals investing in qualifying affordable housing. This means investors in qualifying affordable housing will be entitled to a 60 per cent discount on capital gains tax.

To qualify for the additional discount, housing must be provided at below-market rent and made available for eligible tenants on low to moderate incomes. Tenant eligibility will be based on household income thresholds and household composition.

The affordable housing must also be managed through a registered community housing provider, and the investment held as affordable housing for a minimum period of three years.

The additional discount will be pro-rated for periods where the property is not used for affordable housing purposes.

Resident individuals investing in qualifying affordable housing will be eligible to receive the additional CGT discount. Non-residents will continue to be ineligible for the CGT discount.

The additional discount will also flow through to resident individuals investing in qualifying affordable housing through Managed Investment Trusts (MITs), where the property has been held for a minimum of three years (see next section).

Consistent with current rules, non-residents investing in eligible affordable housing through a MIT will not receive the additional CGT discount. However, they will generally be subject to a 15 per cent final withholding tax rate on capital gains after a qualifying investment period of 10 years.

Encouraging Managed Investment Trusts (MITs) To Invest in Affordable Housing

For income years starting on or after 1.7.2017, the Government has introduced new rules that enable MITs to acquire, construct or redevelop property to hold for affordable housing. Under the former law, the ATO had generally taken the view that investment in residential property is active, with a primary purpose of delivering capital gains from increased property values, and therefore taxed on income at a 30 per cent rate as it is not eligible for the MIT tax concessions which apply to passive investments only.

Consistent with current MIT withholding tax rules, non-resident investors who invest in these MITs from countries Australia have a recognised exchange of information arrangement will generally be subject to a concessional 15 per cent final withholding tax rate on investment returns, including income from capital gains.

Resident investors in these MITs will continue to be taxed on investment returns at their marginal tax rates. Income from capital gains will be eligible for the increased CGT discount of 60 per cent, where applicable.

MITs must hold, and make available for rent, affordable housing assets for at least ten years.

Should these assets be held for a period of less than ten years, non-resident investors can still receive the concessional 15 per cent final withholding tax rate on investment returns. But will be subject to a 30 per cent final withholding rate on the proceeds of any capital gains.

Further, MITs must ensure that at least 80 per cent of their income is derived from affordable housing in an income year. Failing that, non-resident investors will be subject to a 30 per cent final withholding rate on all investment returns for any year if this requirement is not met.

Foreign institutions and non-resident investors will now be able to invest in affordable housing through concessionally taxed MITs.

Resident individual investors will be able to pool their money with others to invest in qualifying affordable housing and receive the CGT discount, including the additional discount.

These changes create the right incentives to make more affordable housing available for Australians.

CGT IN FAMILY LAW PROPERTY SETTLEMENT

Tax costs have an effect on the property pool available for distribution. In property cases, the Court may take into account CGT allowances when determining the asset pool.

CGT Rollover Relief

Usually, CGT is payable after a change of ownership of a non-exempt asset. However, assets transferred because of the breakdown of a relationship are subject to rollover relief, which means that the recipient party can disregard or defer any capital gain which would otherwise arise until the asset is ultimately disposed of. The cost base of the asset is also transferred to the recipient party.

Rollover relief can apply where:

- an asset is transferred pursuant to a Financial Agreement or court order; and
- ownership is transferred from one spouse/party to another or from a company or trust to a spouse/party to the relationship.

PROPERTY DEVELOPER ENTITLED TO CAPITAL GAIN TAX CONCESSION

Re FLZY and FCT [2016] AATA 348, 27 May 2016

Here the taxpayer had a win in the AAT in contending that a commercial property it acquired and developed and later sold for a profit of some $40 million had been acquired as a capital asset to generate rental income. As a result, the AAT found that the profit of $40 million was assessable as a capital gain and entitled to the CGT 50% discount.

In coming to this conclusion, the AAT noted that even though the taxpayer's property development business involved purchasing properties for resale at a profit, this was only part of the business carried on by the taxpayer. A "wide survey and an exact scrutiny of the activities" of the taxpayer showed that over a 40-year period, they involved everything from the acquisition, development, and sale of residential properties to the acquisition and development of commercial properties to hold as capital assets for the purpose of deriving rental income. Consequently, the AAT rejected the Commissioner's basic claim that the taxpayer was carrying on "a business of the acquisition, development and disposal of properties for a profit".

The AAT found all the evidence pointed to the fact that the taxpayer intended to develop the original vacant car park into a commercial property to lease to government agencies. This evidence included:

- The clear evidence of the father and son controllers of the business in the past had purchased property for investment purposes.
- Contemporaneous bank records (noting that the building was to be "retained on completion for investment").
- That a 15-year lease agreement was originally entered into; and
- That the intention to eventually sell was because the offer to sell "was simply too good".

The AAT also noted that as part of the sale deal, the purchaser offered the taxpayer a deal to acquire substitute investment commercial properties; indeed, the three properties purchased by the taxpayer as part of this arrangement were still owned by the taxpayer almost nine years after the relevant transaction. The AAT also noted that it is always possible that the owner of an asset will sell it, "but to elevate that possibility into an intention to make a profit by selling the property is to draw a longbow indeed" – particularly in the circumstances of this case and given the nature of the transaction in question.

PRINCIPAL PLACE OF RESIDENCE

We focus on the main residence CGT exemption because 20 years of experience has shown that the "principal residence exemption" accounted for more than 75% of the CGT enquiries received by the ATO.

Consider the Following Circumstances:

A taxpayer purchased a townhouse in Sydney and lived in the premises for 10 weeks. He then relocated to Brisbane and has been renting out the Sydney property for 5 years.

The taxpayer is aware of the 6-year temporary absence rule and wonders if he has physically occupied the dwelling long enough in order to access the CGT main residence exemption and take advantage of the 6-year rule.

Contrary to popular belief, the CGT provisions do not specify a particular period that a dwelling must be occupied in order to be the taxpayer's main residence.

1. Whether a dwelling is a taxpayer's sole or principal residence is an issue that depends on the facts in each case, and the ATO's view was contained in CGT Determination No. 51, which has been withdrawn.
2. Some relevant factors may include, but are not limited to:
   The length of time the taxpayer has lived in the dwelling.
   - The place of residence of the taxpayer's family.

- Whether the taxpayer has moved their personal belongings into the dwelling.
- The address to which the taxpayer has their mail delivered.
- The taxpayer's address on the Electoral Roll.
- The connection of services such as telephone, gas, and electricity.
- The taxpayer's intention in occupying the dwelling.
- The relevance and weight to be given to each of these or other factors will depend on the circumstances of each particular case.

3. On occasion, a taxpayer may elect which of two or more dwellings is his main residence. When changing main residences, it is possible to have two main residences for a maximum period of six months.

The fundamental question would be (after considering the above) – what led the taxpayer to vacate the building? For instance, if it were due to a job transfer to Brisbane, it may be possible to access the concession. In a 1993 case, the Administrative Appeals Tribunal (AAT) expressed the view that whether a dwelling is a person's principal place of residence is a matter of fact and degree, and that, in determining this question, the decision-maker had to make a common-sense assessment taking into account a number of varying and even conflicting circumstances. Significantly, in this case, the AAT accepted as relevant, though not exhaustive, the consideration listed in TD 51.

There has been nothing to contradict TD 51 as such – it is more that a number of AAT cases have confirmed the determination rendering TD 51 surplus to needs. For instance, Couch and Anor v FCT of T 2009 ATC 10-072 (2009) AATA at paragraph 14 – the Tribunal is of the opinion that something that is only an intention by a taxpayer to occupy a property as a main residence is insufficient to give rise to the exemption in section 118-110.

Family members and the sole and principal residence

Consider the following scenario. Patrick Patriarch believes Melbourne's inner-city units are undervalued. He has a 21-year-old daughter Pricilla attending Melbourne University. Pricilla plans to complete her degree then travel overseas. She has no plans to enter the housing market in the foreseeable future. A unit is purchased in Pricilla's name, and she lives there for six months prior to departing overseas. The unit is let out and derives a rental income.

Over the next five years, the unit doubles in value. What is the CGT situation?

No CGT will be payable on disposal. The unit is Pricilla's sole and principal residence, and it is within the six-year temporary absence rule. This example included in past years is certainly affected by the changes that apply to foreign tax residents from 1.7.2019 discussed on pages 30 and 31. If Pricilla moves out of the unit and remains in Australia, then there is still the prospect of a tax-free capital gain.

6 Year Temporary Absence

Although most people are aware of the CGT exemption for sole and principal residence, many are unaware of the ability to "double-dip" in tax benefits even if the home has been used as an investment property at various times.

If you rent out your home for **less than 6 years** before the house is sold, there may be CGT consequences. As long as you started renting out your home after 20 August 1996, you can still have a partial main residence exemption apply **and** obtain an uplift in the cost base of your house, providing you have not treated any other property as your main residence during this period.

Note under legislation passed in December 2019, Pricilla will need to be a genuine resident of Australia at the time of the sale to access this benefit.

Increasing Your Cost Base

You can obtain an uplift in the cost base of your house by having it deemed to have been acquired at market value on the day your home is first rented out. Note that the following conditions must be satisfied:

1. The home has been rented out for more than 6 years (and no other property is treated as a 'main residence').
2. The home was rented out after **20 August 1996**; and
3. The full main residence exemption would have been available if the house had been sold just before it was rented out.

To determine the market value of the house for CGT purposes, a person has the option of:

1. Obtaining a valuation from a qualified valuer; or
2. Calculating their valuation based on reasonably objective and supportable data.

Generally, if significant amounts are involved, it will be prudent to obtain a valuation from a qualified valuer, particularly if there is any doubt about the property's market value.

Note the changes for non-residents from 1.7.2019 disposing of their main residence.

DEMOLISHING THE FAMILY HOME – THEN SELLING THE LAND

It should be noted that the main residence exemption only applies if the land is sold with a dwelling on the land. If sold as vacant land, then the main residence exemption does not apply at all – an exception to this is where the dwelling is accidentally destroyed, and the land is sold without rebuilding.

Consider the case of a couple with a home on two hectares, in matrimonial difficulties doing a property settlement by way of demolishing the family home, subdividing the land, and splitting the proceeds.

They may have lived in the family home for many years, but they miss out on the main residence exemption resulting in a less than ideal tax outcome.

Think very carefully before demolishing the main residence, making sure you fully understand the tax consequences and get your Accountant to do the sums.

WHO IS ON THE TITLE...? BE VERY CAREFUL

This may seem obvious, yet people still get caught out. Some people may put the main residence in a company or a trust for asset protection purposes – be very clear the main residence exemption will not apply – the names(s) on the title must be those individual(s) with a family living in the dwelling.

In a case several years ago, a well-intentioned father bought a townhouse with his 23-year-old son. The father's assets were necessary for the finance, but this could have been resolved by way of a personal guarantee. The father also took the view his son had not fully matured and might unwisely sell the dwelling without getting the full benefit of long-term home ownership. The father was on the title for 50%, and when the townhouse was eventually sold, the father's share was subject to CGT, resulting in a substantial tax liability.

The taxpayer unsuccessfully took the matter to the AAT, who simply applied the letter of the law. These matters need to be carefully considered prior to purchase.

NO OWNERSHIP INTEREST IN DWELLING – SO NO MAIN RESIDENCE EXEMPTION

Mingos v FCT [2019] FCAFC 211

Staying with the subject of ownership interest Mingos is worth considering.

It is quite possible for a person with "an ownership interest" in a dwelling to qualify for the CGT main residence exemption. A person has an "ownership interest" in a dwelling if they have a legal or equitable interest in the land on which it is erected, or a licence or right to occupy it s118-130 of the ITAA 1997.

This case considered whether the discretionary beneficiary of a trust had an ownership interest in a dwelling owned by the trust.

The taxpayer and his family had resided in the dwelling for many years, originally held on trust for the taxpayer. In 2006 it was transferred into his name and subsequently transferred to his wife. When the marriage broke down a few years later, as part of the divorce settlement, the Federal Court ordered the taxpayer to pay just over $2m to his wife, in return for the transfer of the dwelling to the taxpayer "or his nominated entity".

The nominated entity chosen by the taxpayer was a company (Lemnian) that was the trustee of a discretionary trust (the Lemnian Trust). The taxpayer and his brother controlled the company. The transaction was financed by a bank loan secured by a mortgage over the property.

When the property was later sold, the taxpayer argued that title to the property had been transferred to Lemnian solely in order to obtain the bank loan and that the property was owned by him beneficially pursuant to a sub-trust. The taxpayer argued that he was entitled to the CGT main residence exemption, the ATO disagreed.

The primary judge held that the taxpayer did not have an ownership interest in the property. The Full Federal Court unanimously dismissed the taxpayer's appeal.

The evidence presented did not help the taxpayer's case. Emails showed that the bank was prepared to advance the funds on the basis of the property remaining in the taxpayer's name (subject to obtaining a mortgage over the property) and that it was the taxpayer's former accountant and tax agent who instructed that title to the property should be in the name of the Lemnian Trust.

There was also evidence, including signed accounts and the trust's tax return, showing that the property was treated as an asset of the trust.

Other findings by the primary judge upheld on appeal included:

- the Federal Magistrates Court's order in the divorce proceedings did not confer upon the taxpayer a full equitable interest in the property; and
- the taxpayer did not have an absolute entitlement to the property as against Lemnian.

THE SHARING ECONOMY AND THE CGT EXEMPTION FOR THE FAMILY HOME

With the sharing economy still in its infancy, this is definitely an issue for the future.

The ATO has confirmed that when a taxpayer rents out part or all of their residential home, they become liable for CGT when they eventually sell their principal place of residence (PPR). According to the ATO, this will be based on the proportion of floor space set aside to produce income and the period used for that purpose.

Further, if paying guests also have the use of other rooms such as lounge room, bathroom, or kitchen, then that user has to be apportioned between them and the main residents.

If a person has only been renting out rooms in their house for a short time relative to the period of ownership, then this will not be a major issue. However, over time it could be, and such a taxpayer could wind up with a significant CGT bill when their PPR is sold.

Given the ATO's enhanced data matching capabilities, people who do not declare Airbnb or Stayz rental income do so at their peril.

All parties operating in the sharing economy need to be fully aware of their taxation obligations.

CGT ON THE SALE OF HOLIDAY HOUSE

There may be capital gains to take into account when you eventually sell your holiday house, as only your "main residence" is exempt from CGT. A capital gain is calculated by subtracting, from the property's sale price, your original outlay plus certain eligible expenses incurred over the time as a consequence of owning the property — referred to as your "cost base".

Where the property has been owned for at least 12 months, you may be entitled to the 50% individual discount, which will be taxed at your marginal tax rate.

Keeping accurate and valid records from the time you buy your weekender is essential. But when the time comes to make your CGT liability calculation, some common expenses that may qualify to be included as part of the cost base of your holiday house are:

- legal fees and stamp duty on the purchase
- selling costs such as sales commissions and legal expenses
- certain capital improvement costs
- "holding costs", such as water or council rates, and
- mortgage interest.

Expenses incurred on assets acquired after August 1991 for which a tax deduction has not been claimed, such as council rates and interest, are known as third element cost base items. Do not forget to include these in the calculation.

TAX TIP: CGT AND YOUR HOLIDAY HOME

Ongoing expenses can be included in the property's cost base, and through time this may result in your having a lower capital gains tax liability when you or your children sell the property.

Even though you may never rent out your holiday home, viewing it as a lifestyle possession rather than an investment, it will still be treated as an investment for capital gains tax purposes. It will be subject to CGT when sold because it is not your primary residence.

This is a major consideration for inheritance: one child may get the family home and the other the holiday home. Not only is the former invariably worth more than the latter, but the child who inherits the holiday home could also be hit for CGT.

You should keep accurate records from the moment you purchase the holiday home; this could save you thousands of dollars.

CAPITAL GAINS TAX AND GOING OVERSEAS

Main Residence Exemption and Temporary Absence

If you leave your main residence temporarily, you may want the ATO to treat it as your main residence while you are away; for example, if you:

- Move because of a temporary job transfer.
- Study overseas.
- Take an extended overseas holiday.

Under the capital gains tax (CGT) rules, if you:

- Use your vacated home to produce income; you can choose to treat that home as your main residence for a period of up to six years.
- Do not use your vacated home to produce income; you can choose to treat it as your main residence for an unlimited period after you cease living in it.

If you choose to treat that home as your main residence, you cannot nominate any other dwelling as your main residence during your period of absence, even if you actually live in that other dwelling.

There is one exception - the maximum six-month period you can qualify for the exemption on two homes when you are moving from one main residence to another.

You must make a choice by the day you lodge your tax return for the income year in which a CGT event happens, such as selling the house. The ATO will use this information on your return as evidence of your choice.

If you make a choice, it is not affected by you becoming a foreign resident during the period of absence. But note the recent changes to legislation discussed below-concerning non-residents and the six-year temporary absence rule.

Renting out your home during a period of absence

If you rent out your home while away, the relevant expenses may be higher than the rental income. If this is the case, you will only make a loss for Australian tax purposes if your deductible expenditure is higher than the sum of your assessable income and net exempt income.

If you retain your residency status for tax purposes while you are overseas, you will need to offset foreign-sourced income against any Australian rental loss. For most people, this means you would generally not have any rental losses available to be carried forward if you are employed overseas. Any loss brought forward from a prior year must first be offset against any exempt foreign source income from the current year before being deducted from your assessable income.

CAPITAL GAINS TAX CHANGES FOR FOREIGN INVESTORS

On 9 May 2017, the government announced that Australia's foreign resident capital gains tax (CGT) regime would be extended to deny foreign and temporary tax residents' access to the CGT main residence exemption.

The original bill to effect these changes was introduced to parliament but lapsed when the 2019 election was called.

According to the original bill, the change was to apply from the announcement date, and properties held prior to this date would be grandfathered until 30 June 2019.

Following consultation, the government also amended the change to the main residence exemption to ensure that only Australian residents can access the exemption for tax purposes. As a result, temporary tax residents who are Australian tax residents will be unaffected by the change.

On 23 October 2019, a new bill was introduced to parliament. This new bill, which revised the original bill, provides exclusions in certain circumstances. The new bill also extends the grandfathering period from 30 June 2019 to 30 June 2020.

The changes impact certain foreign residents as follows:

- For properties held before 7:30 pm (AEST) on 9 May 2017, the CGT main residence exemption will only be claimed for disposals that happen until 30 June 2020, provided they satisfy the other existing requirements for the exemption. The disposal of these properties that happen from 1 July 2020, at the time of the CGT event, will no longer be entitled to the exemption unless any of the following life events occur within a continuous period of six years of the individual becoming a foreign resident:
    - Either the foreign resident, their spouse or their child who was under 18 years of age, has a terminal medical condition.
    - Their spouse, or their child who was under 18 years of age at the time of their death, dies.
    - The CGT event involves the distribution of assets between the foreign resident and their spouse because of their divorce, separation, or similar maintenance agreements.
- For properties acquired at or after 7:30 pm (AEST) on 9 May 2017, the CGT main residence exemption will no longer apply to disposals from that date unless certain life events (listed above) occur within a continuous period of six years of the individual becoming a foreign resident.

If the foreign resident dies, the changes also apply to:

- legal personal representatives, trustees, and beneficiaries of deceased estates
- surviving joint tenants
- special disability trusts.

The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Bill 2019 received royal assent on 12 December 2019.

CAPITAL GAINS AND CAPITAL LOSSES WHEN CEASING BEING AN AUSTRALIAN RESIDENT

If you are an individual, you may choose to disregard all capital gains and capital losses you made when you stopped being a resident.

If you ceased being a resident before 12 December 2006 and you make this choice, those assets are taken to have the necessary connection with Australia until the earlier of:

1. a CGT event happening to the assets (for example, their sale or disposal), or

2. you are again becoming an Australian resident.

The effect of making this choice is that when working out your capital gains and capital losses on those assets, the ATO takes into account the increase or decrease in the value of the assets from the time you cease being a resident to the time:

- Of the next CGT event, or
- You again become a resident.

The way you complete your tax return is sufficient evidence of your choice.

Assets with The Necessary Connection with Australia

Assets you may own that have a necessary connection with Australia include:

- Land or a building in Australia (or an interest in land or a building).
- A CGT asset you have used in carrying on a business through a permanent establishment in Australia.
- A share in a private company that is an Australian resident company for the income year in which the CGT event happens.
- A share, or an interest in a share, in a public company that is an Australian resident company and in which you and your associates have owned at least 10% of the value of the shares at any time during the five years before the CGT event happens.
- A unit in a unit trust that is a resident trust and in which you and your associates have owned at least 10% of the issued units at any time during the five years before the CGT event happens.
- An interest (other than a unit) in a trust that is a resident trust for CGT purposes for the income year in which the CGT event happens.
- An option or right to acquire any of the assets in this list.

Assets that do not fall within one of the above categories - for example, land or a building overseas or shares in a foreign company - do not have the necessary connection with Australia.

Taxable Australian Property

Taxable Australian property includes:

- A direct interest in real property situated in Australia or a mining, prospecting, or quarrying right to minerals, petroleum, or quarry materials in Australia.
- A CGT asset that you have used at any time in carrying on a business through a permanent establishment in Australia.
- An indirect Australian real property interest - which is an interest in an entity, including a foreign entity, where you and your associates hold 10% or more of the entity and the value of your interest is principally attributable to Australian real property.

Taxable Australian property also includes an option or right over one of the above.

For CGT events happening on or after 20 May 2009, a leasehold interest in land situated in Australia is 'real property situated in Australia'.

If you are a foreign resident or the trustee of a trust that was not a resident trust for CGT purposes, and you acquired a post-CGT indirect Australian real property interest before 11 May 2005, and that interest did not have the necessary connection with Australia but is taxable Australian property, the ATO treats it as though you acquired it on 10 May 2005 for its market value on that day.

Removal of the Capital Gains Tax Discount for Non-Residents

The Government has removed eligibility for the 50% discount on capital gains earned after 8 May 2012 by non-residents on taxable Australian property, such as real estate and mining assets. Non-residents will still be entitled to a discount on capital gains accrued prior to this time (after offsetting any capital losses), providing they choose to value the asset at that time.

RECOUPING UNPAID FOREIGN RESIDENTS' CAPITAL GAINS TAX

Increased Compliance Costs Fall Mainly on Purchasers

Purchasers are required to withhold and pay 12.5% of the sale proceeds of taxable Australian property to the ATO.

Schedule 2 of the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015, to apply on 1.07.2016, improved compliance with Australia's foreign resident capital gains tax (CGT) regime. However, concerns have been expressed that these measures will adversely affect purchasers, vendors, and the property market in general.

This withholding tax (with 2017 changes included) is limited to these types of taxable Australian property:

- Real property situated in Australia (including a lease of land situated in Australia) – land, buildings, residential and commercial property.
- Mining, quarrying or prospecting rights if the minerals, petroleum, or quarry materials are situated in Australia.
- Interests in Australian entities that predominantly have such assets (called indirect interests).

If the foreign resident vendor falls within one of these exclusion categories, then there is no obligation to withhold the 12.5%:

- Taxable Australian Real Property (TARP) transactions valued under $750,000.
- Transactions that are conducted through a stock exchange.
- An arrangement that is already subject to an existing withholding obligation.
- A securities lending arrangement.
- The foreign resident vendor is under external administration or in bankruptcy.

TRUST IN TRUSTS

Discretionary trusts are usually created by having a settlor contribute a nominal sum to establish the trust and are commonly used as tax-effective vehicles and in asset protection planning.

After a trust has been established, business or investment assets are then transferred into the trust. A trustee is appointed, and his powers, responsibilities and obligations are normally defined in the trust deed and at trust law. Ultimate power usually rests in the hands of a principal or appointor who has the power to change the trustee.

Discretionary trusts can be created by the terms of a Will and are known as testamentary trusts. The trustee has discretion regarding how the trust's income and/or capital are allocated among the beneficiaries identified in the trust deed. Given this high degree of flexibility, the trustee is able to make tax-effective distributions and vary allocations to suit family circumstances.

This flexibility to allocate income to low tax beneficiaries is augmented by the fact that:

1. Providing effective distributions, income flows through trust and retains its character. Thus, individuals can access the 50% general CGT discount for assets held longer than 12 months. This is not available in a company.
2. The most suitable beneficiaries to access the CGT Small Business Concessions may be selected.
3. It is possible that an individual or corporate beneficiary may have a capital loss to absorb the capital gain. Also, an associated trust may be a beneficiary and may also have a capital loss. Always consider this.
4. More importantly, because the CGT Small Business "Active Asset" 50% exemption flows down to an individual beneficiary, a trust allows full access to all CGT Small Business Concessions. This should be compared to a company where eventually a shareholder will have to receive unfranked dividends.

The Bamford and Greenhatch cases

In past years we discussed streaming of trust income in accordance with Taxation Ruling TR 92/13. This ruling, of course, was withdrawn in 2011 in the wake of the Bamford case.

Since then, there have been significant developments in the law relating to trusts following the Bamford decision and Colonial First State Investments Ltd v Commissioner of Taxation (2011) FCA 16. Legislation to clarify the operation of the character attribution rules is contained in Subdivisions 115-C and 207-B of the ITAA 1997. Of course, this means your trust deed must allow for this.

To recap Bamford v Commissioner of Taxation (2010) HCA 10, the High Court held that:

- Under the Act, "net income" means taxable income, that is, income after all allowable deductions have been subtracted. Accordingly, the "net income" of a trust includes capital gains; and
- "Income" of the trust estate means the trust's income calculated according to trust law and accounting principles. While this would not generally include capital gains significantly, it was held that a trust deed could define the "income of the trust estate" to include both income and capital gains.

In Bamford's case, applying the above principles, capital gains made by the trust could be distributed to and taxable to income beneficiaries instead of being taxable to the trustee at the highest marginal tax rate.

Review your trust deed to:

- Ensure "income of the trust" is defined.
- Ensure that the trustee has sufficient powers to permit a trustee to determine trust income in each income year.

- Ensure Trust resolutions concerning distributions are drafted in accordance with the terms of the Trust Deed.

We suggest this is a task for your lawyer.

The key extract from the 2013 ATO Decision Impact Statement on the Greenhatch case is the ATO view that streaming of amounts for trust law purposes by reference to the character of those amounts will only be effective for tax law purposes where specific statutory rules facilitate that result.

In addition to capital gains forming part of the income of a trust, questions as to the tax effectiveness of streaming of amounts for trust law purposes, by reference to character, arise from time to time in other contexts, for example, in relation to:

- Franked dividend income.
- Foreign sourced income streamed to non-residents.
- Income streamed to non-residents that is subject to non-resident withholding; and
- Foreign source income on which foreign tax has been paid.

As with Subdivision 115-C of the ITAA 1997, Subdivision 207-B of the ITAA 1997 (concerning franked distributions and trusts) was likewise significantly amended in 2011 with the express intent of facilitating the tax-effective streaming of franked distributions through trusts.

CGT TIPS

Timing is everything

- We have seen in an earlier example that CGT events are triggered not by a change of ownership (on settlement) but by contract.
- Always be aware of this when seeking to access the 12-month 50% reduction.
- If selling some (but not all) shares in a particular company, carefully review each parcel of shares held to determine which parcel gives the best CGT outcome.
- If possible, defer a disposal subsequent to 30 June in order to defer the tax liability for another 12 months.

Consider Rollover Relief

There are a number of instances where rollover relief may be available. The most commonly accessed is CGT rollovers caused by marital breakdown.

A compulsory same-asset rollover will occur if a CGT event involves an individual taxpayer disposing of an asset to or creating an asset in the name of their spouse (or former spouse) because of:

- A court order under the Family Law Act 1975 or an equivalent foreign law.
- A court-approved maintenance agreement under the Family Law Act 1975 or equivalent agreement under a foreign law.
- A court order under a state, territory or foreign law relating to de facto marriage breakdowns.

In December 2006, the Government improved the CGT marriage breakdown roll-over provisions by extending the roll-overs to include assets transferred under binding financial agreements and arbitral awards.

This measure has encouraged separating couples to settle their own affairs rather than involve the courts.

The amendments have also ensured that the CGT main residence exemption rules interact appropriately with the CGT rollover and that marriage breakdown settlements do not give rise to CGT liabilities. In relation to the CGT main residence exemption, the amendment has taken into account the way in which both the transferor and transferee spouses have used the dwelling when determining the transferee spouse's eligibility for the main residence exemption.

In 1999 the Commissioner released a number of determinations relating to marriage breakdown roll-overs (TD 1999/47 to TD 1999/61). All of these are still current.

When a marriage breakdown rollover occurs, any capital gain or loss from the CGT event made by the transferor is ignored.

However, the first element of the asset's cost base (or reduced cost base) in the hands of the transferee is the assets cost base (or reduced cost base) in the hands of the transferor at the time the transferee acquired it.

It should be noted that automatic rollover relief from CGT also applies where assets are transferred from a company or trust to the trust if the transfer is court directed (or sanctioned or subject to binding financial agreements or arbitral awards.

Maintaining CGT records

You may find that a useful way to keep records of assets is to keep a CGT asset register. This is a register of information about your CGT assets that you have transferred from your CGT records (for example, invoices, receipts, and contracts).

For most assets, this information includes:

- The date the asset was acquired.
- The cost of the asset.
- A description, amount and date for each cost associated with purchasing the asset (for example, stamp duty and legal fees).
- The date the asset was disposed of.
- The amount received on disposal of the asset; and
- Any other information is relevant to calculating your CGT obligation.

You can discard your CGT records five years after having an asset register entry certified if:

- You enter all the necessary information about an asset in your CGT asset register.
- The entry is in English and is certified in writing by an approved person (for example, a registered tax agent); and
- The asset register entry is certified after 31 December 1997 (although the asset itself may have been acquired before this date).

If you do not keep an asset register, you generally must keep CGT records for at least five years after you dispose of an asset. For example, if you hold an asset for 10 years and then sell it, you will have to keep the records for 15 years.

Thus, the retention of records is something you should take personal responsibility for. Request copies from your current accountant's working paper files.

This is prudent given that taxpayers change accountants over the years, and Taxation Determination TD 2007/2 bears this out. Your CGT asset register is permanent. Safeguard this register – otherwise, you may pay too much CGT.

TD 2007/2 made it clear that for the ascertainment of a capital loss, records should be kept beyond the statutory retention period (5 years) because, as a practical matter, it may be necessary to demonstrate the basis of the tax loss deducted or net capital loss applied if a dispute arises, or continues on foot, outside that period in respect of the claim.

Increased ATO focus on losses

Capital Gains Tax record keeping assumes even greater importance due to the latest ATO project on testing the losses of small to medium enterprises (SME).

Note that capital losses can be carried forward indefinitely and in the wake of the global financial meltdown, plenty of us have them. If these are not carefully documented, you may wind up paying too much tax in the future. Always consider entities you own (e.g., companies and trusts) may have capital losses in them, and every effort should be made to offset these losses before you consider making investment decisions within your family structures.

However, be very careful about claiming capital losses where the transactions involve associated parties. Also, be aware that you cannot claim capital losses on personal use items.

Dealing with large capital gains

In the past, we have done detailed case studies showing how capital gains tax may be reduced in limited circumstances by making large superannuation contributions. However, in the May 2009 Budget, maximum concessional (deductible) contributions were effectively halved from 1st July 2009. Clearly, the potential savings have diminished, but the principles remain.

1. Suppose you are aged less than 65 years or age and not receiving substantial employer support (salary <10% of taxable income), you can make tax-deductible contributions to superannuation. So, if you have a taxable capital gain, this may be diminished by making a concessional contribution to a complying superannuation fund. Under the current regime, this is a maximum of $25,000. Note, however, that "catch up" contributions from prior years commencing 1.7.2018 may also be available. These catch up contributions can substantially reduce your CGT bill.
2. If you are an employee and cash flows allow, consider salary sacrificing additional funds into superannuation up to the maximum allowable limits outlined above. Note that salary sacrifice will keep you in a lower marginal tax bracket and that if you have sold an asset for a capital gain, you may well have sufficient cash reserves to draw down on in lieu of wages.

SMALL BUSINESSES CONCESSIONS

In order to assist small businesses, a number of concessions are available for CGT purposes. The main criteria for eligibility are:

- A capital gain would have resulted from a CGT event in regard to an asset owned by the entity.
- Just prior to the CGT event, the net assets of the business and its related entities did not exceed $6 million.
- The CGT asset must be an active asset.

- There must be a "significant individual" with the right to at least 20% of the distribution of income from the entity or has 20% of the voting power.

The concept of 'active asset' is very important. An active asset is one that the taxpayer uses in carrying on the business (e.g., Plant, goodwill). The asset must be active at the time of disposal or sold within 12 months after. The asset must also be an active asset for at least half of the ownership period or 7.5 years.

When determining the $6 million net assets threshold, net assets also include assets held by business affiliates, i.e., the spouse or children of the taxpayer.

The four available small business concessions are:

- 15-year exemption
- 50% reduction
- Retirement concession
- Rollover

15 Year Exemption

A small business can disregard a capital gain rising from a CGT event concerning a CGT asset that it has owned for periods totalling 15 years or more, provided:

- If the entity is an individual, the individual is over the age of 55 and permanently retires or is incapacitated.
- If the entity is a trust or company, the controlling individual permanently retires or is incapacitated.
- The asset was an active asset at the time of its disposal.
- The active asset was active for at least half of the period of ownership or 7.5 years.

Where the 15-year Exemption applies, none of the other small business concessions apply.

Small Business Active Asset Exemption
A 50% active asset exemption is available to active assets of a small business with net assets up to $6 million. This 50% exemption is applied to the net capital gain after making adjustments for any capital losses.

Retirement Concession
A full CGT exemption may be able to be claimed by a taxpayer up to a lifetime maximum of $500,000, where those proceeds are used for retirement. If the significant individual is over 55, the gain can be disregarded. If the significant individual is under 55, the capital proceeds must be rolled into a complying superannuation fund until the preservation age.

The CGT exempt amount becomes an Employment Termination Payment and, if deposited into a superannuation fund, will not be treated as taxable contributions and will not be subject to tax on withdrawal in retirement. The superannuation fund must receive the capital proceeds during the period beginning one year prior and ending two years after the sale.

Rollover Relief – Small Business
The capital gain made on the disposal of a small business can be rolled over into a new business provided that the new active assets are acquired during the period commencing one year before and ending two years after the CGT event occurred.

Using More Than One Concession
One of the most important aspects of the concessional treatment of CGT for small businesses is that multiple concessions can be used to obtain the optimal outcome for the taxpayer.

An individual operating a small business could be eligible for:

50% CGT discount for individuals.

50% active asset exemption on the balance of the capital gain.

The remaining 25% of the gain could be rolled over into replacement assets or applied to the $500,000 CGT retirement exemption.

Other Rollover Relief
Rollover relief allows a taxpayer to preserve the pre-CGT status of some assets or defer CGT payable on assets in certain circumstances. The main areas of rollover relief are:

- Rollover to a company.
- Replacement Asset Rollovers.
- Same Asset Rollovers.
- Small Business Disposal.

Rollover to a Company
Rollover relief is available when a CGT asset is transferred into a company, and the consideration is non-redeemable shares are that of a comparable value of the net assets transferred. After the event, the transferor must own all the shares in the company.

FOR EXAMPLE, The GPR Partnership has two partners, Steve and Jane – each with a 50% share in the partnership. The partnership has net assets (excluding trading stock) of $20,000, and the partners wish to roll the assets into a company and continue trading in the corporate entity GPR Pty Ltd. For rollover relief to be available, Steve and Jane should be each issued 10,000 $1 shares each in the company.

Replacement Asset Rollovers
Rollover relief is generally available in the following circumstances:

- Involuntary disposal (and subsequent replacement) of a CGT asset, for example, is lost or destroyed or becomes part of compulsory acquisition by the Government.
- Renewal or extension of a statutory licence or Crown lease.
- Exchange of shares, rights, or options.
- Strata title conversions.
- Replacement of a mining or prospecting licence after its expiry or surrender; or
- Scrip for scrip rollover where an interest in an entity is replaced by shares or an interest in the acquiring entity. The acquiring entity must hold at least 80% of the voting rights in the original (target) entity.

Same Asset Rollovers
Rollover relief is available for the following same asset rollovers:

- A CGT asset is transferred to a spouse as a result of a court order after a marriage breakdown.
- A CGT asset is transferred to a spouse under a binding financial agreement; or
- A CGT asset is transferred between companies with 100% common ownership at the time of the CGT event.

Effect of Rollover Relief

Where rollover relief is available to the taxpayer, any capital gain that would have resulted from the transfer is disregarded, and the CGT asset retains its original cost base.

Once the asset is sold to a third party, the taxpayer's capital gain is based on the difference between the selling price and the original cost base of that asset. If the original asset had been purchased pre-CGT, no assessable gain would arise.

Small business roll-over

Small businesses can change their legal structure without attracting liability for capital gains tax (CGT).

Small Business owners who find they are using a legal structure that does not suit their needs do not have to be stuck with the structure. They may restructure their business without incurring an immediate CGT liability. The roll-over applies where:

Each party to the transfer is:

– A small business entity (SBE) that satisfies the maximum net asset value (MNAV) test; or

– An affiliate of, or an entity that is connected with, such an entity.

– And the transferee is not an exempt entity (such as a charity) or a complying super fund.

The relevant asset(s) either:

– Are CGT assets used in a business carried on by the SBE; or

– (If the relevant party is an affiliate or connected entity of the SBE) satisfy either subsection 152-10(1A) or (1B) (which deem the "used in business" condition to be satisfied indirectly through use by your affiliate or connected entity).

The transferor transfers one or more CGT assets, or all the assets of its business, for no consideration, to the transferee (both of whom are Australian tax residents), and the transaction is part of a restructure of the business that has the effect of either (or both):

– Changing the type or any of the entities through which the business (or a part of it) is carried on; or

– Changing the number of entities through which the business (or part of it) is operated; and

– The transaction does not have the effect of changing an individual's Ultimate Economic Ownership (UEO) of the asset (or any individual's share of the UEO), and any individual with UEO after the transfer is an Australian tax resident.

The asset will then be deemed to have been disposed of for consideration at which neither a capital gain nor loss is incurred.

ULTIMATE ECONOMIC OWNERSHIP (UEO)

The new roll-over will benefit business owners wishing to implement a more efficient structure. It is not intended to enable the transfer of valuable assets to other individuals – hence the requirement for UEO (which can only be held by individuals) to remain the same before and after the transfer.

Identifying who holds the UEO in an asset through interposed companies, unit trusts, and partnerships is "relatively straightforward" because "the degree to which they can benefit from the asset will be expressly set out in the documents and agreements that support the business".

There are specific provisions relating to discretionary trusts, prescribing that UEO will not change if:

- Just before or after the transaction took effect, the asset was included in the property of a non-fixed trust that was a "Family Trust"; and
- Every individual with UEO before and after the transfer was a member of that trust's "Family Group".

Consequently, discretionary trusts may access the roll-over simply by making a "Family Trust Election," whereby its Family Group members will be UEOs of its assets.

"Family Trust", "Family Group", and "Family Trust Election" are defined in Schedule 2F to the Income Tax Assessment Act 1936, which prescribe the rules by which a trust may carry forward losses.

PRE-CGT ASSETS

Pre-CGT assets will retain their exempt status in the hands of the transferee following the transfer.

Access Threshold – Differs from CGT Small Business Concessions (Div 152)

The legislation states the parties must be SBEs (i.e., satisfying the $2 million aggregated turnover test) **and** satisfy the Maximum Net Asset Value (MNAV) "$6 million" test.

Opportunities
Significantly, the new rules will enable trustees of discretionary trusts to transfer active assets to other discretionary trusts without triggering capital gains.

This concession is notable because such transfers have triggered CGT consequences since the repeal of the "trust cloning" exception in 2008.

Subdivision 328-G provides opportunities to small and family business groups currently utilising trust structures, providing considerable flexibility when separating ownership for business or family reasons.

The new rules will also provide opportunities for small businesses to shift to a more efficient business structure by making demergers easier.

Additionally, the changes may facilitate (if strict requirements are satisfied) the "break up" of small businesses operating through trusts which are in danger of failing the MNAV test, enabling future access to the CGT small business concessions.

FOREIGN RESIDENT CAPITAL GAINS WITHHOLDING PAYMENTS

Since 1.7.2016, there has been a foreign resident capital gains tax withholding (Withholding Tax) regime to all contracts for the sale of Australian property, which is entered into on or after that date.

Where the property's market value exceeds $750,000, the Purchaser of certain taxable Australian assets from a foreign resident is required to withhold and remit 12.5% of the total consideration to the Commissioner of Taxation.

The Purchaser is obliged to comply with a Withholding Tax (even if the Vendor is not a foreign resident) unless the Vendor has supplied a clearance certificate from the ATO.

The Withholding Tax applies to the following assets:

- Real property in Australia with a market value of $750,000 or more including:
  - Land, buildings, residential and commercial property
  - Lease over real property in Australia
  - Mining, quarrying or prospecting rights.

The withholding tax will not apply when the vendor disposes of either:

- Australian real property and provides the purchaser with a clearance certificate from the ATO; or
- Any other asset (other than Australian real property) where the purchaser is given a vendor declaration:
  - As to the vendor's Australian tax residency; and
  - Confirming that interest being disposed of in an Australian entity is not an indirect Australian real property interest.

The Purchaser can rely on the declarations unless they know the declaration is false. Penalties apply where the Vendor has knowingly, recklessly or failed to take reasonable care in making a false or misleading declaration.

AMENDED CAPITAL GAINS TAX RULES AND EARN OUT ARRANGEMENTS

Essentially capital gains or losses arising out of qualifying earn-out arrangements will be viewed as part of the initial transaction and disregarded for the purposes of CGT until and to the extent that they become certain providing greater certainty to sellers in merger and acquisition (M&A) transactions that are subject to earn-out arrangements in respect of the tax treatment of the earn-out.

Formerly, the only guidance on how an earn-out arrangement should be treated was draft taxation ruling *TR 2007/D10, Income tax: capital gains: capital gains tax consequences of earn-out arrangements* issued by the Commissioner in 2007.

Earn-out arrangements may arise between a buyer and seller in a M&A transaction where consideration may be paid to the seller after completion of the transaction based on specific conditions being met, including the business's future performance.

A reverse earn-out arrangement occurs when the seller undertakes to make repayments to the buyer if the business or asset does not perform to those standards within a specific timeframe.

Earn-out arrangements are often used in transactions where the value of the assets or business are not agreed on or depend on future events. They reduce the buyer's risk for a portion of the transaction and provide a mechanism for the seller to maximise its return.

Seek specialist advice before considering whether your arrangements qualify for "look though" treatment. Both sides of an M&A transaction will generally have lawyers advising them.

YOU'RE STUCK IN BAD COMPANY

As discussed, a discretionary trust normally gives the best outcome for capital gains tax.

If you have a business owned by a company and believe there is a likelihood of it being sold for a capital gain, you need to assess your options carefully.

The ideal outcome when selling the business is to see if the buyer will purchase the shares in the company.

As the company may have a "past", a potential buyer will sometimes baulk at this step into the unknown, notwithstanding the fact that the directors may be willing to provide indemnities.

However, if the company has been operated cleanly and has maintained a good set of books, this is still a possible outcome.

- First, examine whether the CGT 15-year exemption applies.
- If not, consider the CGT Small Business Retirement Exemption. Under the new changes, up to 5 "Significant Individuals" can assess this concession, allowing $500,000 per individual.
- However, under this concession, if you are aged less than 55 years of age, the $500,000 has to be contributed to a complying super fund.
- Note that each significant individual may only access this concession once in their lifetime.
- Another option may be to access the "Active Asset" 50% exemption.
- Note that this exemption's ultimate outcome clearly shows why companies are <u>not</u> the vehicle of choice where capital gains are concerned.
- It is all well and good to access this concession, but eventually, dividends have to be paid, and to the extent, company tax has not been paid, these dividends are unfranked, leaving tax to be paid by the shareholder. In this instance, companies are merely a mechanism to defer tax compared to trusts where much better outcomes can be achieved.
- The benefits of legitimate tax deferrals are still worthwhile. Careful planning in the staggering of dividends over a number of years can still save significant amounts of tax.

Also, refer to tax tip #71- page 25 in Issue #0109. This applies to assets purchased prior to September 1985 in a Company and deals with the Archer Bros Principle.

NEW AUSTRALIANS AND CGT

Non-Australian assets are considered to have been acquired at their market value at the time of becoming an Australian resident. Although the taxpayer may have owned such an asset for more than 12 months, the 50% discount is only available if they have been an Australian resident for more than 12 months.

The ATO has effectively reset the purchase date at the time of becoming a resident.

DECEASED ESTATES – CGT BASICS

To qualify for the 12-month 50% CGT discount, 12 months must have elapsed from the deceased contracting to purchase the asset regardless of whether the asset is held by the trustee or the beneficiary when disposed of.

It should be noted that the effective date of introduction of CGT is 19.9.1985. Assets purchased prior to that date are not subject to CGT.

In most cases, death does not trigger CGT, but the clock does start ticking on these pre-CGT assets. As such, it is important to have these valued at the date of death, and this becomes the cost base.

If sold within two years, the deceased's main residence will not attract CGT.

Pre 19.9.1985, main residences enjoyed the two-year concession even if they were rented out before or after death.

Those purchased after that date only receive the concession if the dwelling was the deceased main residence just before death and was not income producing at that time.

If this is not the case, then market value becomes the cost base at the date of death.

Any capital loss accumulated by the deceased can only be offset against actual capital gains crystallised prior to the date of death. This is worth thinking about because neither the trustee nor beneficiary can take advantage of the deceased's carried forward losses.

Division 128-10 states that passing an asset from the deceased to either Executor or the Beneficiary will not trigger a CGT event, nor will the transfer from the Executor to the Beneficiary.

DIVISION 128 AND TESTAMENTARY TRUSTS

A testamentary trust is designed to provide maximum flexibility and allow for tax-effective distribution of capital and income and provide possible protection of your beneficiaries from third parties such as creditors.

These trusts allow for optimum allocation of income and capital, which in turn may permit beneficiaries to qualify for aged, disability and sole parent pensions, Austudy or the like, for which they would otherwise not have qualified under a normal inheritance.

In practice statement PS LA 2003/12, the ATO has recently confirmed they will treat the Trustee of a Testamentary Trust similarly to a legal personal representative (LPR).

UTILISE CAPITAL LOSSES OF THE DECEASED BEFORE DEATH

Such carried forward (and current years) capital losses a taxpayer has incurred are effectively lost at the date of death.

They **cannot** be transferred to a beneficiary of the deceased estate or be utilised by the LPR – see Taxation Determination TD 95/47.

If taxpayers know of a terminal condition, they could consider getting CGT assets to intended beneficiaries before death. This means the carried forward losses will lower the actual capital gain. The market value substitution rule will also step up the recipient's cost base to market value on the date in question.

Note that SMSFs have similar considerations for post-death distributions to non-dependents, which is dealt with in-depth in bonus issue #0114 page 43.

DOES YOUR WILL INCLUDE A NON-RESIDENT BENEFICIARY?

A detailed discussion of CGT event K3 is beyond the scope of this paper.

However, if your will contains a non-resident beneficiary, be aware that s104-215 ITAA97 operates to tax a capital gain on an asset passing under a will from a deceased person to a non-resident beneficiary.

It should be noted the section also applies to assets passing to exempt entities and complying with superannuation funds.

A perusal of the text of s104-215 reveals the unfortunate consequence: the taxation of an unrealised capital gain on death.

There are drafting and non-drafting techniques that may alleviate the threat of CGT Event K3, and you will need to raise these with a lawyer that specialises in Estate Planning.

UNIT TRUSTS AND CGT EVENT E4

When two or more arm's length parties need a business structure, a unit trust is often recommended due to the fact that it is a flow-through for taxation purposes – this means that the income of the trust flows to the beneficiaries in untaxed form and is taxed at the beneficiary level.

Usually, the beneficiary of a fixed trust is a discretionary trust allowing family interests flexibility in distributing income.

What is often overlooked is the application of capital gains tax event E4 (section 104-70 of the ITAA 1997). Apart from some limited exemptions, this has the effect of reducing the cost base of units in the trust held by the discretionary trust where the accounting profit exceeds the taxable profit for the year.

In the event the cost base is eventually reduced to nil, this can lead to all subsequent distributions of accounting profit being made assessable pursuant to section 97 or as a capital gain where CGT Event E4 is triggered.

In the event of a business sale, the double discount (12 month and active asset discount) may not eventually flow down in full to the ultimate individual beneficiaries.

It is clear CGT Event E4 occurs where amounts are paid to unit holders that represent a distribution attributable to the active asset 50% discount.

For this reason, if at all possible and if all parties agree, consideration should be given to forming a partnership of newly formed discretionary trusts. For asset protection purposes, avoid using existing trusts with assets in them.

If this occurs, CGT Event E4 will not be an issue, and with careful planning, full individual access to all the CGT Small Business Concessions will be available.

CAPITAL GAINS TAX – COURT CASES

Commissioner of Taxation v Eichmann (2019) FCA 2155

This case dealt with the CGT small business concessions and whether the essential active asset" test was valid.

The taxpayer carried on a business of building, bricklaying and paving through a trust. The land that had no business signage had been acquired next to their home contained sheds, and the open space was used to store materials, tools, and park work vehicles.

The ATO had issued an unfavourable private ruling that the use of the property in the taxpayer's business was incidental and not sufficient for the land to be an 'active asset' for these purposes. However, the AAT held that the use of the land was sufficient to be 'in the course of' carrying on the business, and it did not need to be integral to the business, which meant the active asset test was satisfied.

The ATO appealed to the Federal Court, which held that the active asset test requires the use of the land to have direct functional relevance to the carrying on of the normal day-to-day activities of the business. As the use for storage was a preparatory activity and not acting in the ordinary course of the taxpayer's business, the land was not an active asset.

On 18.9.2020, the Full Federal Court overturned this decision resulting in a win for the taxpayer. In short, it was found that "use was enough"- meaning that at some point, the asset was used in the course and conduct of the business.

Excellar Pty Ltd v FCT (2015) AATA 282

Excellar dealt with the maximum net asset value test (MNAVT) calculation.

The taxpayer was a private company that sold a boarding house. In this case, the taxpayer was not entitled to the small business CGT concessions in respect of the capital gain it made on the sale of the boarding as the MNAVT was not met.

The AAT considered a number of issues:

- The appropriate market value of the boarding house.
- Whether cash at the bank was a CGT asset.
- Whether the liabilities related to the CGT assets were the GST-inclusive amounts for the purpose of the MNAVT calculation.
- Whether a holiday home owned by Mr A (a connected entity of the taxpayer) should be included in the MNAVT calculation.
- Whether guarantees provided by Mr A constituted related liabilities for the MNAVT.

In establishing the correct market value of the boarding house, the AAT did not accept the property's market value was lower than its sale price. The AAT held that the property's market value was to be determined in accordance with the principles stated by the High Court in Spencer v Commissioner (1907) 5 CLR 418. This often-quoted case deals with the willing but not anxious seller and the willing but not anxious buyer.

Accordingly, the sale price is the appropriate value.

Federal Commissioner of Taxation v Devuba Pty Ltd (2015) FCAFC 168

The Full Federal Court decided in favour of the taxpayer that the capital gains tax (CGT) small business concessions applied to reduce a capital gain that arose from the sale of shares. The Court also clarified the application of the small business CGT concession rules in section 152 of the Income Tax Assessment Act 1997.

The taxpayer, Devuba Pty Ltd (Devuba), sold 45% of its shareholding in Primacy Underwriting Agency Pty Ltd (Primacy). The share sale caused Devuba to make a capital gain of over $4 million. Devuba contended that a number of CGT concessions for small businesses applied with the effect that the capital gain was reduced to nil.

The Commissioner of Taxation (Commissioner) argued that the CGT small business concessions did not apply in this case. The AAT was found for the taxpayer, and the Commissioner appealed to the Federal Court.

The key issue in dispute was whether the CGT concession stakeholders in Primacy held a small business participation percentage (SBPP) in Devuba of at least 90%. A CGT concession stakeholder is an individual or their spouse who holds at least a 20% SBPP in the company. An SBPP includes the percentage voting power held in the company and the percentage of dividends that the company may pay to a particular person.

The issued shares in Devuba included one share to an individual, one to trust and one 'dividend access share' to an individual who did not have any voting rights but gave an entitlement to dividends only when determined by the directors. Devuba argued that the CGT concession stakeholders were the two individual shareholders, and together they had a 95% SBPP, which was greater than the required threshold.

The Commissioner argued that the directors had a discretion to pay a dividend on the dividend access share to the exclusion of all ordinary shareholders such that the ordinary shareholders may not obtain a dividend and therefore, their SBPP interest is nil. The question for the Full Federal Court was whether Devuba's Articles of Association operated to give the dividend access shareholder a right to dividends to the exclusion of ordinary shareholders.

The Full Federal Court dismissed the Commissioner's appeal, finding that if Devuba was to declare a dividend just before the sale of Primacy, it would have been to the ordinary shareholders, not the dividend access shareholder. No determination had been made at the time of the CGT event that would allow a dividend to be paid to the dividend access shareholder. As such, the SBPP was not reduced to nil, and the small business concession was available to reduce Devuba's capital gain.

This case shows the importance of carefully considering the details of each transaction before applying the small business CGT concession provisions.

Breakwell v Commissioner of Taxation (2015) FCA 1471

The Federal Court dismissed the applicant's appeal, holding that the pre-1998 loan from Mr Breakwell's family trust to Mr Breakwell was not statute-barred under s35(a) of the *Limitation of Actions Act 1936* (SA). Therefore, the applicants exceeded the $6 million threshold in the maximum net asset value test (MNAVT) and could not claim the small business CGT relief.

PFGG Case

The taxpayer has appealed to the Federal Court against the Tribunal's decision in PFGG and *Commissioner of Taxation (Taxation) (2015) AATA 972*. The Tribunal had affirmed the ATO's decision to deny the taxpayer's claim for small business CGT relief as the annual turnover exceeded the $2 million thresholds for a "small business entity."

The sole director and shareholder of trustee company did not "control" trust – *Gutteridge and FCT (2013) AATA 947 (AAT, O'Loughlin SM, 24 December 2013)*

Here, the tribunal held that a trust was not controlled by Sarah McKenzie, the sole director and shareholder of the company acting as a trustee but was controlled by her father, Timothy Gutteridge.

In the relevant year, the trust sold 50% of its business and, consistent with years, distributed all of the trust's income, including its capital gain on the sale of the business, to Mr Gutteridge and his wife. Mr and Mrs Gutteridge claimed the 50% small business reduction provided for by s152-205, the small business retirement exemption provided by s152-305 and the small business roll-over provided for by s152-410.

The Commissioner contended that Ms McKenzie, as the sole director and shareholder of the trustee company, was a controller of the trust and, therefore, the trust was connected with another entity owned and controlled by Ms McKenzie (Jigsaw). Accordingly, the trust was not eligible for Small Business Relief under Division 152. The reason being, taken together, the aggregated turnover of Jigsaw and the trust exceeded $2 million, and the asset values owned by them at the time of the CGT event in question exceeded $6 million. However, if Ms McKenzie did not control the trust, neither threshold was exceeded.

Evidence Submitted Included:

In the relevant period, Mr Gutteridge gave advice and support to Ms McKenzie on the running of the business of the trust, and she needed that advice.

Notwithstanding that he was not a director on the ASIC database, Mr Gutteridge attended the trustee company directors' meetings with the relevant personnel accepting that he played a major advisory role in ensuring the trust's business was successful.

During the relevant period, the trust was considered by those with relevant knowledge to be a "Tim Gutteridge entity" with all non-bank funding provided by Mr and Mrs Gutteridge.

The appointor of the trust, Mr Coffey, had the power to remove the trustee company.

Crucially Mr Coffey gave evidence that Mr Gutteridge controlled the trust from behind the scenes with no action taken in relation to the trust unless in accordance with Mr Gutteridge's wishes and directions.

In the event that there were disagreements in the running of the trust, or there were steps to be taken in the running of the trust contrary to Mr Gutteridge's wishes, Mr Coffey would have acted in accordance with any directions from Mr Gutteridge including, if required, removing a trustee from that role.

Mr Coffey was clear that he would disregard any instructions or entreaties from Ms McKenzie to the contrary.

In finding for the taxpayers, the AAT said at paragraphs 23-24:

"The circumstances of the present case call for conclusions that the Trust was not accustomed to act in accordance with Ms McKenzie's wishes independently of her father's wishes in circumstances where her wishes and directions were her father's. She was acting as the director of the trustee in circumstances where the trustee could be removed at the will of Mr Coffey (sic), and Mr Coffey (sic) regarded himself bound by the wishes and directions of Mr Gutteridge. Further, suppose it was necessary to find that Ms McKenzie was a puppet director, or that Mr Gutteridge was a shadow or de facto director. In that case, there is ample material on which to rest such a finding....

The facts as found above require a finding that Mr Gutteridge alone was the person who controlled the Trust within the meaning of s328-125(3) of the 1997 Assessment Act. Accordingly, as that was the only matter in controversy, the Applicants have demonstrated that the Trust is entitled to the Small Business Relief as claimed."

DECISION IMPACT STATEMENT

August v Commissioner of Taxation

This Decision Impact Statement issued 16.02.2015 outlines the ATO's response to this case concerning whether the profit from the sale of properties was income according to ordinary concepts or income of a capital nature.

In 1995, Helen and Peter August established various companies and trusts, including Toorak Management Pty Ltd (Toorak) and Toorak Unit Trust. Toorak was the sole trustee of the Toorak Unit Trust. Each taxpayer held 50% of the issued units in the trust. Helen and Peter August were the sole directors and shareholders of Toorak.

Directional Developments Pty Ltd (Directional Developments) was a company in which Mr August had an interest as a shareholder. He was also a director of the company.

As trustee for Toorak Unit Trust, Toorak acquired a number of properties between late 1997 and the middle of 2000 (the Melba Properties). The properties were developed and ultimately sold for a profit in early 2007.

Directional Developments acquired a lease of land (the Hume Property) in late 2001. The property was sold in late 2005 for a profit.

The issue at first instance was whether the profits on the sale of the Melba Properties and the sale of the Hume Property was income according to ordinary concepts or income of a capital nature. The trial judge found in favour of the Commissioner.

Issues Decided by the Court

In their reasons for the decision, the Full Court considered the three issues raised by the applicants and on each issue found for the Commissioner.

Firstly, in respect of the applicant's application to adduce three further expert reports to address the authenticity of a document relied on by the taxpayers and rejected by the trial judge, the Full Court dismissed their application. Their Honors' found that the trial did not miscarry in relation to the document and that it was not appropriate for the Court to determine the issue of the document's authenticity.

Secondly, the Full Court rejected the applicant's argument that the trial judge erred in law in that he applied the incorrect test for determining what income according to ordinary concepts was.

Thirdly, the Full Court rejected each of the applicant's submissions on the findings of fact.

ATO View of Decision

The Full Court applied settled principles of law to the facts in this case. The decision has no wider ramifications.

REMOVING CAPITAL GAINS TAX FOR GRANNY FLATS

In the October 2020 Federal Budget, the Morrison Government introduced a targeted Capital Gains Tax (CGT) exemption for granny flat arrangements with a formal written agreement.

Tax consequences can be a key impediment to families creating formal and legally enforceable granny flat arrangements.

When faced with a potentially significant CGT liability, families may opt for informal arrangements, which can leave open the risk of financial abuse and exploitation, for example, following a family or relationship breakdown.

Under the measure, CGT will not apply to the creation, variation or termination of a formal written granny flat arrangement providing accommodation for older Australians or people with disabilities.

This measure which is now law commenced on 1.7.2021.

This change will only apply to agreements entered into because of family relationships or other personal ties and will not apply to commercial rental arrangements.

Currently, around 3.9 million pensioners and around 4 million Australians with a disability could be eligible for this exemption under this change.

Under Division 137 of the Income Tax Assessment Act, a CGT event does not happen on entering into, varying or terminating a granny flat arrangement if the following apply:

- the person has or will have the right to occupy a dwelling for life (called a "granny flat interest"). This includes the dwelling's adjacent land and structures, up to a limit of 2 hectares.
- the person who holds the right either:
    - Has reached pension age at or before that time. Pension age is the same age threshold that is used in determining eligibly for the Age Pension and varies according to date of birth and gender; or alternatively
    - For the next 12 months, needs and are likely to continue needing assistance to carry out most day-to-day activities of a disability. Disability takes its ordinary meaning. The ability to recover from a disability is not an impediment to accessing the CGT exemption, nor is the ability to undertake employment while having the disability.

If the person meets either of the above two requirements relating to age or needing assistance, then they will be "eligible for a granny flat interest".

- Another person ("the owner") owns the dwelling, which will be the subject of the granny flat arrangement. This can be prospective with both parties entering an arrangement that the owner will acquire a dwelling where the other party will hold their granny flat interest at a future time.

- The owner and the holder of the granny flat interest must be parties to the arrangement, which must be in writing and indicate an intention for the parties to be legally bound by it.
- The arrangement must not be commercial in nature, and this is determined on a case-by-case basis. For instance, the requirement to pay market rent might indicate that the arrangement is of a commercial nature. If the granny flat interest holder merely contributes to the costs of running the household, this might indicate that the arrangement is not of a commercial nature.

DISTRIBUTING CAPITAL GAINS TO NON-RESIDENT BENEFICIARIES

This article is definitely aimed at tax practitioners and advisers. Carefully consider the situation before making a distribution to a non-resident beneficiary, particularly if the case distribution results from a capital gain relating to non "taxable" Australian property. These were the facts in Greensill, and recently the taxpayer was denied leave to appeal to the High Court.

The facts in *Greensill* are as follows:

An Australian resident trust made a series of capital gains. The CGT assets were not 'taxable Australian property'. The trustees distributed those capital gains to a non-resident beneficiary.

The Commissioner issued assessments to the trustee for the capital gains.

Different parts of the legislation deal with the tax treatment of capital gains made by trusts, which are then distributed to non-resident beneficiaries.

- Division 6 of the 1936 Act contains the primary provisions for taxing trust income.
- Division 115-C of the 1997 Act contains the relevant provisions for taxing capital gains that may be streamed to specified beneficiaries.
- Division 6E of the 1936 Act excludes capital gains from being taxed under Division 6 (given they would be taxed under Division 115-C).
- Division 855 of the 1997 Act contains provisions that allow foreign residents to disregard capital gains from CGT assets that are not 'taxable Australian property'.

In *Greensill* and Martin, the Full Federal Court concluded that:

- Division 115-C applied so that the non-resident beneficiary was deemed to have capital gains that reflected the trust's capital gains; and
- Division 855 did not apply to disregard those capital gains because the non-resident beneficiary did not make the relevant capital gains.

Here is the inconsistency - there is no taxing point in Australia where an Australian resident trust distributes trust income with a foreign source (that is not capital gains and not franked dividends) to a beneficiary who has been a non-resident for the whole income year.

The foreign source income is not included in the non-resident beneficiary's income under section 97. This is because section 97 tests both the beneficiary's residence and the source of the income. The foreign source income is also not included in the trustee's assessable income under section 98 for the same reason: section 98 also tests both the beneficiary's residence and the source of the income.

The inconsistency for capital gains being treated differently to other trust income arises because there is no equivalent provision in Division 115-C for testing the source of the capital gains.

Separately, the effect of Division 855 is that there is no taxing point in Australia where either:

- A non-resident has a capital gain in relation to a CGT asset of theirs that is not 'taxable Australian property, or
- A non-resident beneficiary has an interest in a fixed trust, and that fixed trust has a capital gain about a CGT asset that is not 'taxable Australian property'.

However, there is no relief for non-resident beneficiaries of discretionary trusts or unit trusts that are not fixed trusts, who receive capital gains distributions.

An exhaustive discussion of Greensill and Martin is beyond the scope of this publication but is important for practitioners to be aware of this anomaly in the tax law. If there is a closely held discretionary trust, the remedy may be to allocate non-capital gains (normal income) to the non-resident beneficiary. This may not be possible, of course, in the case of fixed (unit) trust. In this event, seek specialist advice, and there may be remedies in double tax agreements if a skilful submission is made.

GREIG v COMMISSIONER OF TAXATION

On 8.7.2020, the ATO released its Decision Impact Statement (**DIS**) on the Full Federal Court decision of *Greig v Commissioner of Taxation* [2020] FCAFC 25.

Mr Greig was confident that his investment in Nexus

Energy Limited (**Nexus**) would be successful despite declining share prices spent $11.8 million making 65 separate acquisitions of Nexus shares. However, in 2014, Nexus was placed into administration, and his shares were transferred for nil consideration.

The Full Federal Court found that Greig held Nexus shares on revenue account and was entitled to deductions for their cost. Individual shareholders with significant investments may have some concern at this point, particularly where hopes of claiming the capital gains tax discount are cast into doubt.

The Decision Impact Statement outlines in full:

- The issues decided by the court
- The ATO views of the decision and
- The implications for impacted advice or guidance.

For a detailed analysis of Greig, refer to page 43, Issue #113.

CASH OR SHARES

This issue comes up frequently. It is common to be a beneficiary to an estate that holds some shares in a range of companies. The choice is whether to have the inheritance paid in cash or have ownership of the shares transferred to the beneficiary.

There are two main issues. First, the taxation of the shares and second, whether the beneficiary wishes to retain the shares long-term in your portfolio.

The shares held in the estate will have a cost base being the price paid for the shares. If the shares were purchased before capital gains tax (CGT) was introduced, pre-September 20, 1985, they can be transferred to the estate without CGT applying. If the shares are transferred into your name, then your cost base will be the market value of the shares as at the date of death of the deceased.

Where the shares were purchased post-September 19, 2005, the cost base will be the price paid by the deceased. If you then sell the shares in the estate, the capital gain or loss will be assessed in the estate's income tax return if you have the shares transferred to your name, the cost base when sold will be the same as the deceased. Essentially you inherit the deceased cost base.

The second issue is if you do not wish to retain the shares long-term in your portfolio and that the shares have an accrued capital gain, here it will be necessary to calculate the tax payable should they be sold in the estate versus the tax payable if you transferred them into your own name and then sold them. The shares would then be sold where the lowest amount of tax would be paid.

Do not forget to take into account how the capital gain in your tax return could affect other issues such as your entitlement to superannuation co-contribution, family tax benefits or other income-tested benefits.

If you want to hold the shares long term in your portfolio, follow the steps above and if the lower tax is payable by selling in the estate, then have the estate sell them, receive the cash, and repurchase them in your own name. If not, just transfer them to your own name.

Make sure you do the analysis for each share, as it may be better to sell some in the estate. But if a capital loss applies, it may be better to realise the loss in your own name.

In summary, there are plenty of calculations to undertake to determine the best outcome for you from a tax perspective, and this will need to be done on each share parcel separately.

Halving tax on shares

Many of you may ponder the relevance of the following example in what has been a turbulent market. However, we should note that markets always recover, and capital gains could once again become an issue sooner than you think.

With the stock market enjoying a bull run in recent years, many share traders are sitting on substantial accrued profits. Did you know that if you hold these shares long term, you can legally halve your tax bill on not only future gains but also the substantial gains already accrued?

The trading stock provisions of the Tax Act allow you to change the manner in which you hold your shares. This means you can cease to hold shares as your trading stock even though you continue to own them.

This 'change of use' has no tax implications as the original shares are treated as having been disposed of and immediately 're-acquired' as a capital asset at their original tax cost. Effectively, an item that was originally trading stock then becomes a capital asset upon the change of use. No formal written election is required to evidence the change.

Below is an example of ceasing to hold an item as trading stock and beginning to hold it as a capital asset.

***EXAMPLE*:** You are a share trader and purchased 20,000 shares in Gold Ltd in November 2019 as trading stock at the cost of $5 per share. In January 2022, the shares were worth $9 per share. You are considering holding the shares as a long-term dividend-yielding investment, as commodity demand is likely to underpin the value and yield on the shares for the foreseeable future.

If you sell the shares now, you will pay a tax of $39,200 (i.e., a profit of $80,000 at the 49% tax rate). However, if there has been a genuine change of intention with respect to specifically identified shares and those shares are subsequently retained for more than 12 months, you are entitled to claim the CGT discount upon a sale of those shares.

Assuming the value of the shares remains unchanged, the tax on the eventual share sale will be only $19,600 (i.e., $80,000 x 50% CGT discount x 49%).

The trading stock provisions apply only to a genuine change of intention regarding your ownership of items previously held as trading stock. Whether there has been a bona fide change of use may be evidenced by conduct before and after applying the trading stock 'change of use' rule.

TAX INCENTIVES FOR EARLY-STAGE INVESTORS

If you invest in a qualifying early-stage innovation company (ESIC), you may be eligible for tax incentives.

The tax incentives provide eligible investors who purchase new shares in an ESIC with a:

- Non-refundable carry forward tax offset equal to 20% of the amount paid for their qualifying investments. This is capped at a maximum tax offset amount of $200,000 for the investor and their affiliates combined in each income year.
- Modified capital gains tax (CGT) treatment, under which capital gains on qualifying shares that are continuously held for at least 12 months and less than ten years may be disregarded. Capital losses on shares held less than ten years must be disregarded.

The maximum tax offset cap of $200,000 does not limit the shares that qualify for the modified CGT treatment.

Investors that do not meet the 'sophisticated investor' test under the Corporations Act 2001 will not be eligible for any tax incentives if their total investment in qualifying ESICs in an income year is more than $50,000.

The tax incentives for early-stage investors (sometimes referred to as 'angel investors') are contained in Division 360 of the Income Tax Assessment Act 1997.

Qualifying for the tax incentives
To qualify for the tax incentives, investors must have purchased new shares in a company that meets the requirements of an ESIC immediately after the shares are issued. The shares must be issued on or after 1 July 2016.

If, after the company has satisfied these requirements, it ceases to be an ESIC, this will not affect the investor's entitlement to the early-stage investor tax incentives for the shares.

The early-stage investor tax incentives are available to both Australian resident and non-resident investors.

If the investor is a trust or partnership, special rules apply so that the entitlement to the tax offset flows through to the member of the trust or partnership (or the ultimate member if there is a chain of trusts or partnerships).

If the investor is a superannuation fund, the trustee of the fund and not the fund members would be entitled to the tax incentives (tax offset and the modified CGT treatment).

This is very much a niche market situation for incentives, and a detailed discussion is beyond the scope of this publication.

PERSONAL USE ASSETS

Forgiveness of related party loans and CGT event c2

Some taxpayers are of the mistaken belief that if an entity forgives a debt to a related party, it will give rise to a capital loss.

This is not the case if a related party loan is a personal use asset under subdivision 108-C ITAA97. In such an event, any capital loss is disregarded.

Another misconception is that if the lender is not a natural person, they cannot have a personal use asset!

Clearly, a Company or Trust can have a personal use asset just as a natural person can.

Section 108-20(2) ITAA97 deals with a lender's loan assets stating that:

"A personal use asset is:

- A debt arising other than:
  - In the course of gaining or producing your assessable income; or
  - From you carrying on a business."

You need to establish (if relevant) that the loan was provided in the course of producing assessable income or from you carrying on a business.

Two cases worth reviewing are:

- FCT v Total Holdings (Australia) Pty Ltd
- Macquarie Finance Pty Ltd v FCT

If the loan is **not** a personal use asset, take legal advice on steps required to forgive a loan.

The key here is whether interest has been charged on the loan – if not, there is a problem. If the client forgives the outstanding balance of the loan, then this could potentially trigger a capital loss. A loan receivable is an asset for CGT purposes. As such, the loan could be a CGT asset of the client. When the loan is forgiven/released, CGT event C2 will be triggered as ownership of the asset will end.

There may be a capital loss if the proceeds from forgiving/releasing the loan are less than the loan's outstanding balance. The market substitution rules apply in this situation (s116-30(2) ITAA 1997). In this instance, the client will be deemed to have received capital proceeds equal to the market value of the loan receivable just before it was forgiven.

If the company cannot repay the loan when the loan is waived, then it is arguable that the value of the forgiven portion of the loan is nil (or close to nil).

However, if the company does have the ability to repay the loan, then the value of the loan may be its face value, in which case there would be no capital loss to the client. Of course, this will depend on the facts.

Assuming the company does not have the ability to repay the loan, the forgiveness of the debt by the client should give rise to a capital loss.

However, this does not apply if the asset is a personal use asset. As mentioned, the definition of a personal use asset includes a debt arising other than:

- In the course of gaining or producing assessable income; or
- From your carrying on a business. (see s108-20 ITAA 1997).

So here, it is clear that the personal use asset rules could apply to deny a capital loss for your client. If the client has charged interest, he should be okay.

If not, the loan will be treated as a personal use asset. We would also refer you to CGT Determination Number TD2.

CGT DETERMINATION NUMBER 60

The value of a taxpayer's labour included in the cost base

TD60 Capital Gains: Can the value of a taxpayer's labour be included in the cost base of an asset constructed or created by the taxpayer?

This question comes up time and again. The answer is:

1. **No,** where an asset is constructed or created by the taxpayer, no value can be attributed to that labour for inclusion in the asset's cost base.

TRANSACTING WITH CRYPTOCURRENCY

We refer you to pages 48-51, inclusive of issue #113, which deals with this topic in some detail. If you are a new subscriber and require this material, please contact us.

THE INTRODUCTION OF THE WINDFALL GAINS TAX (WGT) BILL IN VICTORIA

This Bill introduces a new windfall gains tax imposed on specific land value uplifts that arise as a result of rezoning and generally applies to Victorian landowners on or after 1.7.2023.

This was announced in the 2020-21 Victorian State Budget, with new legislation introduced into State Parliament.

The WGT will apply when the taxable value uplift of land owned by either an owner or group resulting from the same planning scheme amendment (rezoning) exceeds $100,000.

Members of a group will be assessed on the aggregated taxable value uplift of all land that is rezoned and owned by the group members, with each member being jointly and severally liable for the tax assessed to the group.

When will the tax be payable?

The following table summarises how Victoria's WGT will be imposed under the draft legislation:

Value uplift	Windfall gains tax payable
Less than $100,000	$0
Between $100,000 and $500,000	62.5% of the uplift exceeding $100,000
Exceeding $500,000	50% on the total uplift

Victorian landowners who are liable to pay WGT will be able to defer payment of up to 100% of the tax until the earlier of:

- 30 years after the rezoning
- a dutiable transaction (other than certain excluded dutiable transactions) occurring in relation to the rezoned land; and
- a relevant acquisition (other than certain excluded relevant acquisitions) occurring in respect of a landholder who is the owner of the rezoned land.

There are exceptions to this, and specialist advice should be sought.

The WGT will be imposed on amendments to planning schemes that take effect on or after 1 July 2023. Importantly, transitional arrangements will apply for certain contracts, option arrangements and proponent-led rezonings that were underway when the windfall gains tax was announced on 15 May 2021.

Situations will arise where Victorian taxpayers become liable for the WGT in addition to other taxes imposed on the same gain (i.e., capital gains tax which is generally payable on a capital gain made by a taxpayer).

It remains to be seen whether similar legislation will be introduced in other States and Territories across Australia.

New South Wales is currently considering legislation that will introduce a new 'development contribution regime' payable by landowners who benefit from land value uplift as a consequence of a rezoning.

DISCLAIMER

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