bO2 Corporate Essentials

Tax Smart Australia

Issue
#0110

Tax Essentials
Capital Gains Tax Minimisation Strategies 2021

APRIL	2021

THE NEWSLETTER

Tax Planning Update

MICHAEL'S CORNER

Article No. 10

6 Steps to Ensure Success with Accountability and Delegation in The Workplace

Also Including....

Employers-Consider the Health & Safety of Those Working Outside of Normal Hours

SPECIAL BONUS ISSUE

Capital Gains Tax (CGT)- Minimisation Strategies

ANOTHER ESSENTIAL TAX SMART AUSTRALIA RESOURCE · CLARITY · CONVENIENCE · CONFIDENCE ·

bO2.com.au

Contents

The Newsletter

ATO CIRCLES PRIVATELY OWNED AND WEALTHY GROUPS AS AUDITS HEAT UP

Speaking at an Accountants luncheon in March, Jonathan Ortner, a partner at law firm Arnold Bloch Leibler, warned practitioners the ATO may ramp up its auditing efforts, notably larger companies, after compliance activities were deferred due to COVID-19..

According to Mr Ortner

- The ATO has deferred disputes due to COVID-19 but this is likely to end soon.
- It is likely that companies and individuals that fit the criteria of the Tax Office's Top 500 and Next 5,000 programs are likely to attract auditing efforts. Here the ATO is likely to take an industry-by-industry approach.
- Emerging privately owned and wealthy groups with a combined annual turnover — including associated subsidiaries — of more than $10 million, or controlled wealth of over $5 million, are also likely to be captured by the ATO audits, due to a tax gap of 7.7% indicating $772 million in lost revenue.

What Attracts Attention...

The following behaviours and characteristics of privately owned and wealthy groups may attract ATO attention:

- tax or economic performance not comparable to similar businesses
- low transparency of their tax affairs
- large, one-off or unusual transactions, including the transfer or shifting of wealth
- aggressive tax planning
- tax outcomes inconsistent with the intent of the tax law
- choosing not to comply, or regularly taking controversial interpretations of the law, without engaging with the ATO
- lifestyle not supported by after-tax income
- accessing business assets for tax-free private use
- poor governance and risk-management systems.

EXTENSION OF GOVERNMNET ASSISTANCE

The Morrison Government will expand and extend its 'SME Loan Guarantee Scheme' as part of its commitment to support up to $40 billion in lending to small and medium enterprises.

Under the existing Scheme, more than 35,000 loans worth more than $3 billion have already been provided, helping thousands of small businesses get to the other side of this pandemic.

As Australia moves into the recovery phase, the Scheme will be targeted and tailored to support those businesses that have been relying on JobKeeper during the March quarter.

The SME Recovery Loan Scheme will benefit from an increased Government guarantee, increasing from the current 50/50 split between the Government and the banks to an 80/20 split. This will encourage more banks to support small businesses and demonstrates the Government's commitment to back those businesses that are prepared to back themselves.

The expanded Scheme will also increase the size of eligible loans, increasing from $1 million under the current Scheme to $5 million. Businesses with a higher turnover will also benefit under the expanded Scheme, with the maximum eligible turnover increased from $50 million to $250 million.

Maximum loan terms under the expanded Scheme will also be increased from 5 to 10 years – providing businesses and lenders with greater flexibility.

The expanded Scheme will also allow lenders to offer borrowers a repayment holiday of up to 24 months.

Importantly, the Scheme will also be able to be used by eligible businesses to refinance their existing loans. This will allow SMEs to access the more concessional interest rates available under the program and to better manage their cash-flows through an extended loan term and lower combined repayments.

The Government has also extended the following programs to 30 September 2021:

- the successful Domestic Aviation Network Support (DANS) and Regional Aviation Network Support (RANS) programs
- the 50 per cent waiver of domestic air services charges for Regular Public Transport (RPT) and aeromedical flights

- the International Freight Assistance Mechanism.

The $50 million Business Events Grants Program will also be extended by three months to support Australian businesses to hold multi-day business events, covering up to 50 per cent of costs incurred in participating business events during the 2021 calendar year. This will help restart Australia's business events sector.

The $94.6 million Zoos and Aquarium program will be extended by six months to support zoos, aquariums and wildlife parks to maintain their animal populations where their tourism revenue has been affected by travel and social distancing restrictions.

The COVID-19 Consumer Travel Support Program will also be extended for three months beyond 13 March.

ATO UPDATE ON THE IMPACT OF COVID-19 ON CAR PARKING AND MOTOR VEHICLE FRINGE BENEFITS

In February, the ATO updated their Covid-19 guidance relating to car parking and vehicles.

No car parking fringe benefit will arise if:

- a work car park is closed due to COVID-19, as no car space will have been available for use by the employee for more than 4 hours between 7am and 7pm on that day
- all commercial parking stations within a one km radius of business premises are closed on a particular day due to COVID-19, or
- the reduced rates at commercial parking stations on 1 April 2020 within a one km radius of the business premises for all-day parking where less than $9.15.

The ATO has also provided guidance on cars returned to the employer's business premises during the period of COVID-19 restrictions. A car fringe benefit will no longer arise where:

- the car is returned to your business premises
- your employee cannot gain access to the car, and
- your employee has relinquished an entitlement to use your car for private purposes.

TAXATION DETERMINATIONS

The following Taxation Determinations relating to Fringe Benefits Tax were released by the ATO in March.

- TD 2021/3 – Fringe benefits tax: reasonable amounts under section 13G of Fringe Benefits Tax Assessment Act 1986 for food and drink expenses incurred by employees receiving a living-away-from-home allowance fringe benefit for the fringe benefits tax year commencing on 1 April 2021.
- TD 2021/4 – Fringe benefits tax: what are the rates to be applied on a cents per kilometre basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the fringe benefits tax year commencing on 1 April 2021?

FCT V HEALIUS [2020] FCAFC 173

The taxpayer's special appeal application against the Full Federal Court's decision has been declined by the High Court.

In this case it held that lump sum payments by a medical centre to its doctors were on capital account. The Full Federal Court had held they were not simply payments to secure medical practitioners as customers who would then pay to use the facilities provided by the centre. Rather, they were payments made for the practitioner to cease operating an existing practise, to commence trading as a part of the centre's mode of practise, and to accept a restraint on establishing a competing practise.

YOUR FUTURE, YOUR SUPER REFORMS INTRODUCED INTO PARLIAMENT

On 17.2.2021, the Morrison Government introduced legislation into parliament to ensure the superannuation system works harder for all Australians.

These measures will reduce waste in the system and save Australian workers $17.9 billion over 10 years by holding underperforming funds to account and strengthening protections around the retirement savings of millions of Australians.

Australians currently pay $30 billion per year in superannuation fees, while three million accounts sit in underperforming funds worth over $100 billion in retirement savings.

The Treasury Laws Amendment (Your Future, Your Super) Bill 2021 also addresses key recommendations from the Productivity Commission's (PC) comprehensive assessment of the system, Superannuation: Assessing Efficiency and Competitiveness.

The Your Future, Your Super package is scheduled to commence on 1 July 2021. Under the package, the superannuation system will be significantly enhanced by:

- **Having your superannuation follow you:** preventing the creation of unintended multiple superannuation accounts when employees change jobs.
- **Making it easier to choose a better fund:** members will have access to a new interactive online YourSuper comparison tool which will encourage funds to compete harder for members' savings.
- **Holding funds to account for underperformance:** to protect members from poor outcomes and encourage funds to lower costs the Government will require superannuation products to meet an annual objective performance test. Those that fail will be required to inform members. Persistently underperforming products will be prevented from taking on new members.
- **Increasing transparency and accountability:** The Government will increase trustee accountability by strengthening their obligations to ensure trustees only act in the best financial interests of members. The Government will also require superannuation funds to provide better information regarding how they manage and spend members' money in advance of Annual Members' Meetings and disclose all of their portfolio holdings to members.

This package builds on the Government's superannuation reforms which include consolidating $2.9 billion held in unintended multiple accounts on behalf of 1.4 million Australians, capping fees on low balance accounts, banning exit fees and ensuring younger Australians do not pay unnecessary insurance premiums.

EXTENSION OF MEASURES RELATING TO VIRTUAL AGMS AND SIGNING AND SENDING ELECTRONIC DOCUMENTS

On 17.2.2021, the Morrison Government announced it will introduce legislation into Parliament to extend the application of temporary relief measures introduced at the height of the coronavirus crisis relating to virtual AGMs and signing and sending electronic documents.

Specifically, the Treasury Laws Amendment (2021 Measures No. 1) Bill will extend from 21 March 2021 to 15 September 2021 the expiry date of the temporary relief allowing companies to use technology to meet regulatory requirements to hold meetings, such as annual general meetings, distribute meeting-related materials and validly execute documents.

Following 15 September 2021, member meetings will need to be conducted consistent with pre-COVID-19 laws which require an-in person meeting to be held.

The Government will also conduct a 12-month opt-in pilot for companies to hold hybrid annual general meetings to enable a proper assessment of the shareholder benefits of virtual meetings.

The Government will finalise permanent changes to allow electronically signing and sending documents prior to the expiry of these temporary arrangements on 15 September.

Extension of this temporary relief will allow businesses to continue to comply with their regulatory requirements as they continue to deal with and emerge from the COVID-19 pandemic.

TRANSFER BALANCE CAP

The transfer balance cap began on 1 July 2017. It is a lifetime limit on the total amount of superannuation that can be transferred into retirement phase income streams, including most pensions and annuities.

All retirement phase income streams and retirement phase death benefit income streams you receive count towards your transfer balance cap. The age pension (or other types of government payments) and pensions received from foreign super funds do not count towards your transfer balance cap.

The general transfer balance cap, currently $1.6 million, will be indexed to $1.7 million on 1 July 2021.

TRANSFER BALANCE CAP CHANGES ON 1 JULY 2021

Before 1 July 2021, all individuals have a personal transfer balance cap of $1.6 million.

From 1 July 2021, all Individuals will have a personal transfer balance cap between $1.6 million and $1.7 million. Individuals who start their first retirement phase income stream on or after 1 July 2017 will have a personal transfer balance cap of $1.7 million.

You will be able to view your personal transfer balance cap in ATO online.

Individuals who had a personal transfer balance account before 1 July 2021 will have a personal transfer balance cap calculated proportionally based on the highest balance of their transfer balance account. Their personal transfer balance cap will not be increased if, at any time before 1 July 2021, the balance of their transfer balance account met or exceeded $1.6 million.

PRIVATE WEALTH – WITHHOLDING TAX ON OVERSEAS INTEREST

The ATO's International risk for Private Groups program has launched a campaign focusing on non-resident withholding tax relating to interest expenses paid overseas for the 2018- and 2019-income years.

Taxpayers who have paid interest to a non-resident must meet certain obligations, including:

- lodging a PAYG withholding from interest, dividend and royalty payments paid to non-residents – annual report (PAYG annual report)
- paying withholding tax to the ATO (typically at the rate of 10%) unless a withholding exemption or double-tax treaty relief applies.

As part of the campaign, the ATO intends to contact identified taxpayers by an initial letter and a follow-up phone call. This is to ensure compliance with withholding tax obligations.

The campaign will also deliver targeted education to assist taxpayers in meeting their obligations to:

- withhold and remit tax
- claim deductions for overseas interest expenses
- lodge the PAYG annual report.

LARGEST PROMOTER PENALTY IN R&D HISTORY HANDED DOWN

The Federal Court has handed down a judgement against Mr Paul Enzo Bogiatto and ordered $22.68 million in penalties be paid.

On 12.2.2021, Mr Bogiatto was ordered to pay $6.51 million, in addition to $6.01 million and $3.65 million penalties for his related entities, Ryusei, Lambda Chase Chartered Accountants and Lambda Chase Service, respectively.

Between 2012 and 2015, Mr Bogiatto operated as a Research and Development Tax Incentive (R&DTI) adviser for a range of businesses in his capacity as a registered tax agent and chartered accountant.

Investigations into Mr Bogiatto's activities began in late 2015 and uncovered Mr Bogiatto's promotion of arrangements for his clients to lodge overstated and unsubstantiated R&DTI claims. In total, research and development (R&D) tax offset refunds of $45.5 million were paid to Mr Bogiatto's clients.

Evidence gathered in relation to Lambda Chase's activities indicated systematic abuse of the R&DTI, with claims that were not reflective of taxpayers' actual R&D expenditure for the relevant years.

Mr Bogiatto avoided regulators when investigated and never looked to redress any amount of loss or damage incurred by scheme participants.

According to Assistant Commissioner Ash Khera:

- This outcome reflects the scale of Mr Bogiatto's scheme, which had a devastating impact on the individuals and businesses that followed his advice and trusted him. The size of the penalty is the highest ever seen in Australia and reflects the scale and abusive nature of these schemes.
- The ATO aims to protect individuals and businesses from being unwittingly caught up in schemes like this one. Those who encourage others to do the wrong thing and claim the incentive to which they are not entitled will be caught and held to account for their actions.
- This decision builds on several previous successful results under promoter penalty laws that are designed to ensure that promoters are held accountable when they encourage their clients to enter into risky tax schemes.
- The ATO will continue to protect the tax system by those seeking to undermine it.
- The ATO has the tax technical and investigative skills to deal with those who promote non-compliance with the tax and superannuation system.
- This decision provides further judicial clarification on the application of the promoter penalty laws and the eligibility of the R&DTI.
- The ATO and the Commissioner view this recent decision as a strong deterrent for the advisers exhibiting repeated poor behaviour.

As a result of these investigations, Mr Bogiatto was also investigated and de-registered as a tax agent in October

2017, as well as forfeiting his membership of the Institute of Public Accountants. He had his CA membership terminated and his name removed from the Registers in 2018.

FBT RETURN – DUE DATES

The ATO has informed tax agents that fringe benefits tax (FBT) returns can only be lodged through the practitioner lodgement service (PLS).

The statutory due date for lodgment and payment is 21 May. The due dates for lodgment of 2021 FBT returns for all tax agents are:

- 25 June if the return is lodged electronically.
- 21 May if the return is lodged by paper.

The due date for payment under the lodgment program remains as 28 May or 21 May if lodging by paper.

To ensure you are covered by your lodgment program for their 2020 FBT return, you must appoint your tax agent in that role by 21 May.

DATA MATCHING UPDATE ANNOUNCED THAT WIDENS SERVICES AUSTRALIA ACCESS

In February, a notice of Single Touch Payroll (STP) Data Matching Programme was gathered signalling further meshing of STP data sourced through ATO systems and individuals relying on Services Australia.

The payroll information is to be matched against the latter's records, with guidance issued by Services Australia outlining this process.

A VERY COMMON QUESTION: CAN THE ATO KEEP MY REFUNDS DURING BANKRUPTCY?

Yes, but only if you owe a debt to them or another Commonwealth agency e.g., Child Support or Family Assistance. They will use the tax refund to go towards what you owe.

The ATO can withhold your tax refunds even if you list these debts in your bankruptcy.

CASE STUDY: Tax Obligations in Bankruptcy

Felicity is a 37-year-old unemployed woman from Dandenong in Victoria. She is currently single and has no children.

For 8 years she was a sole trader running a small business as a pastry chef. Felicity struggled to stay on top of her bookkeeping and bills. As a result, personal and business debts built up until Felicity had no choice but to close the business.

Felicity ended up filing for bankruptcy. At the time she had not lodged a tax return for the past 4 financial years.

Felicity listed the Australian Taxation Office (ATO) as a creditor on her bankruptcy form. She did not know how much she owed because of her unfiled tax returns. She estimated on her form that it would be about $150,000.

AFSA contacted Felicity to talk about her bankruptcy. AFSA explained that Felicity still needed to lodge her overdue and future tax returns in the normal way. AFSA does not do this for her, and bankruptcy does not remove this obligation.

AFSA explained that most ATO debts are covered by bankruptcy. This means they do not have to be repaid (except in certain circumstances). The ATO would still be a creditor in the bankruptcy, which meant that if any money became available to pay creditors, the ATO would get a share.

However, any tax refund Felicity is entitled to during her bankruptcy may be kept by the ATO. The ATO would use this money to pay off some of her tax debt. This would reduce the ATO's claim against Felicity's bankrupt estate.

After Felicity's bankruptcy ends, she does not need to keep paying back any of the remaining tax debt from the period before she became bankrupt. She can also keep any future tax refunds after her bankruptcy ends.

Without the constant pressure of running her business and mounting debts, Felicity finally made an appointment with an accountant. She intends to get her outstanding tax returns lodged with the ATO in the next few weeks.

FIRST CRIMINAL CONVICTION FOR JOBKEEPER FRAUD

Mr Raed Saleh has today been convicted in the Heidelberg Magistrates Court of three counts of making a false and misleading statement to the Commissioner of Taxation, in order to receive $6,000 in JobKeeper payments to which he was not entitled to.

In addition to the conviction, Mr Saleh was fined $3,000, ordered to pay reparations of $3,000 and costs of $282.

Mr Saleh applied for and lodged two months of JobKeeper claims online, declaring he had experienced a downturn of at least 30% for the months of May and June, he was a sole trader, his business met all the eligibility requirements and he had not agreed to be nominated by any other employer or entity. He confirmed prior to submitting the applications and claims to the Australian Taxation Office (ATO) that it was all true and correct.

The true state of Mr Saleh's affairs was that he was not operating a genuine business and he had already agreed to be nominated by his full-time employer for the allowance.

Mr Saleh received $3,000 from his false May 2020 claim, but his June claim was stopped by the ATO pending further investigation.

Mr Saleh pleaded guilty to the charges after admitting to the ATO that he had not been carrying on a business as a sole trader, had agreed to be nominated as an employee with his full-time employer, and was not eligible for the JobKeeper payments.

According to ATO Deputy Commissioner Will Day:

- The ATO has an important role to ensure the integrity of the stimulus measures and when they uncover fraud or people seeking to exploit them, they will take action, as the community would expect.
- Since the first payments were made in April, the ATO has monitored every payment, every day, every month, and will continue to do so until the last payment is made.
- The ATO understands how vital the JobKeeper payment is to the community. As at 16 February 2021, $84 billion in JobKeeper payments have been made by the ATO to over 1 million businesses.
- The ATO has a dedicated integrity strategy that supports the administration of the Government's stimulus packages, with robust and efficient compliance systems that make it very easy to identify fraudulent behaviour and stop it.

There has been some concerning and fraudulent behaviour and claims by a small number of individuals. While most businesses and employees are doing the right thing, the ATO is committed to tackling illegal activity and behaviour of concern to protect honest businesses and the community.

Penalties for fraud can include financial penalties, prosecution, and imprisonment for the most serious cases.

TAX DETERMINATION TD 2021/2

This settles what is a common query for Advisers – the question being:

Income Tax: can a company that carries on a business in a general sense as described in Taxation Ruling TR 2019/1 Income tax: when does a company carry on a business? but whose only activity is renting out an investment property claim the capital gains tax small business concessions in relation to that investment property?

Ruling

1. No. A company that carries on a business in a general sense as described in Taxation Ruling TR 2019/1 Income tax: when does a company carry on a business? but whose only activity is renting out an investment property cannot claim the capital gains tax (CGT) small business concessions in Division 152 of the Income Tax Assessment Act 1997[1] in relation to that investment property. This is because an asset whose main use is to derive rent (unless such use was only temporary) is subject to an exclusion from those concessions[2], even if it is used in the course of carrying on a business.

Example - property investment company

2. InveproCo is a company incorporated in Australia. InveproCo owns a commercial property, which it has rented to unrelated third parties at market rates on normal commercial terms since its inception. InveproCo provides no other services in relation to the property and conducts no other activities. InveproCo has produced a profit in each of the income years it has rented out the property. InveproCo is engaged in ongoing activities that have a purpose and prospect of profit, namely letting out the property.
3. In this situation, the company has derived rental income from the leasing of a property to an unrelated third party. Accordingly, the company carries on a business in a general sense described in TR 2019/1. However, the main (only) use of the property is to derive rent and it is therefore excluded from being an active asset

under paragraph 152-40(4)(e) regardless of whether the activities constitute the carrying on of a business in a general sense. Therefore, the investment property would not satisfy the active asset test in section 152-35 and InveproCo would not meet the requirement in paragraph 152-10(1)(d) to be eligible for the CGT small business concessions in Division 152 in relation to the disposal of the investment property.

Date of effect

4. This Determination applies both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 Public Rulings).

bO2 READERS QUESTIONS AND ANSWERS…………

Question 1

Subject - Legal Obligation- Breastfeeding

I have a few questions regarding maternity leave (returning to work).

I have 2 staff members currently on maternity leave both breastfeeding. They are due to return March / April.

I am wondering what I can legally do regarding them being able to feed their babies - off site (as we are preschool 3-5 years) and do not have enough to cover ratios?

Answer

We need to be mindful that a business cannot discriminate against a person who is breastfeeding.

As each state differs on discrimination law, they all cover breastfeeding parents.

The answer to the question is that the employer does not have a legal obligation to let the employee go home to breastfeed but may find the employee takes the employer to the Anti-Discrimination tribunal.

Negation is the key word here, support breastfeeding in the workplace by allowing expressing of milk etc, as not to do so would be discriminatory, the matter of the business owners need for cover ratios to be maintained would be a key consideration in making an agreement.

The information below is from NSW Health when returning to work.

Can I go to work and still breastfeed my baby?

Many mothers return to work while their baby is breastfeeding. Although it may take some time before you get into a routine that works for you and your baby, it is well worth the effort. There are many ways you can balance breastfeeding and work. This will be determined partly by the kind of work you do and the length of time you will be away from your baby.

An increasing number of workplaces actively support women to return to work and breastfeed. Many workplaces are designated 'mother friendly workplaces. This means that facilities are available to express and store breastmilk and mothers are entitled to 'lactation breaks' to breastfeed their baby or express.

Talk to your employer before you go on maternity leave to find out what options are available for you when you return to work.

There are a number of options for balancing breastfeeding and work:

- Ideally you should feed your baby just before you go to work and as soon as you return home. You may be able to arrange childcare close to work so you can feed your baby in the 'lactation breaks'.
- If you miss a feed while you are at work, express and store your milk (see section on Expressing your breastmilk). This milk can be given to your baby at a later time.
- Babies will need to be fed your breastmilk by spoon, bottle, or cup

if under 6 months while you are at work. Once babies are over 6 months bottles may not be necessary as your breastmilk can be given by cup and they are eating family foods.

- You also have the option to provide bottles of formula for worktime feeds while continuing to breastfeed at non-work times. Remember – the longer you breastfeed, the greater the benefits.

Question 2

Subject: Independent Contractor - Paying SGL

I am a subscriber to your excellent magazine.

I have recently become aware that in some circumstances an entity engaging a person to do work as an independent contractor rather than an employee may have to pay SGL to the contractors nominated super fund.

I have not been able to find any clarity on this and the circumstances in which it might apply.

Can you advise me of the circumstances when this may be payable?

I assume the rate would now be 9.5 percent but if not, I would appreciate confirmation of the applicable rate.

I get it that if a worker is in fact an employee and not an independent contractor, even though contracted on that basis, then SGL would be payable by the head contractor as the employer in truth (along with the proper leave entitlements). This would depend on the arrangements being determined to be a sham though I assume.

My concern is that in some circumstance's SGL may be payable by a head contractor to a person who is in fact properly engaged as an independent contractor arises out of the Fair Work Fact sheet. http://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/rights-and-obligations/independent-contractors-and-employees

Please see the note in para 5 in the independent contractor side of the table. The wording of the note suggests that SGL may be legally payable even though there is a legitimate contractor relationship and no question of a sham arrangement. In support of this interpretation, it does not make the same qualification in terms of leave at the last paragraph in the table.

If this is right, I am keen to ascertain in what circumstances the obligation to pay SGL to a genuine contractor might apply to a head contractor. Presumably, as a starter, only if the contractor engaged is a natural person and not a company or partnership.

I would be pleased to hear your thoughts on this.

Answer

If you engage an independent contractor then the 9.5% statutory superannuation will not be payable.

Typically, such people are paid for a result, not by the hour and are able to determine their hours of work and able to delegate their work.

You hit the nail on the head when you stated "contractor rather than employee" – if the person works under your direction and control, is paid hourly, working stipulated hours and cannot delegate their work then it is very likely statutory superannuation will be payable.

Some general protections provided under the *Fair Work Act 2009* extend to independent contractors and their principals.

For more information on workplace rights, industrial activities, and what constitutes adverse action, please see the Protections at work fact sheet. https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/rights-and-obligations/protections-at-work

Question 3

Subject: Deceased Estate

I am dealing with a lawyer who is winding up a deceased estate. I have received a letter from the lawyer asking me these questions.

Please would you confirm the following:

1. A new TFN must be obtained for the deceased estate.
2. The estate becomes a Trust following the death.
3. Any Income that the estate earns within 3 years from the death, must be distributed to the beneficiaries as per the will, on a Trust tax return form.
4. The beneficiaries record this income on their personal tax returns and pay income tax on this income.
5. If the estate is not wound up after 3 years from the death, the estate pays income tax on its income.
6. Any value of the assets (Cash, shares, property etc) that are distributed to beneficiaries, as per the will instructions, is Tax free in the beneficiary hands.

Answer

1. Correct…
2. Obtain a **tax file number (TFN)** for the **deceased estate**. … This is required as a **deceased estate** is treated as a trust for tax purposes.
3. Broadly correct – in practical terms, the total distribution is normally made well within the three years with income earned simply forming part of the estate – if the estate is still being determined, there is no need to make an annual distribution.
4. Disagree- for the first three years of the estate, it is the estate that pays tax being taxed at normal adult marginal rates.
5. Correct – this at highest marginal rate.
6. Correct - both super funds will have already paid the necessary tax for payments to non-dependents and made the required notifications to the ATO – there is no further tax to be paid by the beneficiaries and the proceeds simply form part of the capital of the estate.

Question 4

Subject: Division 293

Can you please assist me with the date that Section 293 came into effect?

Answer

We believe you are referring to Division 293 tax which is a 15% super surcharge tax on high income tax earners.

This was announced in the May 2012 Federal Budget and first applied in the year ended 30 June 2013.

The threshold of adjusted taxable income of $300k was lowered to $250k in the year ended 30.6.2017.

Question 5

Subject: Casual Rates or Normal Rates?

We have a cert 3 (children services) who works permanent hours (Thursday & Friday).

If she gets called in on another day to replace another worker. Does she get paid casual rates or normal rates?

Answer

They are paid at ordinary time for the first 8 hours then over time as per the award.

Question 6

Subject: Overseas Company Tax Return

This is about an Australian private company (Pty Ltd), but 100% of ordinary shares are held by overseas company. It has one Australian resident director and main activity is medical research and development.

Q1. 1- Ultimate and immediate holding company name and ABN or country code:

Should I put the name of overseas company for this question in the above scenario?

Q2. 26- International related party dealings/transfer pricing - Did you have any transactions or dealings with international related parties (irrespective of whether they were on revenue or capital account)? I just want to confirm that IDS (international dealings schedule) is required for Equity contribution from overseas parent company or not as some people say “not required” for equity contribution by overseas parent company.

a. Overseas company provided the fund for issued capital for the value of shares (paid shares amount by overseas company). Should we say to YES to this question?

b. Should we complete an International Dealings Schedule?

Q3. This Australian private company (Pty Ltd) is conducting the medical research in Australia. Total income / turnover of Parent and Australian company is AUD 6 mil. So, I believe that Australian private company (Pty Ltd) can apply for R&D tax incentive if all other conditions are met.

Australian private company (Pty Ltd) is wholly owned subsidiary of parent company. Is this going to affect the outcome of R&D tax incentive?

Q4. What is the impact / consequences if we answer Yes to above questions?

Answer

Q1. Yes

Q2. a. Yes

b. Yes. The following is a direct quote from International dealings schedule instructions 2020:

<u>Trigger points that will require completion of this schedule.</u>

If you are a relevant company, you must complete an International dealings schedule if you have written an amount or Y (for yes) at certain labels in your relevant tax return listed below

“Company tax return 2020

Question 6 Calculation of total profit or loss

J Interest expenses overseas

U Royalty expenses overseas

Question 7 Reconciliation to taxable income or loss

C Section 46FA deductions for flow-on dividends

P Offshore banking unit adjustment

Question 27 International related party dealings/transfer pricing

Y Was the aggregate amount of the transactions or dealings with international related parties (including the value of property transferred or the balance outstanding on any loans) greater than $2 million?

Question 28 Overseas interests

Z Did you have overseas branch operations or a direct or indirect interest in a foreign trust, foreign company, controlled foreign entity or transferor trust?

Question 29 Thin capitalisation

O Did the thin capitalisation provisions affect you?”

Q3. The ownership of the subsidiary company has little impact on the eligibility of Research & Development Offset. As Division 355 covers company either incorporated in Australia or overseas.

We suggest that you consider two aspects of the R&D tax offsets.

1. Whether or not the company is an R&D entity. You can only claim an R&D tax offset for expenditure on R&D activities conducted for you rather than for another entity. Working out for whom the R&D activities are conducted involves determining who receives the major benefit from carrying out the activities (for example, who owns the results of the activities). I refer you to Subdivision 355.35 & 355.220 of the ITAA 1997.

2. Whether or not the company has incurred notional deductions of at least $20,000 on eligible R&D activities. I refer you to Subdivision 355.20, 355.25 & 355.30 of the ITAA 1997.

Q4. 1. Please refer to the Company Tax Return Instructions 2020, which states:

"Under the income tax transparency reporting requirements, the Commissioner of Taxation will publish Report of entity tax information about:

- Australian public and foreign owned corporate tax entities with total income of $100 million or more, and
- Australian resident private companies with total income of $200 million or more.

The information will be extracted from tax returns and amendments by the relevant entity that have been processed by 1 September in the year following the one being reported, and the report will be published around December. For example, information from 2018–19 will be extracted on 1 September 2020 and published around December 2020.

The information you include at items 1, 2 and 3, along with certain income labels, will be used to identify entities for inclusion in the Report of entity tax information."

And...

2. "International related parties are persons who are not dealing wholly independently with one another in their international commercial or financial relations, and whose dealings or relations can be subject to Subdivision 815-B of the ITAA 1997 or the associated enterprises article of a relevant double tax agreement (DTA). The term includes:

- any overseas entity or person who participates directly or indirectly in the company's management, control, or capital.
- any overseas entity or person in which the company participates directly or indirectly in the management, control, or capital.
- any overseas entity or person in which persons who participate directly or indirectly in its management, control or capital are the same persons who participate directly or indirectly in the company's management, control, or capital.

Participates includes a right of participation, the exercise of which is contingent on an agreed event occurring.

Person has the same meaning as in subsection 6(1) of the ITAA 1936 and section 995-1 of the ITAA 1997.

For more information as to the relevant degree of participation, see Taxation Ruling IT 2514 Income tax: Company Schedule 25A: Information return for companies that transact business with related overseas entities.

The type of 'dealings or transactions' that will require the entity to answer yes at this question are dealings by the entity with related parties (as mentioned above), such as an overseas holding company, overseas subsidiary, or a non-resident trust in which the entity has an interest. These dealings or transactions may be the provision or receipt of services, or transactions in which money or property has been sent out of Australia or received in Australia from an overseas source during the income year. The dealings may also include transfer of tangible or intangible property, or the provision or receipt of loans or financial services."

Question 7

Subject: Small Business Entity Criteria

We have a client that has several commercial properties.

At what point can this be classed as a small business entity, and what are the relevant criteria to be met?

Are there any expenses that cannot be claimed?

Also, can you please confirm if Commercial Rental Income is to be recorded under a rental schedule like residential properties or under Business income.

Answer

Answer to first question...

The fundamental question is whether your client is conducting a business such as short-term rental accommodation or a hotel?

You indicate that this is only passive rental income. This may not be a small business entity.

Useful guidance is contained in Taxation Ruling TR 2019/1 Income Tax: when does a company carry on a business?

Although it may meet the criteria, the Capital Gains Tax

Small Business concessions will not be available – refer to page 7 of this edition.

Second question – It should be recorded in the rental schedule.

Question 8

Subject: Instant Asset Write Off- Luxury Cars

We understand that there is an instant asset write off (100%) for assets up to $150,000 each. Please advise if this is also related to luxury cars bought in the business and if so, is there a limit to the number of luxury cars that can be bought under this ruling?

Answer

The accelerate deprecation tax incentive applies to all depreciable business assets. However, there is a ceiling for luxury cars. The car limit for 2021 financial year is $59,136. Costs over this amount should be capitalised. Please refer to Section 995.1 of ITAA1997 for definition of car and taxation ruling MT2033 for modification of car.

Question 9

Subject: Anniversary/Entitlement Date?

Employee started with us 27.1.16. She went on maternity leave on 11.4.18 & returned 29.1.19. Then took maternity leave on 21.7.20 & returned on 27.1.21. What would be her anniversary/entitlement date?

Also, how do I calculate personal leave?

Answer

The anniversary date does not change it is the original commencement date.

The length of service is counted as approximately 44 months and 8 days or 3.6 years' service upon her return to work on 27/1/2021.

The entitlement to **personal**/carer's **leave** is **calculated** based on an employee's hours of work, not days.

Sick and carer's leave comes under the same leave entitlement. It is also known as personal / carer's leave.

The yearly entitlement is based on an employee's ordinary hours of work and is 10 days for full-time employees, and pro-rata for part-time employees. This can be calculated as 1/26 of an employee's ordinary hours of work in a year.

Refer to: https://calculate.fairwork.gov.au/leave

Question 10

Subject: FBT - Definition of an "Associate"

We understand that FBT is payable for any fringe benefits provided to an associate of an employee. What is the definition of an "associate", does it include wife, mother, children, in-laws, etc?

Answer

The term 'associate' is widely defined to include a spouse, a child, or any other relative. Please refer to S318 of ITAA1936. It also includes any trust under which the employee could benefit.

Question 11

Subject: Clarification on The Margin Scheme

My client's scenario is:

The client decided to purchase land and build a duplex. At the completion of the duplex, he decided to sell one of them and keep the other as an investment property. I then advised my client that this would more than likely attract GST on the sale of the one he sold.

He then went away and sought some advice from the ATO who said that he should register himself for GST and backdate it to before the signing of the land contract. So, the GST registration was backdated to 14 March 2019. They said that he could use the margin scheme.

I have attached for your reference the original land purchase contract together with the sale contract and the settlement statement that shows the tax withheld.

My questions are:

Is he entitled to use the margin scheme in the first place?

He cannot claim GST on Stamp Duty which we agreed, but the ATO literature shows that he cannot claim GST on his Conveyancing/Legal Fees on the purchase?

We have attached a spreadsheet with our calculations which divides everything by 50% to apply to the duplex he sold, do you agree with these calculations.

We have attached the settlement statement that shows the GST withheld of $32,452 of the sale price.

Answer

We make general comments and given we do not have source data do not check calculations.

It is correct that GST cannot be claimed on legal fees for the purchase.

The ATO advice to register for GST is correct - there is no doubt that your client was conducting an enterprise.

As the vendor of the land was a company, we suggest that GST was charged on the transaction.

Therefore, unless there was a mutual agreement in writing that the margin scheme applied, then there is no scope to use the margin scheme.

Question 12

Subject : Using Franking Credits?

The question is:

If a client declares a dividend in 2021 using franking credits from 2017 to 2020 (during which different tax rates applied for small companies), what % will the franking credit be, 30%, 27.5% or 26% ?

Answer

The franking rate applicable will be that of the current tax year - if it is prior to 30 June 2021, the franking rate applicable will be 26%.

Question 13

Subject : GST - Investment Property Transfer/Sale

I have a few questions about GST on investment property transfer as below:

1. My individual client bought a brand-new house from the developer. She then leases it back to them (for them to use as a display unit) for two years. After that she plans to sell the house immediately. Will there be GST on the sale price?
2. My corporate client enters a contract to build 4 houses for their client. The total value of the building contract will be $950,000. On completion, their client will transfer 2 houses back to them as the payment for the contract. My client will then sell these 2 houses to the public at an estimated price of $810,000 each. What are the taxes on the sale? Is there GST on the sale? If there is GST, what does my client need to do so GST does not apply to the sale?

Answer

1) The key issue you need to determine was whether there was a genuine change of title and your client paid GST on the purchase – if she did then a second-hand property is being disposed of and there will be no GST. If not, then it is very likely that GST will need to be charged. It sounds like the developer and your client may be associated in some way. GST needs to be paid once on the sale of the property at market value. If your client purchased the property at a significant discount to market value two years ago, then there is a real problem.

2) Refer to my earlier comments – again there is no way to avoid the fact that GST must be paid on the market value on the sale of the properties. The building contract is $475k for each property and GST is included in this amount.

For your client to own the property again there must be genuine change in title with stamp duty paid. Having effectively paid $475k… it now transpires the properties are worth $810k each – it goes back to our earlier comments that GST must be collected on the market value of the property. If the ATO uncovers a scheme to avoid GST they will take a dim view of this, particularly where the parties are closely associated.

Question 14

Subject : Employee - Not Called or Reported to Work

We require clarification on an issue we are experiencing with an employee.

The individual has not called or reported to work yesterday or today. Their usual workdays are Tuesday, Wednesday & Thursday.

Can you advise how long it must be before they have "abandoned" their place of employment?

Can you advise if we still must pay them for a "notice" period of two weeks if they do not return?

Do we still issue a letter of termination?

Answer

Abandonment of employment is a complicated and risky area, and employers should not lightly conclude that it has happened, especially if there is any indication the employee intends to return.

Employers should, at a minimum, try to make contact with the employee. If an employer can reasonably assume an employee has abandoned their employment, there are a number of steps it can take. Which steps are appropriate will depend on the circumstances?

The employer has an obligation to try and contact the employee via telephone on a couple of occasions, then try the next of kin, failing any of that they should report the matter to police as a welfare check if they cannot get in touch with the employee or and relevant next of kin. Also, they need to send a registered letter to the employees last known address at about the same time they call the police.

There is no set period of time that an employer must wait before they can assume an employee has abandoned their employment.

Clauses in modern awards previously required a period of at least three days' unexplained absence before there was prima facie evidence an employee had abandoned their employment. There is no longer any abandonment of employment clauses in the modern awards, as the Fair Work Commission considered they were not necessary to meet the modern awards objective.

Once a reasonable period of time has passed and an employer can reasonably assume the employee is not coming back, there are a number of options available to an employer.

Which option is appropriate will depend on the relevant employment instruments and the facts of the matter?

If there is no reply from the phone calls or reply from the letter it is only then that they can assume the person has terminated their employment due to abandonment and they pay the employee all outstanding entitlements up until the last day worked and the relevant notice period (casuals excluded from notice period).

Whilst the process seems a little arduous anything less may be seen as an unfair dismissal.

Question 15

Subject: CG Distribution

My query relates to Capital Gains distribution in a family trust.

Have 3 beneficiaries who are presently entitled and could receive a distribution of CG in the 20/21 year.

A - earns $3000 in the year.

B - earns $50,000.

C - is a foreign resident for tax purposes (no earnings here).

Could you please show what would be the likely tax payable on $30,000 CG distribution made to each beneficiary?

Answer

Firstly, we assume the $30k distribution has taken into account the CGT individual 50% discount.

Also, that we are dealing with adults.

A – will pay very little tax but take $2,392 as a guide – if a senior Australian this figure could be less.

B – will pay $10,350 on the distribution (at the 32.5% marginal rate plus 2% Medicare).

C - will pay $9,750 tax at a non-resident flat rate of rate of 32.5%.

Question 16

Subject: SMSF and Limited Recourse Borrowing

Hi, this query relates to self-managed superfund and limited recourse borrowing .

An existing client (SMSF and member thereof) jointly own commercial premises in Canberra, i.e., leasehold property as is all land in Canberra.

The commercial premises are rented to another entity (unit trust) that operates a restaurant business. The commercial property is unencumbered.

The joint owners are considering expanding the commercial premises, however, will require loan funds to facilitate the construction of this extension. The proposed extended premises will also be leased to the current operator.

The issue at hand is how the proposed extension can be funded without exposing the SMSF's assets including its 50% share in the existing property.

My initial thoughts were (subject to ACT Gov approval) to subdivide the existing leasehold property with the subdivided vacant parcel being owned (leased) by a new unit trust which in turn is owned 50/50 by the same joint property owners.

I understand that under the limited recourse borrowing provisions, providing the new asset is held in a trust, the trust is able to borrow the necessary funds providing the debt is secured only by the property of this trust and not by the SMSF.

Should the ACT Gov not allow the subdivision of the existing leasehold, could the joint owners still borrow the necessary funds with the member using his own personal assets as security?

As such neither the existing commercial premises nor other assets of the SMSF would not be exposed.

Answer

You are correct to identify that no existing asset owned by a SMSF may then be pledged as security or encumbered in any way .

This should not be confused with limited recourse borrowing arrangements (LRBA), where a SMSF purchases an asset using a bare trust arrangement.

The subdivision proposal you suggest may have merit, but you will need to take legal advice from a lawyer specialising in SMSFs and ACT long term leases .

First, there will need to be an assignment of the long-term lease for consideration at market value and care taken to ensure the unit is not a related trust.

If the trust is related (more than 50% ownership), then the in-house asset rules apply.

Of course, the SMSF trust deed has to be checked to confirm such activity is allowed. LRBAs do not apply to purchases by unit trusts but to the bare trust arrangements outlined above.

In the event subdivision is not allowed and the fund members finance the development themselves, then there is the danger of these funds being deemed to be contributions to the fund.

Depending on the funds required and the fund balances this could be formalised by making non-concessional contributions.

In summary there is a lot that can go wrong here – seek specialist advice.

Question 17

Subject: SMSF – Single Member Fund

I have a question regarding an SMSF.

I have a single member fund with a corporate trustee who also is the only director and member of a private company (A) that owns 16% of the shares in another private company (B) which the member is not a director or a majority shareholder.

My question is, can the SMSF buy from Company A - the unlisted shares in company B or does that constitute an in-house asset?

Answer

Buying these shares from the member (or associate) would certainly constitute an "in house asset."

This means no more than 5% of the fund's assets are allowed to be in-house assets.

There are only two exceptions:

- Business real property
- Listed shares on the ASX or an equivalent approved stock exchange.

Question 18

Subject: Temporary Full Expensing

Regarding the Temporary Full Expensing - can these assets be leased? For example, truck/trailer.

The Client has financed the purchase of the truck/trailer however wish to lease to another entity. The entity is part of a corporate group i.e., the entities are associated.

I am aware that with the instant write off, it is detailed that you are unable to receive the instant write if the asset is leased?

Can you please confirm that the entity that purchases the asset and has leased to an associated entity is able to claim a 100% temporary full expense? As this asset cannot be claimed under the instant write off method.

Also, that there are no issues with leasing out to another related entity as with the instant write off method.

Answer

Yes, we confirm it is the holder of the asset who claims the tax deduction.

This is a common asset protection technique, no issues are highlighted, and we can find nothing to indicate that this a problem.

However, we recommend you contact the ATO to confirm this and/or apply for a private ruling.

Question 19

Subject: Mortgage Refinancing Expenses Tax Deduction

My client has incurred exit fee of $2000 when refinancing the loan in FY 2019. They forgot to claim tax deduction :

My Question:

1. Would that be tax deductible as borrowing expenses?
2. Can this be adjusted in 2020 tax return instead of amending 2019 return?

Answer

Mortgage discharge expenses on investment properties are deductible in the year they are incurred.

For this reason, we would recommend amending the 2019 tax return as it is best practice.

In the event the relevant marginal tax scales are identical and the amendment involves additional work, then you may wish to consider including the expense in 2020.

Question 20

Subject: Tax Payable by Trustee?

A client has passed away and has an amount in super. The Super fund is an Industry fund, and it produces a PAYG Payment Summary – Superannuation Lump Sum.

Total Tax Withheld	$0
Taxed Element	$274,139
Untaxed Element	$65,139
Tax Free component	$0

Death Benefit – Yes

Type of Death Benefit - Trustee of deceased estate.

Other information 16/02/1957 was the Date of Death.

How much tax is payable by the trustee?

Answer

Assuming the Estate is the beneficiary, any tax payable will be paid by the superannuation trustee.

The deceased estate will not be liable for tax.

Question 21

Subject: Normal or Salary Sacrifice?

If a NFP employee is being terminated and being paid 3 week's leave in lieu of notice. Can salary sacrifice be deducted from the ETP?

Currently $610 and $165 of pre-tax pay per f/n is paid to Salary sacrifice and Meals and Entertainment cards as part of our FBT. Do we just pay this as part of her normal salary or as the salary sacrifice?

Answer

It is suggested that the ETP be paid out in normal salary.

A payment on termination means there is no prospect of further salary sacrifice as employment has ceased.

Question 22

Subject: Classic Car in a SMSF

a client of mine wants to buy a classic car in a SMSF (1 member fund).

I am happy for him to do that as long as he follows the storage procedures etc and doesn't drive the car himself etc as pointed out by the ATO.

However, he wants to do some restoration work on the vehicle himself to increase the value of the vehicle, but he is not qualified as such to do that - he knows cars and can work on car as such, but he is not qualified.

I believe this will not be allowed by the ATO but just want your thoughts.

Answer

We would advise against this – as you say he is not qualified, and this could be construed by an Auditor as straying into "personal use and enjoyment of the asset".

Next your client will be suggesting he needs to take the car on a test drive.

Question 23

Subject : What Is the Best Practice?

I am the Director; the staff have made complaints to the Management Committee about a couple of issues.

The main one is ringing me when they are not coming in for work.

We are a in NSW and staff start at 8am or 8.30am. I ask staff to ring me on my mobile by 7.15am in order to organise a replacement. Is this good practice, what is the best practice?

Should I be the one bringing these complaints up at a staff meeting to make changes? How should I do this?

Should they be speaking to me or is leaving a message on the answering machine good enough?

Answer

The Fair Work Act 2009 says, an employee should advise the Employer as soon as practical.

The best solution would be to have a staff meeting and memo regarding personal leave.

The memo should answer these questions below:

The memo should say for example The Fair Work Act 2009 advises that you should notify the centre of your unavailability for work as soon as practical, we would really appreciate notification by 7.15am if you are able to do so.

Best practice is to be flexible but certainly have a set of guidelines that are conveyed to employees so that they have an understanding and yes raise the complaint but as a generalisation only not targeted at any one employee.

About speaking to you personally or is leaving a message, it is entirely up to you whether you feel leaving a message is appropriate or sufficient.

Some employers insist they speak to the manager in this regard, other employers will call their employees back if they leave a message to gauge how legitimate the request for leave is.

There are no rules to suggest what is good enough.

However, we do suggest you have written clearly in your staff policy manual exactly what is expected in this instance and be consistent in the way you manage it.

Remember, there will be times when flexibility, empathy and sensitivity toward the situation will be required.

Question 24

Subject: Employee Returning to Work

We have a teacher returning to work after maternity leave.

She is still breast feeding and wanting time to leave the workplace to feed her baby.

She is an ECT under the Educational Services (Teachers) Award 2020.

Could you please clarify 16 - breaks? We are a preschool that operates for 41 weeks per year not 48.

Also, can you clarify lactation breaks to express, as she will not be included in ratios for the time that she is off the floor ?

Are we obligated to pay her? or are they unpaid breaks? I cannot find anything in the award.

Answer

We believe Clause 10 (below) covers your question. We have also included a link that will go far more in-depth for you and answers a lot of questions regarding breastfeeding and the workplace.

According to the NSW Department of Education under the Educational Services (Teachers) Award 2020.

Clause 10: lactation breaks

10.1 This clause applies to employees who are lactating mothers. A lactation break is provided for breastfeeding, expressing milk or other activity necessary to the act of breastfeeding, or expressing milk and is in addition to any other rest period and meal break as provided for in this award.

10.2 A full-time employee or a part-time employee working more than 4 hours per day is entitled to a maximum of two paid lactation breaks of up to 30 minutes each per day.

10.3 A part-time employee working 4 hours or less on any one day is entitled to only one paid lactation break of up to 30 minutes on any day so worked.

10.4 A flexible approach to lactation breaks can be taken by mutual agreement between an employee and their supervisor provided the total lactation break time entitlement is not exceeded. When giving consideration to any such requests for a flexibility, a supervisor needs to balance the operational requirements of the organisation with the lactating needs of the employee.

10.5 The Department shall provide access to a suitable, private space with comfortable seating for the purpose of breastfeeding or expressing milk.

10.6 Other suitable facilities, such as refrigeration and a sink, shall be provided where practicable. Where it is not practicable to provide these facilities, discussions between the supervisor and employee will take place to attempt to identify reasonable alternative arrangements for the employee's lactation needs.

10.7 Employees experiencing difficulties in effecting the transition from home-based breastfeeding to the workplace will have telephone access in paid time to a free breastfeeding consultative service, such as that provided by the Australian Breastfeeding Association's Breastfeeding Helpline Service or the Public Health System.

10.8 Employees needing to leave the workplace during time normally required for duty to seek support or treatment in relation to breastfeeding and the transition to the workplace may utilise sick leave in accordance with subclause 17.9 Sick Leave of this award or, where applicable, through the operation of the provisions of subclause 8.4 of this award.

https://education.nsw.gov.au/content/dam/main-education/industrial-relations/media/documents/lactation-breaks/Breastfeeding-and-Lactation-Breaks-in-Schools.pdf

Question 25

Subject: Late Lodgement of BAS's

Can you please advise how late lodgement of BAS's impact on our tax agent lodgement program?

Also, how late lodgement of Tax Returns impact on our tax agent lodgement program.

If you can send through a link or documentation to confirm it would be appreciated.

Answer

Generally, if more than 15% of the returns are late, then the ATO may become concerned.

You will sometimes be visited by an ATO official for a discussion.

You may receive a “please explain” letter.

In the event lateness becomes an annual event the concessions accorded in the usual tax agent program may be curtailed.

This rarely occurs.

In the event you have encountered difficulties through staff illness, family circumstances or staff departure, simply email the ATO, outlining this, seeking lodgement extensions.

They will usually grant an extension in legitimate circumstances.

Question 26

Subject: One Off Gift

Our client is a Church based in NSW and they are asking if they can give $10000 one off Gift per financial year to a pastor which is tax free on pastor’s hand .

Answer

If the payment is for work done or can be linked in any way to the performance of the Pastor’s duties, then we suggest it is assessable.

Question 27

Subject: Capital Gains Implications

Our client inherited 2 x investment properties in June 2017 after her husband passed away.

Probate granted, and deceased estate tax return done sometime in August 2017.

She continued to rent the properties and decided to sell one of them last month and entered into contract with settlement by the 1st week of April 2021.

In the title she still appears as “Executor” not the sole owner.

We have established that the Property needs to be transferred to her name as beneficiary from her being as executor.

Our questions:

1. Is there a Capital Gains Implications when she transfers the title to her as beneficiary from her as executor?
2. Is there a Capital Gains Tax Implications in the Settlement happening in the 1st week of April?

Answer

We note that while probate has been granted and a tax return has been lodged, this does not mean the Estate has been finalised.

This only occurs when all assets are dealt with as instructed in the Will.

Further as Executor your client gets to call the shots.

If possible, have the estate dispose of the property.

This avoids paying stamp duty on the transfer to your client.

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

Refer to page 41 of this publication.

If the property was purchased after September 1985 the original cost base to the late husband is used for the sale by your client.

A net foreign resident withholding certificate has to be filled out prior to settlement, if the sale proceeds exceed $750k.

Even if you are an Australian resident this is necessary.

Question 28

Subject: - What Company Rate?

Could you please confirm what company rate is applicable on the following?

Distribution from a Family Trust to a Company. All income is from a trading business within the Trust.

As more than 80% of the income being distribution from the discretionary trust to the company is not passive income, can you confirm that the company tax rate in this scenario is at 27.5% for the 2020 year?

Answer

For the year ended 30 June 2020 the company tax rate for base rate entities is 27.5% (26% in 2021).

To be a base rate entity your turnover must be less than $50 million.

Receiving a discretionary distribution is passive income.

Given more than 80% of the income is a discretionary trust distribution, this means the company in question does not qualify as a base rate entity.

Therefore the 30% tax rate applies.

Michael's Corner

ARTICLE NO. 10 –

6 STEPS TO ENSURE SUCCESS WITH ACCOUNTABILITY AND DELEGATION IN THE WORKPLACE

1.Prepare
Employees cannot deliver quality results if the task delegated to them is not fully thought out, or if expectations keep changing. Take the time and develop the discipline to map out exactly what you are asking for. An ounce of prevention is worth a pound of cure.

2. Assign
Once you have taken the time to map out exactly what you are looking for, you need to convey that information to your employees. Be sure to include clear information on timing, budget, and context, and set expectations for communication and updates, including frequency, content, and format.

3. Confirm understanding
One of the most common mistakes made in delegating is assuming that employees understand what you want, rather than making sure that they do. Confirming understanding only takes about 60 seconds but is the most important determinant of success or failure.

The best way to confirm understanding is to ask your employees to paraphrase the request or assignment in their own words. If you are not comfortable doing that (many managers feel—often correctly—that it makes them sound like a kindergarten teacher), you should, at the very least, ask questions to make sure employees understand all aspects of what's required.

4. Confirm commitment
This is another part of the delegation process that most managers skip. They often just assume that employees have accepted the tasks they have been given. The most important part of a relay race is the handing of the baton to the next runner. Runners spend a huge amount of time learning this skill. It should be no different in the workplace. Commitment means making sure you have successfully handed over the baton.

Confirm that employees are committed to the expected results, and to the process that has been set out (including the schedule, budget, and tools), and that their overall goals for the task are aligned with yours. Make sure they are aware of any consequences (for the company and for themselves) that may result if they fail to deliver on the desired outcomes.

5. Avoid "reverse delegating"
Many managers are extremely overworked. Sometimes, this is because their employees are better at delegating than they are: Managers often end up completing tasks they had delegated to others, because those tasks somehow end up back on their plate. I call this "reverse delegating."

It is rarely, if ever, necessary for a manager to take back a task that he or she had delegated to someone else. (If this is necessary, it likely means that not enough time was spent on the preparation stage, and that time, resource, or other constraints have led to problems that you did not foresee.)

If an employee reaches an impasse, treat it as a learning opportunity. Coach the employee through it, making sure he or she has the resources and knowledge needed to complete the task. That way, you will still be free to focus on other things, and the employee will be better equipped to carry out similar tasks in the future. The bottom line? Do not take tasks back.

6. Ensure Accountability
Two-way communication is a key part of delegating. Finding out at the completion date that a deliverable has not been completed or has been done unsatisfactorily is the nightmare scenario of delegating. That is why you need to make sure your employees are accountable for the task.

Accountability is key to the process of delegation: It means employees are regularly communicating with you about the status of the deliverable and the timing of delivery so that there are no surprises at the eleventh hour. The delegation process becomes faster and more fluid the more you do it. Once you have mastered it, it will become a part of your managerial DNA, and you will consistently reap outstanding results.

Employers- Consider the Health & Safety of Those Working Outside of Normal Hours

Walker v Greenmountain Food Processing Pty Ltd [2020] QSC 329

In the recent judgement of Walker v Greenmountain Food Processing Pty Ltd [2020] QSC 329, the Supreme Court of Queensland found an employer liable for the loss and damage suffered by a worker who sustained serious injuries after falling through a roof at dusk while investigating an issue with a boiler.

The facts
On 12 June 2015, Scott Walker (plaintiff) finished his day's work as the maintenance manager of the Greenmountain Food Processing Pty Ltd (employer) plant at Coominya

and headed to the local pub for a couple of light beers. He left the pub at approximately 5pm and as he was driving by the plant, he observed large plumes of steam venting from a boiler. The plaintiff decided to enter the premises to investigate the issue, which was most likely a malfunctioning relief valve on a boiler.

When the plaintiff arrived on site, he phoned a contractor from his mobile phone to commence the necessary arrangements for having the issue fixed over the weekend. The contractor told the plaintiff that he needed to know which relief valve was leaking so it could be fixed. Accordingly, the plaintiff, while still on the phone, scaled a platform near the top of same large tanks to try and see which relief value was leaking. He could not see from his position on the platform in the fading daylight and so stepped through a gap and onto the roof surface to see if he could get a better view. He subsequently stepped onto Alsynite sheeting which gave way, causing him to fall more than 7 metres onto the concrete floor. The plaintiff suffered a fractured skull, a moderate brain injury, multiple injuries to his spine, knees, and wrist.

Liability

His Honour, Justice Applegarth, made the following liability findings when ruling that the employer's negligence caused the incident and consequent loss and damage suffered by the plaintiff.

- In his role as maintenance manager, the plaintiff was required to maintain all facility and manufacturing assets and was required to be on call at nights and on weekends.
- It was reasonably foreseeable that the plaintiff, in his role of maintenance manager, would need to investigate steam venting from a boiler in order to identify the source of the leak.
- The risk of injury from falling off or through a roof was not insignificant.
- The burden of taking precautions to avoid the risk of injury was not great. Examples of simple and inexpensive precautions the employer could have taken include implementing a policy and safe work method statement for working at heights, fencing off access from the platform to the roof, erecting warning signs regarding the presence of Alsynite.
- If one or more of the above precautions had been taken by the employer, it would have prevented the incident.

Contributory negligence

The employer argued in its defence of the claim that the plaintiff was contributorily negligent for his own injuries for accessing a roof which he knew to have Alsynite panels, in failing dusk light such that he could not see those panels, and while engaged in a phone conversation with the contractor.

Justice Applegarth considered the relevant standard of care for establishing a contributory negligence argument (what a reasonable person in the plaintiff's position would have done) and concluded that the plaintiff's decision to step on the roof when he could not see what he expected to see from the platform was "an inadvertent error of judgment made under pressure". His Honour also made the point that the small amount of alcohol in the plaintiff's system did not add much to the equation.

Had contributory negligence been established, His Honour would have apportioned 10% liability to the plaintiff.

Damages

Justice Applegarth awarded the plaintiff $967,383.39 in damages clear of the WorkCover statutory refund.

The main component of the award for damages was for future economic loss. Despite the fact that the 37-year-old plaintiff (32 at the time of the incident) was able to return to his position as maintenance manager and the employer contending it had no plans to let him go, His Honour held that there was a reasonably significant risk that the plaintiff will lose his current employment, either in the near or not too distant future, and that he would be at a significant disadvantage on the open labour market. While the plaintiff has a residual capacity for work, his honour considered that any future work will likely be insecure and of a part-time nature.

His Honour noted it was not possible to assess the award for future economic loss in the current case with any "mathematical precision" and settled on an award of $765,600 for future economic loss.

Lessons for employers

This judgment is a timely reminder to all employers to:

- consider restricting the physical access of workers to work premises outside normal work hours. If workers do require access as part of their role then specific instruction and training should be provided regarding what activities are allowed / not allowed on site
- ensure policies and safe work method statements are in place or updated for working at heights
- consider erecting warning signs or barricades for identified risks
- ensure you foster a positive hazard reporting system within the workplace to encourage workers to report hazards that are not observed or known to management.

Please note that this is general advice for information only and any application of legislation and/or Industrial Relations or contractual requirements may require professional advice to suit your individual circumstances. If you have questions for Michael's team send us an email ... info@bo2.com.au

Bonus Issue

CAPITAL GAINS TAX MINIMISATION STRATEGIES 2021

WHAT'S NEW IN 2021?

- Healius Ltd – Lump sum payments to doctors. Commissioner is successful in appeal to Full Federal Court.
- Burton's Case – Taxpayer is refused special leave to appeal to High Court and ATO releases Decision Impact Statement. This case dealt with capital gains tax discount and claiming overseas tax credits on capital gains.
- Eichmann – CGT small business concessions and whether land can be an active asset. Taxpayer wins on appeal to Full Federal Court.
- Minimising capital gains tax on the sale of the holiday home.
- Removing capital gains tax for granny flats.
- ATO releases Decision Impact Statement (DIS) on Full Federal Court Decision of Greig V Commissioner of Taxation (2020) FCAFC 25.
- Comment on CGT determination number 60.

HOW ARE YOU GOING TO LOWER OR ELIMINATE CAPITAL GAINS TAX?

1. Do all you can to preserve your main residence exemption. See Issue #0107- pages 26,32,33,38.
2. Be aware of the Main Residence 6-year temporary absence. See page 49 of our annual publication.
3. Some people engage in D.I.Y. home renovations enhancing the value of a CGT Exempt Asset i.e., their main residence then selling 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 pension phase have no tax on earnings or capital gains – see Tax Tip #106-page 30 Issue #109.
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 to when you actually sell them.
7. Fully utilise the CGT small business concessions. *See article pages 49-50 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 #58-page 23, Issue #0109. 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 on being a developer. Specialist advice should be sought. Also see pages 33,37 and 38 Issue #0107.
13. Note that Small Business Entities (SBE) 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 a SBE. This generally means a turnover of less than $2 million.
14. Where there is a CGT event, fully investigate whether rollover relief is available. See Tax Tip, pages 802, Issue #0109, 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 income. See Tax Tip #42-page 21, Issue #0109.

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.
- If it is necessary to apply the hypothesis of a willing seller and buyer, 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 be 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). In substitution, it inserts a new s 152-10(2). 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.

Following, 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	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. 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.	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 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.

HEALIUS LTD V C OF T [2019] FCA 2011 29.11.2019– LUMP SUM PAYMENTS TO DOCTORS ON REVENUE ACCOUNT

This case involved lump sum payments made to doctors in respect of contracts to conduct their practice at medical centres operated by Idameneo (NO 123) Pty Ltd. The Federal Court held these payments were not capital but on revenue account and deductible under section 8-1 of the Income Tax Assessment Act 1997.

Although the contracts involved a "Sale Deed" and "Practitioner Agreement", the legal reality was that the benefits that Idameneo derived from the Sale Deed and Practitioner Agreement were not for the sale of the doctor's practice or goodwill but:

- The doctor's promise to conduct his practice from the medical centre for five years, and
- The doctor's promise not to provide medical services to anyone within a radius of 7km of the medical centre or his own former practice within that period.

As Idameneo consistently tried to engage doctors to meet its ongoing demand for them. Perram J took the view the payments of the lump sums were recurrent and ongoing. In the relevant period, Idameneo did this 505 times, demonstrating the expenditure was in every sense recurrent which pointed to the outgoings being on the revenue account.

The ATO appealed and the Full Court of Jagot, Moshinsky and Colvin JJ allowed the appeal.

Accepting the ATO's contentions, the Full Court found:

"with due respect to the careful analysis of the primary judge, the Commissioner has demonstrated that the Lump Sum payments were capital outgoings. That is principally because they were not simply payments to secure medical practitioners as customers who would then pay to use the facilities and support services provided by the Centre. Rather, they were payments made for the practitioner (a) to cease operating an existing practice (or otherwise practising independently of the Centre); (b) to commence trading as part of the Centre by adopting Idameneo's required mode of practise; and (c) during the arrangements as well as thereafter to accept a restraint on establishing a medical practice that would compete with the Centre."

The acquisition by the taxpayer of the goodwill of the doctors was not an essential part of the arrangement from the perspective of the taxpayer. Rather, the lump sum amounts were paid to secure advantages for the taxpayer that added to and enhanced "the structure (including goodwill) of [the taxpayer's] business". The Full Court, accordingly, found the lump sum amounts were not paid to acquire the goodwill of the existing practices.

In addition, the Full Court considered that the business of the taxpayer was not the provision of services to doctors and other health care providers to conduct their businesses at its medical centres but was more accurately described as the taxpayer operating the medical centres. All material aspects of the conduct of the business of providing medical services to patients of the medical centres were in the hands of the taxpayer.

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.

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 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 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 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). In applying the provision, only net capital gains are included in assessable income. 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.

Special leave to appeal this decision was refused by the High Court. 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 Government by 30 November 2020. The terms of reference can be found on the Board of Taxation's website.

HIGH COURT DETERMINES QUESTION ON 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 a particularly beneficial taxation result in the hands of certain beneficiaries. In the event 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 who could pay 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 with the franked distribution itself.

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

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 distribution of income and the other dealing with distribution 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 pass 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 a 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 in respect of 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 is 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.

There are many forms of arrangements which 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.

CHANGES TO THRESHOLD AND RATE FOR 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 will 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 will be increased to 12.5% (the current rate is 10%).

BOOSTING AFFORDABLE HOUSING FOR AUSTRALIANS 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 with which Australia has 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 10 years.

Should these assets be held for a period of less than 10 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 YOUR 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 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 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 long bow 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 his or her personal belongings into the dwelling.
- The address to which the taxpayer has his or her 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 to the taxpayer to vacate the building? For instance, if it were due to a job transfer to Brisbane then 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 inner-city units are undervalued. He has a 21-year-old daughter Pricilla attending Melbourne University. Pricilla's plans are 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 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 is rented out for more than 6 years (and no other property is treated as a 'main residence').
2. The home has been rented out after **20 August 1996**; and
3. The full main residence exemption would have been available if the house was sold just before it was rented out.

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

1. Obtaining a valuation from a qualified valuer; or
2. Calculating their own 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 also any doubt about the market value of the property.

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

TAX TRAP... 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 being where the dwelling is accidentally destroyed, and the land is then 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 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. Which had originally been 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, a part of the divorce settlement, the taxpayer was ordered by the Federal Court 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 company was controlled by the taxpayer and his brother. 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, the ATO disagreed.

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

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 that is set aside to produce income, and the period it's used for that purpose.

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

Clearly 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.

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

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

TAX TIP: CGT and Your Holiday Home

Ongoing expenses can be included in the cost base of the property 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 when it comes to 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 (CGT) 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 the 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 you are away, it is possible that the relevant expenses will 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 that is 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 will be extended to deny foreign and temporary tax residents' access to the CGT main residence exemption.

The original bill to give effect to 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 date of announcement 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 for tax purposes can access the exemption. 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 7:30pm (AEST) on 9 May 2017, the CGT main residence exemption will only be able to be claimed for disposals that happen up 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 7:30pm (AEST) 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.

CGT ON THE SALE OF YOUR 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.

CHOOSING TO DISREGARD CAPITAL GAINS AND CAPITAL LOSSES WHEN YOU CEASE 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 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 as at that time.

RECOUPING UNPAID FOREIGN RESIDENTS' CAPITAL GAINS TAX, THE PURPOSE OF TAX LAW AMENDMENTS

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 as to how the income and / or capital of the trust are to be 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 are made, income flows through a trust and retain its character. Thus the 50% general CGT discount for assets held longer than 12 months can be accessed by individuals. 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 of the 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 that time there have been significant developments in the law relating to trusts following the Bamford decision but also 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 income of the trust calculated according to trust law and accounting principles. While this would not generally include capital gains, significantly, it was held that a trust deed can 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 that result is facilitated by specific statutory rules.

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.

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 his/her 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 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, 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 in the event that 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 more 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. If you are aged less than 65 years or age and not receiving substantial employer support (salary <10% of taxable income) then you are able to 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.

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 is used by the taxpayer 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 of half of the period of ownership 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 in relation to 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 the 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, then 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 capital proceeds must be received by the superannuation fund 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:

1. The 50% CGT discount for individuals.
2. The 50% active asset exemption on the balance of the capital gain.
3. The remaining 25% of the gain could be rolled over into replacement assets or it could be applied to the $500,000 CGT retirement exemption.

Other Rollover Relief

Rollover relief allows a taxpayer to preserve 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 with 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: if it is lost or destroyed or becomes part of a 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 break down.
- 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, then no assessable gain would arise.

SMALL BUSINESS ROLL-OVER

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

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 be incurred.

Ultimate Economic Ownership

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 straight forward" 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 sale of Australian property which is entered into on or after that date.

Where the market value of the property is 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:

- An 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

Sellers Gain More Certainty as CGT Amendment

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 future performance of the business.

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.

Before considering whether your arrangements qualify for "look though" treatment seek specialist advice. Both sides of a 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 carefully assess your options.

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 which allows $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 the ultimate outcome of this exemption shows clearly why companies are not 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 starts 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 main residence of the deceased will not attract CGT.

Pre 19.9.1985 main residences enjoy the two-year concession even if they were rented out before and/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 case, then market value at the date of death becomes the cost base.

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 the passing of 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 TESTEMENTARY TRUSTS

A testamentary trust is designed to provide maximum flexibility and allow for tax-effective distribution of capital and income, as well as providing 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 in the same way as a legal personal representative (LPR).

UTILISE CAPITAL LOSSES OF THE DECEASED PRIOR TO 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 a taxpayer is aware of a terminal condition, they could consider getting CGT assets to intended beneficiaries prior to death. This means the actual capital gain will be lowered by the carried forward losses. Note, that the market value substitution rule will also step-up the recipient's cost base to market value on the date in question.

Note, SMSFs have similar considerations for post death distributions to non-dependents and this is dealt with in depth in bonus issue #0108 page 40.

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 superannuation funds.

A perusal of the text of s104-215 reveals the unfortunate consequence namely 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 a taxation purposes – this means that the income of the trust flows to the beneficiaries in untaxed form and is taxed at 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.

It is for this reason that if at all possible and if all parties agree, consideration be given to the formation of a partnership of newly formed discretionary trusts. For asset protection purposes avoid using existing trusts that may have 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 – SMALL BUSINESS CONCESSIONS

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 & paving through a trust. The land which had no business signage had been acquired next to their home contained sheds and the open space were used to store materials, tools, and to 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 a 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 activity 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 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 market value of the property 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 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 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. A SBPP includes not only the percentage voting power held in the company but 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 a trust and one 'dividend access share' to an individual which 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 threshold for a "small business entity."

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 company acting as trustee of the trust 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), and 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 of these thresholds 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, a Mr Coffey had the power to remove the trustee company.

Crucially Mr Coffey gave evidence that the trust was controlled by Mr Gutteridge 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, if it were necessary to find that Ms McKenzie was a puppet director, or that Mr Gutteridge was a shadow or de facto director, 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.

Toorak, as trustee for Toorak Unit Trust, 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 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's reports to address the authenticity of a document which had been 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 authenticity of the document.

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 where there is a formal written agreement in place.

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 will commence on 1.7.2021.

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

Currently there are around 3.9 million pensioners and around 4 million Australians with a disability who would be eligible for this exemption under this change.

As part of the 2020-21 Budget, this will boost the construction industry, stimulate demand for new housing and support Tradies jobs at a time when the economy needs it most.

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, in particular, 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 51, Issue #107.

TAX TIP: 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.

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 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 to 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 2013 as trading stock at a cost of $5 per share. In January 2016, the shares are 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 tax of $39,200 (i.e., 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, 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 in respect of 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 the application of the trading stock 'change of use' rule.

Record Keeping for Small Business CGT Concessions

The ATO has issued a reminder that taxpayers should keep good records to help them determine if they are eligible to claim the small business CGT concessions, including evidence of:

- Carrying on a business, including calculation of turnover (to demonstrate eligibility for the 'small business entity' (SBE) test).
- The market value of relevant assets just before the CGT event (to demonstrate eligibility for the $6 million maximum net asset value test).
- How capital losses have been calculated and carried forward to later years; and
- Relevant trust deeds, trust minutes, company constitution and any other relevant documents.

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."

Clearly 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, then take legal advice on steps required to forgive a loan.

The key here is whether interest has been on the loan – if not then 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 outstanding balance of the loan. 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 does not have the ability to repay the loan at the time 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 actual 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 assets 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, then the loan will be treated as a personal use asset. We would also refer you to CGT Determination Number TD2.

CGT DETERMINATION NUMBER 60

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 cost base of the asset.

DISCLAIMER

The information statement and opinions expressed in this publication are only intended as a guide to some of the important considerations to be taken into account relating to taxation matters. Although we believe that the statements are correct, and every effort has been made to ensure that they are correct, they should not be taken to represent taxation advice and you must obtain your own independent taxation advice. Neither the authors, nor the publisher or any people involved in the preparation of this publication give any guarantees about its contents or accept any liability for any loss, damage or other consequences which may arise as a result of any person acting on or using the information and opinions contained in this publication.

Readers seeking taxation advice should obtain their own independent advice and make their own enquiries about the correctness of the information set out in this publication and its accuracy in relation to their own particular circumstances.

ANOTHER ESSENTIAL TAX SMART AUSTRALIA RESOURCE • CLARITY • CONVENIENCE • CONFIDENCE •

bO2

Corporate Essentials

Tax Smart Australia

TSA Unit Trust
t/as bo2 Corporate Essentials Pty Ltd

ABN 70 377 440 020
ACN 119 058 310

PO Box 5179
Bundall QLD 4217

T 1300 55 55 33 | P (07) 5574 0555
F (07) 5574 2881 | E info@bo2.com.au

www.bo2.com.au