

MAY2017 TAX UPDATE

ATO ANNOUNCEMENTS

- Tax Commissioner reappointed until 2024
- Taxation revenue in 2015-16 up by 4.2%
- 2014-15 Taxation Statistics released by ATO
- ATO Decision Impact Statement on Millar case – sham loan
- Super reforms: SMSF commutation requests to stay within \$1.6m pension cap - Practical Compliance Guideline PCG 2017/5
- Super reforms: defined benefit lifetime pensions - Law Companion Guideline LCG 2016/10
- Interest on bank accounts – who should be assessed? - Taxation Determination TD 2017/11
- Franked distributions funded by capital raisings: ATO treatment
- Super guarantee: ATO accepts commission-only salesperson not an employee

LEGISLATION

- LRBA integrity measures for pension cap - draft legislation released
- Exposure Draft- Treasury Laws Amendment (2017 Measures No 2) Bill 2017:
 - o transition to retirement income stream (TRIS) rules;
 - o \$1.6m pension transfer balance cap;
 - o concessional contributions cap; and
 - o objectives of superannuation.

CASES

- Transfer pricing, arm's length interest rate - Chevron Australia Holdings Pty Ltd v FCT
- Damages re breach of duty in tax advice - Ralston v Jurisich
- Taxpayer fails onus of proof – default assessments for \$2 million upheld - Zappia v FCT
- Truck driver loses claim for work-related travel expenses - Re Banks and FCT [2017] AATA 468
- Franking credit distributions and “streaming”: - Thomas & Anor v FCT

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.