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Trusts Update

A recent High court decision and ATO rulings have significantly impacted upon the tax administration of trusts.

As a result, it has become imperative for all discretionary trusts to revisit their trust deed and, if necessary amend them to ensure they comply with the new rules.

We will be contacting all affected clients to ensure that you continue to enjoy the benefits of your trust structure.

We also remind all trustees that they need to consider their distributions of income in the lead up to 30 June and where necessary, document their decision. We will contact you to address these matters.

Offsetting Business Losses against Other Income

Taxpayers who make a net loss in a business activity may, under certain circumstances, claim that loss by offsetting it against their income from other sources. This is restricted by what's known as the 'non-commercial losses rule'. Key changes were introduced late last year to further tighten the rules to restrict access by individuals with an adjusted taxable income of \$250,000 or more. The changes apply from the 2009/10 income year. Despite this, taxpayers who exceed the income threshold can, in limited circumstances, still access the benefit by requesting that the Commissioner exercise his discretion to do so. The Tax Office has released an application form and an evidentiary checklist to assist in this process.

Entrepreneurs' Tax Offset – Income Test Introduced

The Government has presented a Bill in Parliament which proposes to introduce an income test to restrict eligibility to the entrepreneurs' tax offset. The

offset presently provides a 25% tax offset on the income tax liability of small businesses that have an annual turnover of \$75,000 or less, phasing out from a turnover of \$50,000. The proposed test will restrict access to the offset for single individuals with income of over \$70,000 and for families with income of over \$120,000.

Superannuation Clearing House – Coming Soon

The Bill to establish an optional free superannuation clearing house for employer superannuation contributions has been introduced into Parliament. The clearing house, to be Medicare Australia, will allow businesses with fewer than 20 employees to meet their employer superannuation guarantee obligations once payment is received by the clearing house. The clearing house is expected to be available from July 2010. Businesses are expected to be able to register with Medicare Australia from May 2010.

Superannuation – What is Meant By 'Contribution'?

The Tax Office has released Taxation Ruling TR 2010/1 which explains the Commissioner's views on the ordinary meaning of 'contribution', how a contribution can be made to a superannuation fund, and the timing of when a contribution is made. The Ruling also explains key aspects of the income tax rules for deducting employer superannuation contributions and personal contributions.

Self-Managed Super Funds and Acquiring Assets from Related Parties

There are strict rules which prohibit a self-managed superannuation fund (SMSF) from acquiring an asset from a related party. The Tax Office has released Self Managed Superannuation Funds Ruling SMSFR 2010/1 which explains the rules. The

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Commissioner states that under the rules an ‘asset’ means any ‘form of property’ and includes every type of right and intangible personal property that can be enforced by legal or equitable action such as a debt or an interest in a trust fund. The phrase ‘acquire an asset’ encompasses not only the purchase of an asset but also the acquisition of an asset where the SMSF does not provide any consideration (for example, in specie contributions).

Division 7A Applies To ‘Payments by Direction’

The Federal Court has confirmed that the deemed dividend provisions can apply where a payment is made by a debtor of a company to a shareholder at the direction of the company.

The taxpayer and her former de-facto spouse were the shareholders and directors in a private company. In the 2001 income year, the company directed US clients to pay over \$160,000 in debts owed to the company into the account of the taxpayer (of which she was sole signatory). The funds in the account were used for the private expenditure of the taxpayer and her former de-facto spouse.

The Court held that the deemed dividend provisions can apply if a company makes a payment to a shareholder by way of directing its debtors to make the payment. In the Court’s view, there was no reason to construe the notion of ‘pay’ as requiring a direct flow of money from the payer to the payee, or that it precludes payment by direction.

Broadly, a payment or loan by a private company to a shareholder (or their associate) will be considered a deemed unfranked dividend unless steps have been taken to avoid this.

SMSF Trustees with Enduring Power of Attorney

The Tax Office has released a Ruling explaining the Commissioner’s views on how a person who holds an enduring power of attorney in respect of a

member of a self-managed superannuation fund (SMSF) can be a trustee in place of the member (or a director of the corporate trustee) for the purposes of the superannuation legislation.

The Tax Office considers that a legal personal representative (LPR) does not become a trustee of the fund (or a director of the corporate trustee) merely by virtue of holding an enduring power of attorney. Rather, the LPR must be appointed as a trustee of the SMSF in accordance with the trust deed, the superannuation legislation and any other relevant legislation.

Furthermore, the Tax Office says a member must cease to be a trustee of the SMSF or a director of the corporate trustee, except where the LPR is appointed as an alternate director. Provided that the alternate director can only exercise the powers of a director where the main director does not, the Ruling says it is not necessary that the member resign as a director of the SMSF in these circumstances to satisfy the superannuation legislation.

SMSF Trauma Insurance Policies

The Tax Office has also released a Determination in which it sets out the circumstances where a trustee of an SMSF can purchase a trauma insurance policy in respect of a member and still satisfy the superannuation legislation, in particular the sole purpose test.

To briefly explain, the sole purpose test requires an SMSF to be maintained solely for at least one core purpose (eg the provision of benefits for a member on or after the member’s retirement) and, also possibly, at least one ancillary purpose (eg the provision of benefits for a member on or after the member’s death).

The Commissioner says any benefits payable under a trauma insurance policy must be payable to a trustee of the SMSF and become part of the assets of the SMSF, at least until the relevant member can satisfy a condition or release. If an SMSF trustee purchases a trauma insurance policy that provides

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for benefits payable under the policy to be paid directly to someone other than a trustee of the SMSF (eg the insured member or member's relative), the Tax Office says this would contravene the sole purpose test.

Deferring Income

- Income received in advance of services to be provided will generally not be assessable until the services are provided.
- Taxpayers who provide professional services may consider, in consultation with their clients, rendering accounts after 30 June to defer the income.
- Consider whether the requirements to be classified as a small business entity are satisfied to access various tax concessions such as the simpler depreciation rules and the simpler trading stock rules.
- Individuals operating personal services businesses should ensure that they satisfy the relevant test to be excluded from the Personal Services Income regime or seek a determination from the Commissioner.

Maximising Deductions

Business taxpayers

- Debtors should be reviewed prior to 30 June to identify and to write off any bad debts.
- Review the asset register to identify any low-cost and/or low-value assets that may be pooled to access an accelerated rate of depreciation.
- Write off any depreciating assets which are no longer being held for use because a deduction may be available.
- Review trading stock for obsolete stock for which a deduction is available.
- Employees' superannuation contributions should be paid before 30 June to obtain a deduction and to avoid the Superannuation Guarantee Charge.

- A one-off bonus deduction for new investment in tangible depreciating assets purchased between 13 December 2008 and 31 December 2009 may be available. The bonus deduction is in addition to the depreciation deductions available to taxpayers.
- From 1 July 2009, losses incurred by individuals with an adjusted taxable income of \$250,000 or more from non-commercial business activities will be quarantined even if they satisfy the four commerciality tests.

Capital Gains Tax

- Consider deferring the disposal of shortly-held assets to access the CGT discount, where available.
- Individual taxpayers can consider contributing some or all of capital gain to their superannuation fund because a deduction may be available for personal superannuation contributions.
- Consider whether a rollover relief is available to defer any capital gains.
- Consider the availability of the small business CGT concessions which can disregard, reduce or defer a capital gain arising from the disposal of an asset which has been used by an entity in the course of carrying on its business.

Companies

- The franking percentage for distributions to shareholders should be the same for each franking period to avoid a franking deficit tax.
- A private company has four months after the end of the income year to provide its shareholders with a distribution statement for dividends paid.
- Loans, payments and debt forgiveness by private companies to their shareholders and associates should be repaid by the earlier of the due date for lodgement of the company's return for the year or the actual lodgement date.

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- Alternatively, appropriate loan agreements should be in place.

Trusts

- A minor (ie aged under 18) can receive up to \$3,000 in non-taxable distribution for the 2009/10 income year.
- If a company is owned by a discretionary trust, consider whether a family trust election (FTE) is needed to ensure any losses or bad debts incurred by the company will be deductible.
- If shares are owned by a discretionary trust, consider the necessity for the trustee to make a FTE to ensure any franking credits attached to the dividends will not be 'wasted'.
- If a FTE has been previously made, avoid distributing outside the family group to avoid the family trust distributions tax.
- A recent High Court case confirmed that it is correct to apply the proportionate approach if the net income of a trust for tax purposes exceeds its accounting income.
- The Court also affirmed that the trustee can distribute capital gains as income of the trust for tax purposes if the trust deed permits it.
- Avoid retaining income in a trust because the income may be taxed at 46.5%.

Superannuation

- A re-contribution strategy may produce tax benefits for taxpayers under age 60.
- Low-income earners (including self-employed persons) should consider making a personal superannuation contribution to qualify for the government superannuation co-contribution payment.
- The concessional contributions cap for the 2009/10 has been reduced to \$25,000 or \$50,000 if over 50 years of age.

- For the 2009/10 income year, pensioners have the option to draw half of the year's minimum required pension amount.
- From 1 July 2009, a person's 'reportable superannuation contributions' is included in their 'adjusted income' when determining their eligibility for various tax offsets and social security benefits, such as, the pensioner tax offset, senior Australians tax offset, and the spouse superannuation tax offset.
- From the 2009/10 income year, a spouse also includes a same sex partner where they live together on a genuine domestic basis in a relationship as a couple, or a partner (whether of the opposite or same sex) where the relationship is registered under a State or Territory law.

Important Dates Reminder

JUNE 2010

- 21 Activity Statements** May 2010 monthly activity statements: Final date for lodgement and payment.
- 30** End of financial year.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

Important Note: This is not advice. Clients should not act solely on the basis of the material contained in this bulletin. Items herein are general comments only and do not constitute advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of these areas. This bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.

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