OCTOBER 2016 TAX UPDATE

LEGISLATION/ GOVERNMENT ANNOUNCEMENTS

1. Treasury Laws Amendment (Income Tax Rates) Bill (2016)- Personal tax cuts for middle to high income earners

- the rate of tax payable by resident individuals on taxable income between $80,001 to $87,000 will decrease from 37% to 32.5% from 1 July 2016. This will provide a maximum tax cut of $315 for resident individuals on taxable incomes of $87,000 and above

2. Treasury Laws Amendment (Enterprise Tax Plan) Bill (2016)

Company tax cut

- the company tax rate will be progressively cut over the next 11 years to a flat 25% for all companies by the 2026-27 income year
- company tax rate will be reduced from 28.5% to 27.5% for the 2016-17 tax year for a company which qualifies as a small business entity being a company that carries on a business and whose aggregated turnover is less than $10 million for the 2016-17 tax year
- the definition of small business entity will be amended so that the aggregated turnover threshold under section 328-110 refers to a less than $10 million turnover threshold in lieu of the existing $2 million turnover threshold which is discussed further below
- From the 2023-24 tax year all companies will be subject to a standard corporate tax rate of 27.5%
- It is also proposed that this standard company tax rate will then be further progressively reduced from 27.5% in the 2023-24 tax year to 25% in the 2026-27 year

Changed eligibility rules for small business entities

- The definition of a small business entity under section 328-110 of the ITAA (1997) will be amended to increase the aggregated turnover threshold for an entity to be eligible to be a small business entity from less than $2 million aggregated turnover to a less than $10 million aggregated turnover threshold from the 2016-17 tax year onwards
- Access to the small business tax offset will be limited to eligible entities whose aggre gated turnover is less than $5 million from the 2016-17 tax year (rather than the current $2 million aggregated turnover threshold), and the current $2 million aggregated turnover threshold

3. **Proposed Budget Superannuation Changes**

Treasurer's Media Release dated 15 September 2016, Exposure Draft Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 and Exposure Draft Superannuation (Objective) Bill 2016

- exposure draft legislation: enshrine the objective of the superannuation regime in standalone legislation to ensure that future superannuation policy proposals are as sessed on the basis of whether they will result in providing income in retirement which will substitute or supplement the age pension
- reducing the annual non-concessional contributions cap from its current level of $180,000 per year to $100,000 per year effective from 1 July 2017
- the maximum amount of the non-concessional contribution allowed under the three year brought forward rule will be reduced from its current level of $540,000 to $300,000 from 1 July 2017 (subject to certain transitional arrangements concerning the operation of the three year brought forward rule)
- From 1 July 2017 the total amount that can be transferred from an accumulated superannuation account to a tax free retirement account will be capped at $1.6 million, and any amount in excess of this cap will remain in an accumulation phase account bearing tax at the existing concessional tax rate of 15%
- From 1 July 2017 earnings on assets supporting transition to retirement pensions will also be taxed at 15%
- From 1 July 2017 a standard cap of $25,000 will apply to all individuals regardless of age in lieu of the existing general cap on concessional contributions of $30,000 (or 35,000)
- The extra 15% tax paid by high income earners on certain 'low-tax' contributions under Division 293 of the ITAA (1997) will increase from 1 July 2017 where persons derive 'income for surcharge purposes' in excess of $250,000 rather than the $300,000 threshold that currently applies

4. **Budget Savings (Omnibus) Bill (2016) which received Royal Assent on 16 September 2016**

- Cut in R&D tax offsets and single touch payroll

5. **Commissioner's Statutory Remedial Power**

6. **Tax and Superannuation Laws Amendment (2016 Measures No.2) Bill 2016**

CASES

- Re Reany and FCT [2016] AATA 672- Non-deductibility of travel expenses
- DCT v Rodriguez [2016] FCA 860 - Penalties imposed on Trustee for breach of sole purpose test and other contraventions of the SISA (1993)

ATO ANNOUNCEMENTS

- Consulation Paper - More flexible approach to penalties for small business and individuals
- AUSkey for Chrome and Firefox browser

TRUST LOSSES

ATO scrutiny

Prior and current year:
- Revenue losses
- Bad debt or debt/equity swap deductions

N.b Rules do not apply to capital losses

REALLY IMPORTANT: Application of trust loss definitions to other areas e.g CGT rollovers

Four issues:
- Type of trust
- Applicable rules for each type
- Making FTEs
- Income injection test

1. Type of trust

- Fixed
- Non fixed
- Excepted

Commercial aspects

Fixed Trust
Example: Unit trust –SHOULD BE FIXED
- Fixed entitlements to 100% of the income and capital
- Vested and indefeasible interest in a share of income or capital (under the trust instrument)
- Colonial First State Investments decision (power to amend Constitution by special resolution)

  Example:
  Given the Colonial decision, the ATO position per their Impact Statement is:

"The decision confirms the ATO view that very few trusts satisfy the definition of 'fixed trust' in section 272-65 of Schedule 2F in the absence of the exercise of the Commissioner's discretion (essentially because beneficiary entitlements to income or capital are generally liable to be defeated by the exercise of a power in the deed or by a statutory power)."

- It is clear to me that the XX Trust was meant to be fixed and I wouldn't have thought twice about it pre Colonial.
- The issue arises due to Clause 16 Amendment Powers and how the ATO might interpret that. Even though Clause 16.1(c) contemplates that any change impacts all unitholders equally, theoretically the deed could be amended to take away the income or capital rights from all unitholders (not sure why you would but that isn't the point).

  So:
  1. I would not punt on it being fixed.
  2. Commissioner has discretion to treat it as fixed but you would need to ask - e.g private ruling.

Non-fixed Trust

- Any trust that is not a fixed trust -default position

Excepted

- Family trust (FTE in place)
- Deceased estates
- Superannuation funds etc
- Tax exempt fixed unit trusts

2. Applicable rules for each type

Fixed
50% stake test Or
Alternative Test
Plus Income Injection Test

Individuals holding fixed entitlements to more than 50% of the income and capital of the trust

Alternative Test s266-45

Where individuals do not have a 50% or more:

1. 50% or more held by a non-fixed trust (other than family trusts)

2. Fixed entitlements held by another fixed trust or company and non-fixed trust holds 50% or more in the first entity

Non fixed
All three of: (ownership/control)

- 50% stake test s267-40
- Control Test s267-45
- Pattern of distributions s267-35

- Plus Income Injection Test

50% stake test – applies if individuals have fixed entitlements (generally not for standard discretionary trust)

Control Test- broad definition including control income or capital and trustee appointment powers (generally satisfied with a family group)
Pattern of distributions-six year look back tests in relation to "continuity" of distributions
(Assuming it has made any)

3. Making FTEs

- Use of trust losses
- Use of losses in companies owned by trust
- Income injection test
- Dividends

Use if:

- fail trust loss tests or
- if analysis too hard or
- too costly

Watch outs: Test individual, family group etc

Having made one – watch Family trust distribution tax for distributions "outside" group

4. Income injection test

Outsider to family trust–s270-25(1)

- The trustee of the trust
- A person with a fixed entitlement to income or capital of the trust
- The test individual
- A member of the test individual's family
- A trust with the same FTE
- An entity that has made an interposed entity election
- A fixed trust, company or partnership where one of the above entities held fixed entitlements

Provision of a benefit – s270-20

- Money, a dividend or property
- A right or entitlement
- Services
- The extinguishment, forgiveness, release or waiver of a debt or other liability
- The doing of anything that results in the derivation of assessable income
- Anything else that is a benefit or advantage

Example: Trust –no FTE lends to trust with FTE (or distribution from a profit trust)
Losses not available
May need to ask for “late” FTE

DIVISION 7A – STATE OF PLAY

Overview
- direct loans
- Indirect loans
- Unpaid present entitlement

Why does it matter – deemed dividend – tax plus penalties

UPEs and Board of Tax

1. Key concepts for direct loans

Vanilla example. Co to shareholder – money used for private purposes

3 Key features:

- Loan, payment or a debt forgiveness
- payments to a shareholder or an associate
- concept of distributable surplus

Loan, payment or debt forgiveness

Watch out: Don't forget last two

Payments to a shareholder or an associate

Example 1 : Co to family trust – not ok
Example 2: Co to friend – ok

Concept of distributable surplus

Definition
Formula- s 109Y
Net Assets plus Div 7A amounts minus Non-commercial loans minus Paid up share value minus Repayment of non-commercial loans

Examples
- example 1 retained earnings only
- example 2 share capital only
- example 3 share capital and goodwill

Exclusions

Company to company

Biggest mistake: No exclusion if money used for business purposes e.g family trust

- Made in ordinary course of business (s109M)
- Liquidators distribution (s109NA)
- ESS (s 109NB)
- Loan agreement (s109N)
- Bankruptcy (s109G)
- Commissioner's discretion (s109RB)

2. Key concepts for Indirect loans

Two common situations:

1. Company lends to interposed entity; that entity lends to shareholder
2. Trust has distributed to company (unpaid); trust lends to shareholder or associate e.g another family trust

   Comments: Complicated provisions but ATO winning in Court
   Tip: Don't look at last payment because Div 7A might not be obvious.
   Trace funds to original source.

3. Trusts and UPE's with companies

For post 16 December 2009 UPEs, treated in accordance with Practice Statement PS LA 2010/4:
1. 7 year interest only loan
Balloon repayment at end
Benchmark interest rate – 109N(2)

2. 10 year interest only loan
Prescribed interest rate- RBA small business variable overdraft rate

3. Invest in specific income producing asset on behalf of company

Grandfathered pre 17 December 2009
Post 16 December 2009 -now 7 years so need to make balloon repayment
Turn into "proper" Div 7A loan
n.b more likely June 2017 than December 2016
Budget announcement: Board of Tax recommendations – one rate, elective no CGT, ungrandfathering.