



CLIENT BULLETIN— OCTOBER 2010

CONTENTS

- **ATO Compliance Program 2010/2011— Target Areas**
- **Unpaid Present Entitlements**
- **Continuing ATO Support for Businesses in Financial Distress.**
- **Self Managed Super Fund (SMSF) Update**
- **Division 7A Amendments—Private Use of Company Assets**

ATO Compliance Program 2010/2011— Target Areas

The ATO recently released its compliance program for 2010/11.

In relation to tax compliance for small and medium enterprises the ATO will be focusing on a variety of issues, including the following:

Business Activity Statements— Compliance issues related to BASs, specifically reported property sales and acquisitions and application of the margin scheme rules.

Capital gains and losses — The calculation of capital gains and losses including in relation to the application of small business CGT concessions, other CGT concessions or rollovers, calculation of cost base, capital gains and losses on the disposal of shares and property (including non-residents).

Cash economy — Businesses that conduct a high level of cash transactions (such as paying cash-in-hand wages) in order to identify taxpayers that may be using cash transactions to hide income and evade tax obligations. This includes the use of business benchmarks which allow comparisons between similar businesses to identify typical or expected turnover levels.

Company deregistration — The ATO will be examining the affairs of taxpayers who deregister companies.

Employer obligations — The ATO will be monitoring employers' compliance with their PAYG Withholding obligations and superannuation guarantee obligations. In relation to superannuation, the ATO will be focusing on road freight transport, automotive repair and electrical service industries. The ATO will also continue to work with promoters, industry representatives and sporting bodies to provide guidance on withholding obligations for visiting entrepreneurs and sportspersons.

Financial supplies — The GST consequences of transactions related to financial supplies, especially in relation to the appropriate identification and linking of acquisitions to the making of financial supplies. The ATO will focus specifically on capital raising activities, managed funds or superannuation funds, contributory mortgage schemes, small financial transactions (such as pawnbrokers etc) and mergers and acquisitions.

Fringe benefits tax — The treatment of motor vehicles, in particular appropriate recording of private use in relation to luxury car purchases and exempt vehicles.

GST — The GST impact of cross-border transactions, integrity of GST refunds, sales of property and issues concerning retirement villages.

International transactions — Foreign source income, deductions relating to cross border transactions and the application of the thin capitalisation and transfer pricing provisions.

Losses – The utilisation of losses, especially the incorrect treatment of capital losses as revenue losses.

Personal services income – Contractors to ensure that all PSI is appropriately disclosed, with a particular focus on engineers and computer technology specialists in the mining industry.

Self managed superannuation funds (SMSFs) – Loans to related parties, deductions claimed for exempt current pension income, treatment of losses and re-reporting of member contributions.

Shareholder loans – Amounts paid or distributions made by private companies to shareholders or connected entities to ensure any deemed dividends are appropriately reported.

Trusts – TFN reporting obligations of trustees in respect of beneficiaries to whom distributions are made.

Unpaid Present Entitlements

The ATO has finalised its draft ruling on the impact of unpaid present entitlements in favour of private companies in the form of TR 2010/3 and has released a draft practice statement on the application of its position, in the form of PSLA 3362.

This ruling constitutes a significant shift in the way a lot of taxpayers had been treating unpaid present entitlements prior to the release of the ATO's draft ruling. As sections of the ruling apply both before and after the date of its release, taxpayers should carefully consider the application of the ruling in relation to all income years in respect of which income tax returns remain open for amendment.

This ruling relates to when an unpaid present entitlement in favour of a private company will be treated as a "loan" for the purposes of Division 7A, and therefore treated as a deemed dividend to the shareholder of the company, where the trust is a related entity of the shareholder. The ruling broadly applies in the following situation:

- a private company has a present entitlement to an amount from a related trust (i.e. it can call for immediate payment of the amount by the trust);

- the amount remains in the trust rather than being distributed to the private company (i.e. there is an unpaid present entitlement); and
- the amount is used by the trust for its own purposes or intermingled with other trust funds (as opposed to being held by the trust on a sub-trust for the company).

The ruling concludes that a Division 7A loan will arise where:

- a private company beneficiary lends (by agreement, authorisation or ratification) money in satisfaction of an unpaid present entitlement;
- the trustee creates a loan for the benefit of the private company beneficiary pursuant to the trust deed instead of creating an unpaid present entitlement;
- there is a subsisting unpaid present entitlement and the private company has in substance effected a loan or provided financial accommodation in respect of that unpaid present entitlement; or
- an unpaid present entitlement has been allowed to remain outstanding for use by the trust generally (as opposed to being used or invested or lent for the absolute benefit of the corporate beneficiary).

The draft practice statement sets out practical guidance to assist in the application of the Commissioner's position, including guidance in relation to:

- when a loan agreement may be considered 'express' or 'implied'
- when a 'loan' may be taken to have been made
- the resulting tax consequences if a loan is taken to have been made
- the review period that will apply in relation to such loans (generally the ATO will not review the tax consequences of such loans outside the standard amendment period applicable)

- how to determine whether funds representing the unpaid present entitlement are being used for the company's sole benefit (as opposed to trust purposes) and the evidence that may be used to substantiate the position taken
- how to determine if there is a sub-trust in place
- application of the Commissioner's discretion under Division 7A to deemed loans as per the ruling

Continuing ATO Support for Businesses in Financial Distress

For businesses that are experiencing continuing financial distress, the ATO is offering services including flexible payment arrangements, interest-free deferrals of activity statement liabilities, cash flow relief through reduced uplift factor for PAYG and GST instalments and PAYG Instalment variations.

Businesses in hardship should contact the ATO as early as possible to explore available options, otherwise the ATO may seek to take firmer action with businesses that default on payment arrangements, or do not have the capacity to pay.

Self Managed Super Fund (SMSF) Update

Pension Drawdown Relief— In response to slow market recovery after the global financial crisis, the Federal Government has extended the 50% pension drawdown relief for the 2010/2011 financial year.

Revised Borrowing Rules— New legislation was passed on 24 June, 2010 to simplify the borrowing rules. For more information view the latest Q & A Information Sheet on the ATO website - "Limited recourse borrowing arrangements by SMSF".

Carrying on a Business in your SMSF— An information statement confirming their view on running a business in your SMSF has been issued by the ATO. Several issues are raised relating to both income tax and SIS. Therefore, you must take careful consideration to the following requirements before an activity of this nature is undertaken:

- Sole purpose test;
- Incorporating the activities into the SMSF; investment strategy;

- SMSF is prohibited to lend or provide financial assistance;
- The SMSF cannot give charge over an asset;
- Restrictions on acquiring related party assets;
- Restrictions on borrowing money;
- Ensuring all transactions are at arm's length;
- Payments to trustees are prohibited;

A detailed review should be provided on each situation to ensure it is appropriate for the above conditions.

Property development is a common interest for an SMSF and all of the above must be considered before this type of transaction is undertaken.

Other considerations are:

- Whether the development is a "one off" or whether the SMSF will develop multiple properties.
- Whether the members or any associates carry on development activities in other entities.

Contribution Ruling TR 2010/11— This ruling provides confirmation on "when a contribution is received" from a SMSF perspective. Issues covered included:

- Where a member pays expenses on behalf of the fund, the contribution is the date of payment where the SMSF does not reimburse the fund
- Where commercial property is transferred into the fund, the effective date is when the trustees take possession of the title deed and transfer forms. Not the date that the title is registered. Care must be taken when property transfers take place around the end of the financial year.
- Where listed shares are transferred via an off-market share transfer form into the fund, the effective dates is deemed to be when the forms are completed and lodged with CHESS, not the date that CHESS states the registration is.

NSW Stamp Duty Relief— There has been an amendment to the NSW Duties Act to provide nominal duty in respect of the transfer of dutiable property (commercial property) from a member(s) to a trustee of a SMSF. The transfer will attract concessional duty of \$50. The conditions are:

- That the property must be owned by the member(s);

- That the property must be segregated in the SMSF for the benefit member(s) who were the transferor(s);
- The property is used solely for providing retirement benefits for the transferor(s). (It must be used in accordance with the sole purpose test).

Whilst the wording of the legislation would lead to a conclusion that the transferor is the only member of the SMSF the NSW Office of State Revenue accept that the concession will apply where the property is transferred by more than one member. Approval for each transfer should be sought for confirmation.

Division 7A Amendments – Private use of company assets

FBT for shareholders?

The amendments to Division 7A of the Tax Act announced in the 2009/10 Federal Budget have now passed into law. The key amendment is the extension of Division 7A to tax shareholders and their associates on the private use of assets owned by their company unless market values are paid to the company for the use of the asset.

What is private use?

Private use of an asset can occur without a formal agreement between the company and the shareholder. Private use is deemed to occur even if a company asset is made available for private use, and no actual use occurs.

Are there any assets that are excepted?

There are a number of exclusions to this new taxing regime:

- Minor benefits – if they were provided to an employee, would constitute a minor benefit under s58P of the FBT Act 1986⁴ are excepted,
- Otherwise deductible payments – Amounts which if incurred and paid by the shareholder (or their associate) directly would have been eligible for a once off income tax deduction are excepted,
- Use of a dwelling – The use of a dwelling by a shareholder or their associate which does not satisfy the otherwise deductible exemption may be excepted from a Division 7A payment where the following conditions are met:
 - ◊ The shareholder or associate is carrying on a business,

- ◊ The shareholder or associate is granted or has a lease, licence or other right to use land, water or a building for the purposes of carrying on a business, and
- ◊ The provision of the dwelling to the entity is connected with that use or with that lease, licence or other right to use the land, water or building to carry on the business.

Example – Farmhouse owned by a company.

Peter and Sue are shareholders in a private company. The company owns farm land on which Peter and Sue run a farming business through their family partnership.

For the 2009/10 income year Peter and Sue live in a house on the farm. Peter and Sue do not pay rent to their company for the use of this house.

As this use is for private purposes, it does not come within the otherwise deductible exception.

However, as their use of the house is in connection with the partnership's farming business, the provision of the house by the company is disregarded for the purposes of the new Division 7 tax laws).

- Main residence exemption – Dwellings owned by a company before 1 July 2009 which are the main residence of a shareholder (or their associate) are excepted where the company satisfies a continuity of ownership test.

Example – Main residence

Jack is the sole shareholder of a private company. The sole asset owned by the company is a house that the private company acquired in 2005. Jack currently uses this dwelling as his main residence. As long as there is no substantial change in ownership of the company the provision of the house by the company, for Jack's use, is disregarded for the purposes of the new Division 7A laws.

Important: This is not advice. Clients should not act solely on the basis of material contained in this report. Items herein are general comments only and do not constitute or convey advice per se. Also, changes in legislation occur quickly. We therefore recommend that our advice be sought before acting in any of these areas.

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