bO2 Corporate Essentials

Tax Smart Australia

Issue
#0092

Tax Essentials

# Capital Gains Tax 2018

APRIL 2018

## THE NEWSLETTER
Tax Planning Update

## LEIGH'S CORNER
Payment of Wages and Conditions
*Article No.40*

## SPECIAL BONUS ISSUE
Capital Gains Tax- Minimisation Strategies

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# Contents



**Because of the increase in the major cases coming through the Courts and Tribunals in relation to these matters we have raised this issue again.**



### WHAT'S NEW IN 2018?

Foreign investors and entities are most affected by the 2018 changes federal government policy which aims to:

- Address housing affordability
- Stop foreign nationals avoid paying capital gains tax when they sell property
- Attract foreign investment

We also cover in detail significant changes to the CGT small business concessions and an important federal court case on the same topic, Commissioner of Taxation V Miley (2017) FCA 1396, won by the Commissioner on appeal.

We would also draw your attention to the following changes (rulings and guidelines) which we will not expand on... these are readily available on the ATO legal database.

- The application of the transitional CGT relief for capital gains that may arise as a result of the recent superannuation changes has been fully explained by the ATO in (LCC 2016/8)
- Where an option is exercised, CGT event A1 which occurs in relation to the asset is the date of exercise of the option (TD 2017/12)
- An intangible capital asset made to pre-CGT property can be a separate CGT asset (TD 2017/1)
- Retail premiums paid to eligible shareholders are treated on CGT account and eligibility for the CGT discount is based on the date shares were acquired (TR 2017/4)
- Incidental costs incurred after exchange of contracts will be incurred in the cost base if they relate to the CGT event (TD 2017/10)

# The Newsletter

## SUMMARY OF 2018 TAX CHANGES

### 1. Capital Gains Tax

From 01.07.2017, the CGT foreign resident withholding rate is 12.5% this was previously 10% and the threshold at which the CGT withholding obligation applies to Australian real property has been reduced to $750,000 (previously $2m).

From 01.01.2018 a CGT 60% discount is proposed to be available for a resident individual from investments, either directly through certain trusts in qualifying affordable housing.

The CGT main residence exemption will no longer be available to foreign and temporary tax residents from 7.30 pm (AEST) on 09.05.2017 – budget night.

From 01.07.2017, CGT event E4 will not arise where a trust receives a tax-free capital gain under the early stage innovation company provisions.

### 2. Superannuation

A $1.6m transfer balance cap applies to the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase from 01.07.2017; excess transfer balance tax is payable for exceeding the cap.

An individual's total superannuation balance concept is used to determine eligibility for various tax concessions from 01.07.2017.

From 01.07.2017 eligibility for the spouse contributions tax offset has been extended to individuals whose spouses earn up to $40,000.

From 01.07.2017 the tax on working holiday makers' superannuation payments when they leave Australia is 65%.

Transitional CGT relief is applied for assets transfers, in connection with changes, to the tax treatment of transition to retirement income streams and compliance with the superannuation transfer cap.

From 01.07.2017 the anti-detriment provision, which allows superannuation funds to claim a tax deduction for a portion of the death benefits paid to eligible dependants, was removed.

The tax exemption for income derived from assets has been changed to apply only to income streams in the retirement phase.  Individuals can not treat superannuation income stream payments as lump sum superannuation benefits for tax purposes from 01.07.2017.

The low-income superannuation contribution scheme is abolished from 01.07.2017; a low-income superannuation tax offset will be available for 2017/18 and later years.

The 10% test to determine an individual's eligibility for deductions for personal superannuation contributions has been removed from 01.07.2017; contributions to certain prescribed funds are not tax-deductible.

From 01.07.2017, the annual non-concessional contributions cap has been reduced to $100,000; individuals with a superannuation balance of more than $1.6m are not eligible to make non-concessional contributions from 01.07.2017.

The annual cap on concessional contributions has been reduced to $25,000 from 01.07.2017 for all individuals regardless of their age.

From 01.07.2017 the threshold at which high income earners are liable for Division 293 tax has been lowered from $300,000 to $250,000.

### 3. Small Business and Companies

From 01.07.2017, the concessional corporate tax rate of 27.5% will only be available for "base rate entities", being entities with no more that 80% of its income being "base rate entity passive income".

From 01.07.2017 Simplified BAS reporting applies to small business entities.

From 01.07.2017 the ATO will be allowed to disclose to Credit Reporting Bureaus the tax debt information of businesses that have not effectively engaged with the ATO to manage these debts.

### 4. Goods and Services Tax

GST reporting and record-keeping has been simplified from 01.07.2017 for small businesses with a turnover of less than $10m.

From 01.07.2017 GST extends to cross-border supplies of services and intangibles, such as digital products, to Australian consumers.

The GST treatment of digital currency such as bitcoin has been aligned with that of money from 01.07.2017 to avoid potential double taxation.

From 01.07.2017 the definition of "financial supply" has been extended to include the supply of bank accounts and superannuation interests by foreign financial institutions.

### 5. International

From 01.07.2017 the foreign investment framework will be clarified and simplified to make foreign investor obligations clearer.

The diverted profits tax (DPT) applies to tax benefits under a relevant scheme derived in income years commencing on or after 01.07.2017.

From 01.07.2017 failure-to-disclose penalties have been increased for significant global entities.

### 6. Other Changes

Eligibility for deductions for second- hand depreciating plant and equipment in a residential rental property will be limited for certain types of taxpayers. Generally, only the entity that actually incurred the outlay to purchase the plant and equipment can claim the deduction and not successive investors in the property, from 01.07.2017.

Since 01.07.2017, travel expenses related to inspecting, maintaining or collecting rent for a residential rental property have not been deductible.

Managed investment trusts have been allowed to invest in affordable housing since 01.07.2017.

From 01.1.2018, residential properties in metropolitan Melbourne that are left vacant for six months in the calendar year will be subject to a Vacant Residential Property Tax at a rate of 1% of the property's capital improved value.

For 2017/18 a new Queensland absentee surcharge applies at the rate of 1.5% of the taxable value of land in excess of $349,999.

Primary producers are allowed to access income tax averaging 10 income years after choosing to opt out, instead of that choice being permanent from 2016/17.

Foreign owners of residential real estate are liable to pay a vacancy fee where a residential property is not occupied or genuinely available on the market for at least six months in a 12-month period. The fee applies to applications to acquire a residential dwelling or land from 7.30 pm (AEST) on 09.05.2017.

The junior mineral exploration tax credit (JMETC) will replace the exploration development incentive (EDI) from 2017/18.

From 01.07.2017, the Commissioner will limit a taxpayer's PAYG instalment rate in cases where the normal rules would otherwise produce a very high rate.

## GETTINGS GST CREDIT CLAIMS RIGHT

Including GST-free items or claiming credits for ineligible items are common errors when claiming GST credits on a BAS.

You must be registered for GST to claim GST credits.

### Only claim goods and services subject to GST

You can only claim GST on goods and services where the supplier has included GST. You should refer to their tax invoices for the amount of GST they paid, instead of dividing their total business purchases by 11.

Your tax invoices don't specify the amount of GST paid, you need to take special care work it out. Remember to take into account whether the good or service is used solely or partly for their business.

### Have tax invoices

You must hold valid tax invoices for business purchases over $82.50, including GST. Other documents such as bank statements, purchase orders or delivery receipts aren't sufficient to meet the tax invoice requirements.

If this sounds like we are going back to 1999, just prior to the introduction of "GST. 101" then you are right.

Practitioners need to be aware that significant errors are being made by their clients. Taxpayers preparing their own BAS need to have at least a fundamental understanding of GST. Just prior to the introduction of the GST. the Federal Government embarked on a massive education campaign so that business could understand the fundamentals....

Almost twenty years on we have had so many new entrants into small business who for one reason or another have not learnt the fundamentals. It is a real problem and certainly the ATO cannot be blamed because the information is readily available online.

Probably it is the professional advisers who need to be more proactive in the ongoing educative process when errors are detected.

## BUDGETING

This is the time of year where some in small business struggle to pay off the December BAS obligations which were due 21. February. In a moment of quiet reflection that European holiday with the business class seats over Christmas may not have been such a good idea...

The issue here is that PAYG deducted from staff wages and indeed the net GST payable should never be viewed as net asset. It is merely a temporary cash asset of the business – there is a corresponding liability - you are merely holding the asset on trust for the Australian Taxation Office. Many small business owners would do well to remember this.

Of course, there is a key distinction between PAYG deducted from gross wages and the PAYG instalments a business pays on its own estimated taxable income in the current tax year. The prior year's taxable income is normally used a guide and along with both forms of PAYG and along with company tax and/or income tax, it is essential that cash flow budgets be prepared for a business. If the owners have a clear indication of the timing and quantum of future liabilities, then they are more likely to temper their personal expenditure and have adequate funds when the time comes.

Of course, the cash flow finishes with an estimated profit allowing an estimate to be made of the income tax payable.

In the absence of a cash flow budget, as a rough rule of thumb at least 20 per cent of the surplus cash produced by a business should be put aside to pay future tax liabilities and professional advisers can certainly assist in this regard by actively encouraging clients to properly budget for these liabilities.

## ATO DISCLAIMER ON PRIVATE BINDING RULINGS

Professional advisers and on occasion some taxpayers will review the ATO's register of private binding rulings (PBRs).

This is when they are faced with circumstances they are unsure of and they are seeking the ATO view on similar circumstances. However, we would posit that "similar" is not good enough. Carefully consider the ATO disclaimer on the register of PBRs:

"A record in the register is based on the facts of a specific situation as advised to us and reflects our view of the law in force at the time the advice was issued.

The record is not a publication approved in writing by the Commissioner, and is not intended to provide you with advice, nor does it set out our general administrative practice.

A record on this register is non-binding and provides you with no protection (including from any underpaid tax, penalty or interest).

In addition, a record on the register is not an authority for the purposes of establishing a reasonably arguable position for you to apply to your own circumstances."

## COMPLEX ISSUE RESOLUTION

This is an ATO initiative available to professional advisers and it may be a far better option than reviewing the register of private binding rulings.

The complex issue resolution service is available to resolve complex administrative issues and tax technical interpretation queries you have been unable to resolve online or by phone.

- The service is available to all registered agents, legal practitioners and other intermediaries who represent clients in a professional capacity. The service operates on the understanding that if the ATO needs to discuss client specific details, you have been nominated as an authorised representative of that client.

You can use this service for complex administrative issues or tax technical interpretation queries you have been unable to resolve online or by phone.

For example:

- Administrative issues, which are outside the norm and not able be resolved by your standard processes.
- General advice about new or changed legislation.
- Complex or multiple, related tax technical issues, for example where there is an interaction between taxes or a variety of concessions/considerations within a tax.
- General help with legal interpretation – where a decision is required around the ATO view.

The ATO will acknowledge your enquiry within one working day. Their aim to resolve your tax technical issues within five working days. Administrative issues and complex tax technical queries may take longer to resolve.

If this occurs, they will advise you of the timeframe and keep you informed of progress.

## ATO TARGETS CASH-ONLY HAIR AND BEAUTY BUSINESSES

Each year, the ATO will focus on certain sectors of the economy perceived as hotbeds of tax non-compliance.

In 2018, the ATO has set its sights on the cash economy, with the hair and beauty sector coming for close attention.

With widespread use of debit and credit cards, the ATO sees cash-only businesses primarily as a way of avoiding tax.

Although it isn't illegal to operate a cash-only business, the ATO usually uncovers under-reporting of turnover, which in turn results in income tax and GST being underpaid. In addition, cash-only businesses often fail to account for tax and superannuation properly on their employees' wages.

## STRUCTURED ARRANGEMENTS THAT PROVIDE IMPUTATION BENEFITS ON SHARES ACQUIRED ON A LIMITED RISK BASIS AROUND EX-DIVIDEND DATES

### Taxation alert TA 2018/1

The ATO is reviewing arrangements that are intended to provide imputation benefits to Australian taxpayers who are not the true economic owners of the shares.

The arrangements involve an Australian taxpayer with a long position in Australian shares legally acquiring, but having little or no economic exposure to, an additional parcel of the same shares and holding those shares over the ex-dividend date. They will typically involve the use of securities lending arrangements in combination with, repurchase agreements or derivative contracts (contracts), to create what is essentially a circular flow of shares. Although the Australian taxpayer has no or only nominal economic exposure to the additional parcel of shares on a stand-alone basis, the Australian taxpayer claims franking credits in respect of both the existing long position and the additional parcel of shares.

Be very cautious if presented with such an 'opportunity' taking care to refer to TA 2018/1 while getting independent professional advice.

## bO2 READERS QUESTIONS AND ANSWERS.......

### Question 1

**Part (1) -** The Client is 66years old, has made a concessional contribution by way of salary sacrifice to a defined benefit fund since 1/7/2017: $25,000.

The question:

Is he entitled to get a tax deduction up to $25,000 in the year 2018 income tax? If so, what is the negative effect on his retirement in the near future.

The Fund taxed his contribution 15% ($25,000-$3,750) =$21,250.

### Answer – Part (1)

Firstly, as your client is over 65, it is necessary that the "work test" be met in order for a contribution to be made.

If so the client is entitled to a tax deduction but first, consider whether the client needs a tax deduction.

Some or part of this could be characterised as a non-concessional contribution without the need to pay the 15% tax.

You appear to be indicating that the client has already contributed the $25k – so regarding the negative affect on retirement?

Here we assume that you are referring to pension entitlements and we would advise that superannuation fund assets (asset test) and pension streams (income test) are taken into account by Centrelink when considering eligibility for the age pension.

**Part (2) -** Thank you very much for your response.

The client met work test and asset test and income test, and getting small amount of prorate age pension:

The question is that:

Concessional contribution to defined benefit super fund entitles him to a tax deduction and, this deduction has a negative effect on his prorate age pension.

If so, can client complete Notice of Intent to claim deduction for personal super contributions.?

### Answer – Part (2)

In the year ending 30 June 2018 your client is able to claim $25k as a tax deduction as you advise he has met the work test....

We assume he will have other assessable income that makes the claiming of the $25k as a tax deduction tax effective.

Also, that he has no employer support – kindly note that $25k is the total limit that includes individual AND employer contributions.

As his tax adviser you will be doing these sums close to the end of the financial year when you have an overview of the situation.

It may be that it is tax effective to claim only a portion of the payment as a tax deduction... and the fund manager should be advised accordingly.

But as you point out.... there are two issues being the tax saving and the effect on the pension.

Regarding whether the super contribution can reduce income for the pension....

The Dept of Human Services website indicates that they look at income only....

For rental property owners and business owners they look at the concept of net income.

So, if your client operates a business it would indicate that a tax deduction could be claimed for eligible super up to the amount that would make net income nil.

If it were wage or investment income he derived, we suggest that would be another matter i.e. the super deduction would not be taken into account for the pension income test.

We stress that this is our interpretation and that you or client could well hold another view.

Confirmation could be sought from the Dept of Human Services.

**Question 2**

I have a client who is over 60 years old and would like to draw out some of his super.

What are the Income tax implication of this draw down – is it tax free or is a portion tax free?

Does the situation change if the taxpayer had their own SMSF which is in pension phase since the member has ceased working and if the member draws out more than the minimum percentage draw down each year – is this draw down tax free?

**Answer**

We take it the client is over 60 years of age but less than 65....

The preservation age has been met and the issue now is whether the client has retired.

In the case where a member has reached the age of 60, the retirement condition of release is satisfied where:

- they have ceased a gainful employment arrangement and either of the following circumstances apply
- the person attained age 60 on or before the ending of the employment and
- the trustee is satisfied the person does not intend to work again or be employed for more than 10 hours per week.

Comment: people do change their mind about retirement.

Regarding taxation of benefits... please refer to the table page 11 chapter 2 of our annual publication.

**Question 3**

Market Values of Properties that were transferred between related persons not at arm's length...

Capital Gains.

A property was transferred, in stages between related parties not at arms length. There were no sales - merely transfers between related persons.

Ultimately, there was a sale of the property.

We are seeking a valid means of ascribing a market value to the intermediate transfers.

Can you please help?

**Answer**

You can seek a private ruling from the ATO on the market value of the property. We've enclosed a fact sheet for your reference. You can seek assistance from your tax agent.

**Question 4**

We have a client who has just sold a commercial property.

The property was split in half, he lived in the back half and rented out the front half to a tenant who operated a retail shop.

My question is should the seller (my client) be charging GST to the buyer?

He was not GST registered.

**Answer**

Division 38 & 40 of A New Tax System (Goods and Services Tax) Act 1999 contains supplies that are GST free or not subject to GST.

I don't believe the sale falls into Division 38 which deals with the exemption for a "going concern". It is not a supply of going concern since only the property is sold.

Division 40 may have some relevance as the sale of the back half of the property may be input taxed if it is to be used predominantly for residential accommodation. However, it is not input taxed if it is to be used for commercial purpose.

In GST Ruling GSTR 2000/20, the commissioner considers the phrase 'to be used predominantly for residential accommodation.

Your client has 21 days to register from the time the property is sold (S25-1).

### Question 5

Property Matter - Trying to "relinquish title and ownership"

The ex-wife and her ex-husband resided in North Queensland during their posting.

Separated over 5 years ago, the ex-wife is still providing support for these homes (2). One previously owned by Partner and one Marital home. The ex-wife had made capital improvements to his home prior to moving to the second property.

They both reside in NSW; the properties have been rented. The court order for the ex-partner to sell the homes has not eventuated. The ex-wife decided to sign over the properties to the ex-partner.

The bank will not communicate with the ex-wife, and to settle this issue the ex-partner has raised documents that the ex-wife will have to pay capital gains on the properties even though she has NOT received any entitlements from the properties.

The ex-wife would like to sign off on the documents. My advice was to obtain professional advice with an expert in this area.

Are you able to refer someone in property/divorce and capital gains for this situation?

What method of capital gains would apply?

Do defence members obtain any exemptions?

The ex-wife has no idea of what values he will be setting out in the contract.

### Answer

We realise this is a difficult situation and very stressful for all concerned.

However, it is very respectfully suggested that you may not have sighted all the relevant documents and may not have the full facts.

As the bank will not communicate with the ex-wife, and you say she signed over the properties… then the following may have happened.

Title may have passed to the ex-husband due to a binding order of the Family Court (or similar)

If this happened some time ago then it is the ex-husband's responsibility to pay the capital gains tax (CGT) – not the ex-wife's.

There was an effective rollover and the ex -husband is deemed to have a cost base at the original date of purchase.

The exact nature of the documents to be signed by the ex-wife have not been disclosed but legal advice is essential.

We recommend that you contact a reputable family lawyer in a location convenient for the ex-wife so that she may be properly advised.

### Question 6

**Part (1) -** A farming business operates as a family discretionary trust.

The trust holds only bank account, livestock and equipment that is operating assets. The trust holds no land, this is held individually by farm family members mainly Dad & Mum.

Mum & Dad are trustees and appointers of the trust.

We are now considering adding the Son & Daughter in law as additional trustees and substitute appointers to allow them an interest in the farming business.

They work in the business with Mum & Dad currently receiving a wage.

If we do this is there any implication with disposal and acquisition of Livestock and equipment with current tax values much less than market values?

**Answer - Part (1)**

We note there is no mention of a company trustee and if they are individual trustees then this is potentially an asset protection issue.

Note that adding more family members as individual trustees just puts more family members at risk.

This is because an individual trustee can be held personally responsible for the debts of the trust.

Of course, if the trustee acts competently, honestly and in good faith then he/she is entitled to be indemnified out of the assets of the trust.

If currently the trustees are individuals, then this need to be addressed.

This matter needs to be looked at holistically as a business succession and estate planning issue.

Who should be the appointor(s) would be part of this.

It is very important and should not be put on the backburner.

In the meantime, the family can have private agreements in place as to the distribution of income.

**Part (2) -**

I am aware of the issues for individual trustees v corporate, but my question is....

If we add a trustee, even change to a corporate trustee, does this constitute a disposal of the livestock and plant within the trust caused by the new participants?

My opinion is it does not but am looking to confirm this....

**Answer –Part (2)**

As long as there is no change in beneficial ownership there is not a disposal.

Effectively this means that so long as the clause of beneficiaries is not altered then there is not a disposal....

In fact, the ATO have indicated that even where you delete beneficiaries there is not a resettlement.

It's when you alter the deed to add beneficiaries then there is a problem.

New beneficiaries can be used as long as the deed originally contemplated them.... for instance, the new wife of a child of the specified beneficiary etc.

**Question 7**

I have a private company that has a sole shareholder holding over 2 million shares in the company.

They paid $2M for these shares years ago. Can the company buy back some of those shares by repaying the capital?

I understand there will be no value shifting problems as it is only one shareholder, so they are still entitled to all the profits anyway.

**Answer**

We agree there are no value shifting issues under the buyback and that it would be possible for this to apply only to a portion of the shares.

As nearly all the ATO guidance on this seems to be based on ASX listed shares you should seek a specialist opinion outlining the full facts and circumstances.

On the face of it... this does not appear to be a problem, but care does need to be taken particularly if the company has significant retained earnings.

**Question 8**

Hi, I have a question about GST on-charged by a landlord on outgoings.

Our business rents a commercial property and the landlord charges GST on outgoings even when the outgoing is a GST free supply such as council rates.

My understanding is that this is the correct treatment due to the transaction meeting all criteria for a taxable supply. Please confirm my understanding is correct?

**Answer**

This really depends on what the relevant clause of the lease agreement discloses.

In principle we do not agree with GST being charged on a GST free item such as council rates but as you are going to claim the input tax credit... it should not be a matter of great concern.

This really just becomes a cash flow timing issue for you.

Although the liability should be passed on to the tenant if the lease specifies, this should only be to the extent that GST is payable.

What we do have an issue with is landlords charging GST on GST, an example of this may be insurance premiums which do attract GST.

The landlord should only charge GST on the net amount.

### Question 9

My question surrounds a testamentary trust.

We have the Tax Return sorted but have a query regarding entering the opening journal in the ledger for the testamentary trust.

The testamentary trust has received cash and listed shares from the deceased's estate. The Debit side of the journal goes to Cash at Bank and Shares Held, where does the credit side of the entry go: • Corpus Trust Funds • Individual beneficiary entitlement account • Other?

### Answer

It is definitely Corpus Trust Funds.

### Question 10

Hi bO2, scenario....

I am a director of a company which is a unit holder in a trading trust. It exists solely to receive funds from the trading trust, of which I am an employee. My taxable income is approximately $130K. My children are cared for by their grandparents who have $20,000 investment income a year. I pay them after tax cash, and I review their super position in May and possibly top up to maximum allowable amounts (Grandparents are aged 60).

My question is – can I make them an employee of my company, with the added benefits to them of PAYG tax withheld, a group certificate and super? The company would have to take out workers comp as well and has the benefit of claiming the wages as a tax deduction. Wages paid would be a maximum of $50K to each grandparent.

Are there any limitations regarding employment which is relatively detached from the income of the company? I need to have childcare, so I can work, the investment income is received because I am working for the trading trust, if I was still at home on maternity leave the company would not be receiving income.

Alternatively, I could make them shareholders of the company and pay a fully franked dividend to them, but it would not benefit their super like the employee scenario.

### Answer

It is your last suggestion that has the most merit. You are correct about the work test if they are over 65 years of age.

Are your parents on a pension and have you considered all the Centrelink issues?

Additional income could mean their pension incomes falling by 40 cents in the dollar. The work test may be problematical as it states 40 hours work in a 30-day period.

In a passive investment company what work are your parents actually doing?

Having said this… on the face of it and without detailed investigation… the test has been met. There are provisions in the tax act concerning uncommercial wages paid to family members.

It is just a shame there is no underlying trust here – there would be no problem then.

### Question 11

Just wondering if you could look into the below questions given the case facts as follows.

- Individual purchased 10 Acres in 1982,
- Property has always been in the individual's name,
- This land was used for the individuals' small business for the majority of the time they have held it,
- The small business operated through a company of which the individual is the sole shareholder and director,
- In the 2014/2015 year the business was sold, and the individual retires,

- The individual subdivides the land around this time as well into two parcels,
- One parcel holds a shed and is rented out, the other is left vacant,
- The individual, who is now 68 years old, is looking to sell both parcels of land.

My questions are:

1. Provided the individual satisfies the work test in the relevant year, can the proceeds from the sale of the parcels of land (about $1.3m total) be rolled into Super as CGT contribution?
2. Same as above but what if the land was sold in five years' time? (thereby being a longer period between individual's retirement from small business and the sale of these assets).

**Answer**

As the land was purchased in 1982…. this is a pre-CGT asset.

The CGT small concessions exist to reduce, eliminate or disregard a taxable capital gain from the sale of a business.

Yes, the land would appear to be an "active asset" … but we suggest there is no taxable capital gain here.

As such, our preliminary view is that from 1 July 2017, the maximum amount to go into super is $300k with the three year bring forward rule as a non-concessional contribution.

This of course assumes there have been no prior use of this concession to affect the bring forward rule.

**Question 12**

I have a question regarding GST on the sale of advertising space to a non-resident entity and whether this qualifies as a GST Export – even if the advertising space is in an Australian medium (e.g. publication etc).

According to what I have read (thus far), it would seem the provision of advertising space would not represent work physically performed (as the advertising space will only display the completed ad provided to the supplier of the advertising space), nor is it in regard to real property (i.e. not related to land) – but is this correct if the sale concerns a specific/ individual advertising space?

The supplier is selling the advertising space to a non-resident entity not registered in Australia (nor having a branch or agent in Australia). That non-resident customer may, in turn, on-sell the space to a client who may or may not be registered in Australia for GST, but such a sale would be under a separate contract.

The material I have read thus concludes that it should be GST free. Can I get a second opinion on this?

**Answer**

Here the answer is not so clear.

You need to carefully read section 38-190 of the GST Act and carefully consider the following.

Will the advertising service be used exclusively outside of Australia?

The advertising is in Australia for the perusal of Australians and it may well be that non-resident entities are actually conducting business in Australia.

Otherwise why would they advertise here?

If this is the case, then GST will be payable – also if the advertising space is on sold to Australian companies then GST will certainly be payable.

If the supply is in connection with Australia… then GST is payable.

You may wish to apply for a private ruling.

**Question 13**

Hi there, I have a technical query. Can you please let me know how many years a tax agent needs to keep the signed copy of the tax return that he lodged on behalf of a client?

**Answer**

5 years although it would be advisable to retain longer – We would suggest 7 years.

**Question 14**

I wish to obtain some advice regarding a company's franking account.

With the change in the corporate tax rate from 30% to 27.50%, what is the implications on the franking account.

1. Do we need to convert the existing balance to the new tax rate or?

   Should we be recording separate balances i.e. One at the old rate and another at the new rate?
2. Can dividends be franked according to the rate of tax paid in the past i.e. 30%?

Please include in your advice all calculations required and references to the legislation.

**Answer**

Your current franking account balance is not adjusted by the change in company tax rate. Refer to S202-60 of the ITAA 1997.

In the 2016 income year, the maximum amount of franking credits that could be attached to a dividend was 3/7 multiplying the net dividend. Refer to Tax Laws Amendment (Small Business Measures No.1) Act 2015.

However, from 1 July 2016, the maximum amount of franking credits that could be attached to a dividend is: -

Corporate tax rate for imputation purpose of the entity for the income year/divided by (100% - Corporate tax rate for imputation purpose of the entity for the income year) multiplying the net dividend. Refer to the Enterprise Tax Plan Act.

Corporate tax rate for imputation purpose of the entity for the income year is defined as “the entity’s corporate tax rate for the income year, worked out on the assumption the entity’s aggregated turnover for the income year is equal to its aggregated turnover for the previous income year” Refer to S995-1.

## Question 15

My client has a company YellowX Pty Ltd.

John is a director and shareholder of YellowX Pty Ltd.

YellowX Pty Ltd has a liability to pay John of $100,000. I.e. a Credit Loan of $100,000.

YellowX Pty Ltd will never have the funds to pay back John.

What are the implications if, and how does the loan get written off?

Is there no issues to Yellowx Pty Ltd? Is it a capital loss to John?

If John forgives the loan, and does not claim a loss, does the loan in YellowX Pty Ltd have no implications?

**Answer**

The key here is whether your client has charged interest 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. 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 ITTA 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 TD 2.

**Question 16**

A client (salesman based in Sydney) had provided the following information:

Payment summary
Gross: $xx,xxx
PAYGW: $xx,xxx
(no allowance paid)

He has provided a list of places he went, date and amount for expenses he was reimbursed by his employer for travel expenses whilst away from home. (summarised for this purpose, there were many more)

Auckland 01/07/16 $61.00
Brisbane 03/07/16 $77.00

According to his colleagues at work he is entitled to claim a deduction for the reasonable allowance amount. If we assume he can substantiate his claim up to the reasonable allowance amount, with written evidence.

I believe to claim a deduction of up to the reasonable allowance amount he must declare in the tax return the amount he was reimbursed, as the travel allowance. Then at item d2 claim the reasonable allowance amounts, that he can substantiate.

i.e. Allowance rec'd (from the above) (61+77) $138

Deduction claimed ($109.35+$150) (TD 2017/19) $259.35

Is it correct to claim the reasonable allowance amounts and declare the amount paid as income or, is it only correct to not claim a deduction and not declare the amounts paid?

I see a third option to only claim the difference between the ($239.35-138) $101.35 at D2.

What is the correct way to maximise the claim?

**Answer**

There is a lot of misinformation and pub talk on this issue and you should refer to Taxation Determination TD 2017/19.

Certainly, the ATO now has a focus on these claims.

This outlines the terms and conditions for such a claim to be made.

To claim the daily limits in TD 2017/19 it is a condition that a travel allowance was actually paid.

This would not appear to be the case here.

So, it boils down to what expenses have been incurred and your comments about reimbursements are 100% correct.

**Question 17**

We have a client that has a trust with a corporate trustee.

The business is a family business, with father and son and their spouses working in the business.

The father is 76. He works in the business, full time, and gets a wage.

I believe the employer can only claim a deduction for superannuation up to 9.5% (SGC). The amount that is salary sacrificed is not deductible to the employer.

Is this correct?

**Answer**

You are correct about the employer, mandated (9.5%) superannuation contributions.

On the salary sacrifice contributions, it is true that the employer should not claim a tax deduction.

Furthermore, the super fund should not be accepting these contributions as the member's age exceeds 75.

If it is a SMSF there could be compliance issue here.

# Leigh's Corner

## ARTICLE NUMBER 40 -

## PAYMENT OF WAGES AND CONDITIONS

**Because of the increase in the major cases coming through the Courts and Tribunals in relation to these matters we have raised this issue again.**

The number of companies found to have been deliberately underpaying staff through either deliberate deception, invalid agreements or contracts or ignorance is increasing.

Some of the recent cases involving 7 Eleven, Myer, Balada Group, Pizza Hut, Woolworths, Hungry Jacks and KFC involve large amounts of money and proportionally large back payments to staff and financial penalties to be paid by the employers.

There have been other significant cases of a similar nature in the security, cleaning and hospitality industries.

In October 2017, the Federal Government introduced the Vulnerable Persons Act 2017 which introduces the following legislation to combat deliberate underpayment of wages and sham contracts:

The main changes will be:

- The introduction of a higher scale of penalties **(up to 10 times the current amount up to $600,000)** for a new category of 'serious contraventions' of prescribed workplace laws
- To prohibit employers from unreasonably requiring employees to make payments (i.e. 'cash-back' arrangements or threats to cancel visa arrangements or termination of employment)
- To strengthen the evidence-gathering powers of the Fair Work Ombudsman (FWO) to ensure that the exploitation of vulnerable workers can be properly investigated, and
- To introduce stronger provisions to make franchisors and holding companies responsible for breaches of the Fair Work Act where they deliberately set out to contravene or avoid paying the correct wages and penalty rates to employees

The Office of the Fair Work Ombudsman will have increased powers in relation to the gathering of evidence and compliance under these laws.

If an official investigation into an employer's payment of wages and conditions commences the onus of proof under these new laws will be on the employer, which means the innocent until proven guilty rule will no longer apply in these cases.

The employer must prove that the correct payments are being made to employees and failure to keep proper payslips or appropriate electronic records may result in significant fines and possible back payments to staff.

If you are paying employees an all-purpose hourly rate which is supposed to compensate for overtime and penalty rates contained in the applicable Modern Award, it is good practice to check these rates and ensure that they indeed do compensate adequately for all the penalty provisions that may apply.

The test used by the Fair Work Ombudsman and the Fair Work Commission is the Better Off Overall Test or BOOT.

This test is used to determine what rates of pay and applicable penalty provisions would apply to an employee under the relevant Modern Award and compares these rates to the all-purpose rates being paid to ensure that the employee is better off than they would have been under the award provisions.

The Fair Work Ombudsman has a wage calculator which can be found on their website at www.fairwork.gov.au and this calculator is very useful for determining employees' wages and penalty rates.

Unless contained in a suitable employment contract, then these conditions for an employee who would normally be covered by an award should be contained in a registered Enterprise Agreement or an Individual Flexibility Agreement under the Flexibility Clause of the relevant Modern Award.

Failure to correctly calculate these amounts can mean a breach of the Federal legislation and can be very costly.

Some claims of Adverse Action or General Protections are surfacing in relation to these claims by employees and these claims are notoriously difficult to manage and can be expensive to finalise.

With the current pressure being applied by unions and employees on employers in relation to wage increases and a greater level of scrutiny by the governing bodies a review of wages, contracts and general compliance is a prudent action.

**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 question for Leigh's team send us an email ....... info@bo2.com.au**

# Bonus Issue

## CAPITAL GAINS TAX MINIMISATION STRATEGIES 2018

### What's New In 2018?

Foreign investors and entities are most affected by the 2018 changes federal government policy which aims to:

- address housing affordability
- stop foreign nationals avoid paying capital gains tax when they sell property
- attract foreign investment

We also cover in detail significant changes to the CGT small business concessions and an important federal court case on the same topic, Commissioner of Taxation V Miley (2017) FCA 1396, won by the Commissioner on appeal.

We would also draw your attention to the following changes (rulings and guidelines) which we will not expand on… these are readily available on the ATO legal database.

- The application of the transitional CGT relief for capital gains that may arise as a result of the recent superannuation changes has been fully explained by the ATO in (LCC 2016/8).
- Where an option is exercised, CGT event A1 which occurs in relation to the asset is the date of exercise of the option (TD 2017/12).
- An intangible capital asset made to pre-CGT property can be a separate CGT asset (TD 2017/1).
- Retail premiums paid to eligible shareholders are treated on CGT account and eligibility for the CGT discount is based on the date shares were acquired (TR 2017/4).
- Incidental costs incurred after exchange of contracts will be incurred in the cost base if they relate to the CGT event (TD 2017/10).

So here we see these changes as they apply to overseas residents, do not affect many of our subscribers. However, what we do have is suggestions to eliminate or lower capital gains tax:

### How are you going to lower or eliminate capital gains tax?

1. Do all you can to preserve your main residence exemption. See Issue #0089 pages 23, 24, 32,38.
2. Be aware of the Main Residence 6-year temporary absence. See Tax Tip #96-page 23 Issue #0091.
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 attract Capital Gains Tax of 10%.
5. Assets in a super fund in pension phase have no tax on earnings or capital gains – see Tax Tip #95-page 23 Issue #0091.
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 42, 43 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 #0057 page 17, Issue #0091. This means ceasing to hold shares as trading stock even though you continue to own them.
11. If you are not receiving employer superannuation contributions, it may be possible to reduce capital gain tax by making concessional contributions into a complying super fund.
12. Win the capital versus income argument by careful planning i.e. if you engage in development approvals (DAs) and large subdivisions the ATO may argue you are a developer. It may be better to simply sell to a developer. You may wish to calculate the likely receipts and tax implications of both courses of action. You should also carefully assess the business risk of being a developer. Specialist advice should be sought. Also see pages 23, 24, 40 and 41 Issue #0089.

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 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 24, Issue #0091 and our annual publication pages 43 and 44.
15. In the wake of the Bamford decision, ensure your Trust Deed allows streaming of various classes income. See Tax Tip #38, page 15, Issue #0091.

## 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 and 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 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 a 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 are 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 AAT 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

On 8.2.2018, Treasury recently released draft legislation that significantly restricts the availability of the small business CGT concessions where shares or units are being sold. It appears, the changes will take effect, from 1.7.2017, which means that some taxpayers have already been affected retrospectively by these measures.

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

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.

### Exposure draft

On 8.2.2018, Treasury released exposure draft legislation for consultation *(Treasury Laws Amendment (Measures for a later sitting) Bill 2018: improving the small business CGT concessions)*.

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

### New requirements for share or unit sales

The draft legislation repeals s 152-10(2) of the *Income Tax Assessment Act 1997* (the ITAA 1997).

In substitution, it inserts a new s152-10(2). The conditions of the new subsection are:

- a stricter active asset test

- 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
- 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
- the object entity must itself either satisfy the CGT small business entity test or a modified $6m maximum net asset value test.

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

| New Law | Current 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.<br><br>Additional basic conditions apply for capital gains relating to shares in a company or interest in a trust.<br><br>These are:<br>• either:<br>- The taxpayer must be a CGT concession stakeholder in the object entity; or<br>• 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;<br>• the object entity must:<br>- carry on a business just prior to the CGT event; and<br>- either be a CGT small business entity for the income year or satisfy the maximum net asset value test; and<br>• 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.<br><br>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. |

## CAPITAL GAINS TAX CHANGES FOR FOREIGN RESIDENTS

### In brief

In the May 2017 Federal Budget, a range of reforms to reduce pressure on housing affordability were announced.

This included that as of 7:30pm (AEST) on May 9, 2017 foreign and temporary tax residents would no longer be exempt from capital gains tax (CGT) when selling their main residence; this rule was made subject to grandfathering for existing properties held on this date and disposed of on or prior to June 30, 2019.

The Government has ensured all Australian tax residents, including those who are temporary tax residents, can continue to access the main residence exemption. Initially it was thought that all temporary tax residents would not be able to access the concession. Temporary tax residents are individuals who hold a temporary visa and who also meet other requirements.

However, it should be noted that the CGT main residence exemption will be denied from 7:30pm (AEST) on May 9, 2017 for foreign residents. In addition, there will be no apportionment of the main residence exemption based on days of ownership over the whole period of ownership. Existing properties held on May 9, 2017 will be grandfathered until June 30, 2019. For the purpose of the Exposure Draft, “foreign resident” means someone who is not a tax resident of Australia.

Foreign residents, including Australian citizens and permanent residents who are foreign residents, should consider how these changes will impact their circumstances.

## CAPITAL GAINS TAX CHANGES FOR FOREIGN INVESTORS

As mentioned, the Government has 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.

### Administrative treatment

The ATO will accept tax returns as lodged during the period up until the proposed law change is passed by Parliament. Past year assessments will not be reviewed until the outcome of the proposed amendment is known.

After the new law is enacted, taxpayers will need to review their positions:

- for properties acquired from 7:30PM (AEST) on 9 May 2017 – back to the 2016–17 income year;
- for properties held from 7:30PM (AEST) on 9 May 2017 and disposed after 30 June 2019 – back to the 2019–20 income year.

Those taxpayers who lodged their tax return in accordance with the changes do not need to do anything more.

Those taxpayers who did not return their capital gain will need to seek amendments and obtain or reconstruct records to support any costs associated with the property.

No tax shortfall penalties will be applied, and any interest accrued will be remitted to the base interest rate up to the date of enactment of the law change. In addition, any interest in excess of the base rate accruing after the date of enactment will be remitted where taxpayers actively seek to amend assessments within a reasonable timeframe after enactment.

## CHANGES TO THRESHOLD AND RATE FOR FOREIGN RESIDENT CAPITAL GAINS WITHHOLDING PAYMENTS

As outlined in our last CGT bonus issue #0086, 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 are:

- the threshold is being reduced from $2 million to $750,000 – so the regime will now apply 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%).

The current threshold ($2 million) and withholding payment tax rate (10%) will apply for any contracts which are entered into prior to 1 July 2017, even if they do not settle until after 1.7.2017.

## 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 will provide 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 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.

## CGT ROLLOVER FOR MARRIAGE BREAKDOWNS – SANDINI Pty Ltd v Commissioner of Taxation [2017] FCA 287

Anyone interested in the exact facts and circumstances can readily review it – instead we will focus on why this case is significant.

### Who This Affects

- those drafting Family Court orders dealing with assets with potentially large capital gains tax implications.
- individuals looking to place assets the subject of Family Court orders into a more protected environment.

### Key Facts

- The recent Federal Court decision of *Sandini Pty Ltd v Commissioner of Taxation* [2017] FCA 287 has broadened the application of the CGT rollover for marriage breakdowns. The decision also marks a potentially wider application of CGT Event A1.

Where Family Court proceedings will deal with assets with potentially significant capital gains tax consequences you should, seek tax advice on the best approach to structuring orders.

On 22 March 2017, McKerracher J of the Federal Court of Australia handed down his decision in the case of *Sandini Pty Ltd v Commissioner of Taxation* [2017] FCA 287 **(Sandini Case)**. The case marks an important change to how the marriage breakdown rollover in Subdivision 126-A of the *Income Tax Assessment Act 1997*(Cth) **(ITAA97)** can be utilised to allow spouses to receive marital property in an asset-protected environment.

This really is a significant change in how parties the subject of family law proceedings will be able to use the CGT rollover for marriage breakdowns to move assets into a protected environment. Although the rollover may not be used where the Family Court orders assets to be transferred directly into a discretionary trust, it does provide an opportunity, where the Family Court orders an asset to be transferred to a spouse directly, for that spouse to direct the transfer of the asset to a family trust without upsetting the application of the rollover.

In the event a decision is made to transfer a rollover asset to a trust it is essential to seek expert advice. As the Commissioner has appealed this case, it would be advisable to wait on the outcome and we will keep you informed of developments.

## 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 who 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 is within the six years temporary absence rule. (See CGT Determination No. 51 below which deals with sole and principal residence.)

### 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.

### 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.

## 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.

## 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's 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.

### 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 would 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.

### Ceasing to be an Australian resident

If you go overseas and cease to be an Australian resident, or a resident trust for CGT purposes, you are taken to have disposed of certain assets for their market value at the time you cease being an Australian resident.

If you ceased being an Australian resident or a resident trust for CGT purposes:

- before 12 December 2006, the ATO treats this as though you disposed of each of your assets that did not have the necessary connection with Australia for their market value at the time you ceased being a resident,
- on or after 12 December 2006, the ATO treats this as though you:
  - disposed of each of your assets that are not taxable Australian property for their market value at the time you ceased being a resident
  - immediately re-acquired indirect Australian real property interests and options or rights to acquire such interests for their market value.

### Exemption for a temporary resident who ceases being an Australian resident

There is an exception for temporary residents. If you are a temporary resident when you cease to be an Australian resident, the ATO does not treat you as though you disposed of any of your assets.

### Exemption for a short-term resident who ceases being an Australian resident

If you are an individual who was in Australia on 6 April 2006 and have remained here as an Australian resident since that date, you can disregard any capital gain or capital loss if you:

- were an Australian resident for less than five years during the 10 years before you stopped being one
- either
  - owned the asset before last becoming an Australian resident, or
  - inherited the asset after last becoming an Australian resident.

### 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:

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

In brief – Increased compliance costs fall mainly on purchasers.

Purchasers are required to withhold and pay 10% 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 will improve 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 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 10%:

- taxable Australian Real Property (TARP) transactions valued under $2 million
- 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.

As menioned previously from 1.7.2017 the withholding tax as been increased to 12.5%

## 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.

## HALVING TAX ON SHARES

With the stock market enjoying a bull run in recent times, 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.

The following 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.

## 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 don't keep an asset register, you generally have to 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'd 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 of age 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 and this includes employer contributions.
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.

## THE SMALL BUSINESS ROLL-OVER BILL

In February 2016, the lower house of Parliament passed a Bill to enable Australian small businesses to change their legal structure without attracting a capital gains tax (CGT) liability at that time.

Small Business owners who find they are using a legal structure that does not suit their needs will no longer be stuck with the structure. This will allow them to restructure their business without incurring an immediate CGT liability.

The roll-over will apply 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 of 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.

According to the accompanying Explanatory Memoranda, identifying who holds the UEO in an asset through interposed companies, unit trusts and partnerships, will be "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 in the legislation with 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 MNAV

(Maximum Net Asset Value) "$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 will provide 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 (Maximum Net Asset Value) test, enabling future access to the CGT small business concessions.

## FOREIGN RESIDENT CAPITAL GAINS WITHHOLDING PAYMENTS

As people working in the Real Estate industries are well aware of this *The Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016 (Act)* received Royal Assent on 25. 2. 2016.

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 exceeding $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 million 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

### In brief - New legislation applies to earn-out arrangements that qualify

In 2016, Parliament passed legislation that will treat qualifying earn-out arrangements entered into on or after 24 April 2015 with a "look-through" approach for the purposes of capital gains tax (CGT). Earn-out arrangements that don't qualify will need to apply draft taxation ruling TR 2007/D10.

### 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's 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 #62 in Issue #0091. This applies to assets purchased prior to September 1985 in a Company and deals with the Archer Bros Principle.

## NEW AUSTRALIANS AND CGT

Upon becoming residents of Australia, non-Australian assets are considered to have been acquired at their market value at the time of becoming a 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 will be dealt with in depth in forthcoming bonus issue #0096.

## 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

### NEW CASES

#### 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 oftenquoted 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 director's 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 was 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 which was concerned with 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.

### Be careful about property arrangements with family: tax implications

In a recent Administrative Appeals Tribunal (AAT) case a helpful father who jointly owned a townhouse with his son (who lived there) was liable for CGT on his share of the property when it was sold.

In April 2002, the taxpayer purchased a townhouse for his adult son to reside in, but he had both of them registered on the title of the property to prevent against his son acting unwisely.

His son lived in the townhouse until 2007, when he moved into another house and in September 2007 the townhouse was sold and the proceeds from the sale were used to reduce the son's debt to the bank for the second house.

The father was assessed for the 2008 income year for CGT on 50% of the net capital gain arising from the sale of the townhouse.

He claimed that:

- It was never his intention to profit from the sale of the townhouse, and that "he only went on the title to protect his 'inexperienced' son of 23 years from doing something 'silly' and selling the townhouse on a whim'; and
- He did not receive any of the proceeds of sale of the townhouse (as the entire net amount received went towards reduction of his son's loan).

In deciding against the taxpayer, the AAT stated that these matters did not alter his liability, as:

- For CGT purposes, a person is treated as having received money if it is applied as he or she directs;
- To be eligible for the 'main residence exemption' in respect of his liability for CGT on disposal of his interest in the property, the taxpayer would have had to reside in the townhouse himself; and
- There was no evidence that the taxpayer held his interest in the property 'on trust' for his son.

**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 into the beneficiary's.

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.

Don't 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.

## UNPAID PRESENT ENTITLEMENTS (UPEs)

The creation and dealing with Unpaid Present Entitlements (UPEs) has CGT issues, which should receive careful consideration.

### What is UPE?

A UPE is created when the trustee of a trust makes a determination in accordance with the terms of the relevant trust deed, to appoint (distribute) income or capital to a beneficiary of a UPE, the beneficiary in whose favour it has been created will have an immediate right to call on the trustee of the trust, in which the UPE then exists, to pay the UPE in part or in full.

For the background on the ATO view on UPEs, you should refer to TR 2010/3 and PSLA 2010/4, Taxation Determinations TD 2015/D5 and TD 2015/20 and Taxation Ruling TR 2015/4.

A detailed discussion of the CGT implications of creation of UPEs, payment of UPEs, conversion of UPEs into loans and assignment of UPEs is beyond the scope of the publication.

However real care needs to be taken on non-taxable distributions in which case s118-20 will not apply to negate a possible capital gain (D1). When restructuring an entity, UPEs require special consideration but not to extent that commercial consequences take second place.

CGT like any other tax is just a cost of doing business.

### Record keeping for small business CGT concessions

In June 2013 the ATO 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

From 1 July 2016, 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 doesn't limit the shares that qualify for the modified CGT treatment.

Investors that don't meet the 'sophisticated investor' test under the Corporations Act 2001 won't 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 won't 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.

## CAPITAL GAINS TAX RELIEF – SUPERANNUATION

The new superannuation reforms allow the provision of Capital Gains Tax ('CGT') Relief. This allows the cost base of assets to be re-allocated from the pension phase, back to the accumulation phase, in order to comply with the $1.6m transfer balance cap rulings.

As announced in May 2016 budget the $1.6m cap is a limit that an individual can transfer into pension phase from 1 July 2017. Any excess amount will be maintained in an accumulation account (where earnings are taxed at 15%). If this applies to you, you must carefully consider your position, well before 30 June 2017, in order to allow sufficient time to plan for this measure.

Until 30.06.2016, any Capital Gains incurred on the disposal of assets that support a pension – whether it be an Account Based ('ABP') or Transition to Retirement Pension ('TTR') – are exempt from tax. However, the new rules no longer allow for income tax exemptions relating to TTRs and the $1.6m transfer cap from 1.7.2016 – this will limit the CGT exemptions to funds going forward. This explains the introduction of the CGT Relief.

This is means from 9. 11. 2016 to 30. 6. 2017, superannuation funds are able to 'reset the cost base' of assets that are reallocated from the retirement phase to the accumulation phase.

Two forms of CGT Relief are available depending on whether the fund is adopting a 'segregated' or 'unsegregated' method of asset accumulation within the SMSF. Respectively these methods are also referred to as the 'proportionate' method or 'actuarial' method.

### Segregated Funds

The segregation method will not be available to funds with at least one member in pension phase who has a total superannuation balance of more than $1.6m (across all funds they are a member of) from 1 July 2017.

### Unsegregated Funds

Under the legislation, a SMSF Trustee may elect to obtain CGT Relief to reset the cost base of an asset to its market value as at 1 July 2017. The following prerequisites apply:

- The fund must calculate a notional gain on the proportion of the asset that is effectively attributable to the accumulation phase as at 30 June 2017;
- If not deferred, the fund must add this notional gain to its net capital gain (or loss) for the 2017 financial year which effectively crystallises the tax liability that would have arisen if that asset had been sold in the 2017 financial year;
- The deferred notional gain can be carried forward for an indefinite period or until sale date.

### Electing which assets have their cost base reset

This election may be applied on an asset by asset basis however the relevant asset *must have been held by the fund on 9 November 2016*.

You must make this election on or before the tax return lodgement due date for the fund's 2016/17 income tax return - such an election will be irrevocable.

A deferment...effectively an election to "opt out" to pay the tax until the asset is sold must be made in the 2016/17 income tax return.

**Example -** Louise and Mark have an SMSF and their superannuation balances are $1.8m each as at 30 June 2016, of which 95% is supporting their respective Account Based Pensions. The fund's assets have always been unsegregated and include:

- Shares in company Smith Ltd that were bought in 2012 for $500,000
- The shares are expected to have a market value of $2m on 30 June 2017 resulting in an estimated Exempt Current Pension Income (ECPI) of 70% (as a result of both members will exceed their $1.6m Transfer Caps)
- The shares are expected to be sold for $4m on 30 June 2020

### Option 1: Cost base reset and election to defer

If the Trustees chose to apply the CGT Relief, then in the 2020 financial year the fund's assessable income would increase by $475,000 as follows:

- Deferred notional gain: the fund's assessable income would increase by $75,000 (being the $2m – $500,000) x 5% plus. By way of explanation, 5% of the notional gain of $1,500,000 is assessable, because this is portion of the SMSF still in accumulation phase.
- Current year gain: $400,000 (being $4m – $2m) x 2/3 x 30%. The 2/3rds fraction is the amount assessable in a Superannuation Fund that is assessable on assets held longer than 12 months - effectively there is a 1/3 CGT discount for Superannuation Funds. Also, as mentioned above the estimated ECPI is 70% meaning 30% is assessable.

**Option 2: Cost base reset and no deferral election**

Should the Trustees decide to reset the cost base but not to defer the CGT on the reset, the same total amount of assessable Capital Gain is declared, however it is split across two years – $75,000 in the 2017 financial year and $400,000 in the 2020 financial year.

## JAKJOY PTY LTD AND COMMISSIONER OF TAXATION (2013) AATA 526 (Walsh SM, 25 July 2013)

The taxpayer had received a private ruling from the Commissioner that the taxpayer carried on a business of leasing the three commercial properties that it owned.

After that initial ruling, the taxpayer then applied for a further private ruling to confirm whether its properties were active assets under section 152-40 of the ITAA 1997 and whether the properties satisfied the active asset test in section 152-35 of the ITAA 1997.

A taxpayer must satisfy the active asset test in order to establish their entitlement to the various capital gains tax concession in Division 152.

It is crucial that the CGT asset subject to a CGT event is an active asset within the meaning of section 152-40. Subsection 152-40(4) lists the CGT assets that are not 'active assets.' Paragraph (e) of the list in subsection 152-40(4) expressly excludes an 'asset main use by you is to derive interest, an annuity rent, royalties or foreign exchanges gains…' unless the asset is an intangible asset that has been subsequently developed, altered or improved so that its market value has been substantially increased, or it its main use for deriving rent was temporary only.

The private ruling application sought to establish whether the three leased commercial properties were therefore excluded from being active assets by reason of paragraph 152-40(e).

In his private ruling decision, the Commissioner determined that the properties were not active assets under section 152-40 of the ITAA 1997 and as a result the properties did not satisfy the active asset test in section 152-35 of the ITAA 1997.

The taxpayer objected against the Commissioner's private ruling decision and the Commissioner disallowed the objection.

The taxpayer then applied to the AAT to have this overturned. Here the taxpayer argued, based on principles of statutory interpretation that it was necessary to distinguish between those assets used to derive passive investment income such as rental income and those actively used in carrying on a business, which in this case was a commercial leasing business. The argument was that this distinction was relevant as the purpose of Division 152 of the ITAA 1997 was to allow the concessions to apply those assets used by a taxpayer in carrying on their small businesses. The taxpayer argued that if all properties used to mainly derive rent were automatically excluded from being active assets, this unfairly discriminated against small leasing businesses.

However, the Tribunal held that the properties were not active assets under section 152-40 of the ITAA 1997 and the properties did not satisfy the active asset test in section 152-35 of the ITAA 1997.

It was held there was no ambiguity in the wording of these sections and indeed some Practitioners may be surprised the taxpayer took this to the AAT. However, at least the taxpayer applied for a private ruling before lodging the tax returns.

All too often in these Division 152 cases we have seen taxpayers, or their advisors contort logic or events to put up an argument that the concessions apply. With the revenue involved the Commissioner will usually be playing close attention and will review the circumstances and apply the legislation objectively. For their own sale taxpayers and their advisors need to do the same.

## AMENDMENTS TO REVENUE ASSET AND TRADING STOCK CGT ROLL-OVERS

On 12 December 2014 Tax and Superannuation Laws Amendment (2014 Measures No. 6) Bill 2014 received royal assent (the legislation).

The legislation includes amendments to extend the existing business restructure roll-overs available where a member of a company or unit holder in a unit trust can defer the income tax consequences of transactions that occur in the course of a business restructure.

The aim of the amendments includes:

- To ensure that the roll-over for the exchange of shares in one company for shares in another company operates properly so that if the original shares are held on revenue account at the time of the exchange, the profit or loss can be deferred.

This element of the legislation has effect from 7.30pm on 8 May 2012 (by legal time in the Australian Capital Territory).

- Make it easier for unit trust to restructure their affairs by allowing taxpayers who hold units in the trust as revenue assets or trading stock to defer the realisation of a profit or loss on their units until they dispose of the replacement shares.

This element of the legislation has effect from 7.30pm on 10 May 2011.

- For certain disposals of assets by a trust, allowing roll-over relief to apply where a transferee company or trust holds rights, just before the disposal or transfer time, associated with a deed or similar document (that is designed to facilitate the transfer of assets into the company or trust).

For this element of the legislation, changes have effect in respect of each roll-over as follows:

- Transfer of assets between certain trusts has effect for CGT events happening on or after 1 November 2008.
- Disposal of assets by a trust to a company has effect for CGT events happening after 7.30pm AEST on 10 May 2011.

The legislation also makes certain technical amendments to broaden the scope and ensure the efficient operation of the revenue asset and trading stock roll-overs for the exchange of:

- Shares in one company for shares in another company;
- Units in a unit trust for shares in a company;
- The new business restructures roll-over in Division 615 has replaced the former roll-overs for exchange of shares or units for shares in another company in Subdivision 124-G and 124-H from 10 May 2011. This is subject to certain transitional provisions. The roll-over is expanded to apply to defer profits on the exchange of shares or units held as trading stock or revenue assets;
- Where the assets of two or more entities are included in the principal asset test, the test is amended for CGT events that occur from:
  - 14.05.2013 where the entities involved are members of the same consolidated group or MEC group; and
  - 13.05.2014 for any other entities.

## 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.

## TRACK AND ORS AND FCT (2015) AATA 45 (AAT, HACK SC DP, 29.01.2015)

### Scheme to attract Division 152 concessions brought down by Part IVA – Track

Here the taxpayers attempted to access the small business CGT concessions in Division 152 ITAA 1997.
In entering into an elaborate scheme, the taxpayer's argument that capital distributions made to various trusts that were established as part of the scheme were made for "asset protection" purposes were not accepted by the AAT who held that Part IVA applied to the arrangements. Part IVA is the anti-avoidance provision of the Tax Act.

The AAT held:

"...the evidence of the principals does not satisfy me that there was, in 2005, either a need for asset protection or a view, genuinely held on reasonable grounds, that there was a need for asset protection. Mr Forde, who might be thought to have the best grasp of the commercial ramifications of the transactions, acknowledged in his evidence that advice was sought 'in order to pay as little tax as possible' whilst at the same time asserting the need for asset protection.

The manner in which the scheme was entered into, or carried out, points strongly to a contrivance, designed to take advantage of the small business concession threshold, in circumstances where the sale then in prospect clearly demonstrated that the assets of the business exceeded that threshold by a considerable amount. The fact of capital distributions having been made in one financial year, prior to the sale in the following financial year, merely emphasises the contrivance and that the contrivance was directed to obtaining a tax benefit in connection with the scheme."

### Track V FCT (2015) AATA 45

This case's significance is that it is the first reported decision whereby tax benefits obtained in connection with a scheme to apply the small business CGT concessions have been cancelled under the general anti-avoidance provisions contained in Part IVA of the Income Tax Assessment Act 1936 (cth).

The scheme carried out by the taxpayers enabled them to qualify for the small business CGT concessions by way of "creating" liabilities for the purpose of satisfying the MNAVT.

So, tax advisers must consider the possible application of Part IVA where they are called upon to assist in a restructure for their clients when a future business or share sale may be on the cards.

## ROLL-OVER RELIEF DENIED KAFATARIS V DC OF TAXATION (2015) (FCA874)

The Federal Court has held that husband and wife taxpayers who transferred a jointly owned property to a wholly-owned company had created a trust over the property by declaration or settlement (CGT event E1) for which no roll-over relief was available under s122-15 or 122-125 of ITAA 1997.

In April 1988 the taxpayers, who were sole directors and shareholders of Thorium Pty Ltd, jointly acquired a property in the Sydney CBD of $4.03 million. From January 1991 until July 2007 the property was leased out, and then the taxpayers, in their capacity as directors of Thorium, resolved that Thorium should acquire the equitable estate in the property. This was done by way of an allotment of 9,000,000 ordinary shares in Thorium at $1 per share paid to the taxpayers as consideration.

The Deputy Commissioner took the view that a trust had been declared and that the declaration of trust was "manifested and provided by some writing" as required by s23C of the Conveyancing Act 1919 (NSW). A net capital gain of $1,134,894 was assessable to each taxpayer for the 2007/08 income year.

The taxpayers argued the creation of the constructive trust occurred by operation of law (CGT event A1), whereas the Commissioners view was that the taxpayers created a trust over the land in favour of Thorium by declaration or settlement (CGT event E1). If CGT event A1 applied roll-over relief was available to the taxpayers pursuant to s122-15 or 122-125 of ITAA 1997. In the event CGT event E1 occurred, then no roll-over relief was available.

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