

TAXWISE BUSINESS NEWS – DECEMBER 2010



Wishing you a Merry Christmas and a Happy New Year.

Our office will be closing from close of business Thursday 23 December 2010 and will be re-opening on Monday 10 January 2011.

OUR SERVICES

Did you know we can assist you in the following ways:

Income Tax

- Income Tax Preparation
- Tax Planning Advice
- GST
- Business Activity Statements
- Superannuation
- Land Tax
- Fringe Benefits
- Tax Audit Support

Accounting

- Preparation of financial and management accounts
- Company Secretarial services
- Accounting systems and technology
- Better management and procedures for your business

Business and Advisory

- Business plans and cash forecasts
- Start up feasibility studies
- Introduction to financiers and assistance with financial applications
- Preparation for sale of business

Audit

- Statutory Audits
- Not for profit organisations
- Half Yearly Reviews
- Superannuation Funds
- Systems and Control Reviews

Other

- Business valuations and appraisals
- Remuneration planning
- Mediation and dispute resolution

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Unpaid Present Entitlements (UPE) – tax obligations of shareholders

The ATO has recently released its final practice statement in respect of the treatment of unpaid present entitlements (UPEs) under a trust in favour of a private company.

The ATO released TR 2010/3 earlier this year, which set out the circumstances in which a present entitlement in favour of a private company which remains unpaid will constitute a “loan” for Division 7A purposes.

Broadly, Division 7A is designed to ensure that private companies distribute profits to shareholders (or associates of shareholders) as taxable dividends, rather than by

way of non-arm's length payments or loans.

Where Division 7A applies, such payments and loans are treated as unfranked dividends in the hands of the shareholders or their associates, provided the private company in question has sufficient distributable surplus at the time at which the payment or loan is made.

TIP

If you are a beneficiary under a trust which has an unpaid present entitlement in favour of a private company of which you are a shareholder, you should consult with your tax advisor to ensure you don't have to include any deemed dividends in your assessable income.

Research and Development Bill

The new research and development (R&D) bill was re-introduced into a newly formed House of Representatives this month. This Bill remains largely unchanged from its previous version, though minor clarifications have been made to ensure that ‘development’ activities will still be eligible for the R&D concession.

The passage of this Bill through Parliament is not expected to be smooth due to the nature of the minority Government, and if the passage of the Bill is delayed until

the new Senate is formed in July 2011, the passage of the Bill through the upper house could be delayed further.

However, taxpayers should take note of the changes contained in the Bill, as it is due to take effect from 1 July 2010 and is therefore intended to affect the tax position of all entities engaged in research and development activities in the current income year.

The new Bill amends:

- which companies will be eligible for research and development concessions
- the nature of the concession (which is being changed from a credit to a tax offset)
- the amount of the concession (businesses with a turnover of less than \$20 million will have access to an increased tax offset)
- the list of exclusions (i.e. activities that generally cannot be R&D activities for the purposes of the concession)
- the R&D concessions available for costs of software development activities.

As these changes are due to take effect on 1 July 2010, the eligibility for R&D concessions, as well as the amount and type of the concession (i.e. refundable or non-refundable offset rather than a credit) will likely be different for your 2011 income tax return as compared to your 2010 income tax return.

As such, if you have in the past claimed the R&D tax credit, or suspect you may be eligible to do so in the future, you should consult with your tax advisor to identify the challenges and opportunities for you arising from the new Bill.

TO DO

Taxpayers that currently claim research and development concessions, or suspect they may be eligible to do so in the future, should consult with their tax advisor to clarify their tax position under the new Research and Development Bill.

Taxation of Earnouts

Treasury is currently undertaking consultation in relation to new legislation to overhaul the taxation of earn-out arrangements.

An earn-out is broadly a right to ongoing payments from the purchaser after the sale of a business or asset. Such payments are generally based on the earnings or revenues of the business or asset after sale, and typically represent a form of deferred consideration on disposal of the business/asset i.e. as the ongoing payments are contingent on performance, the total consideration paid to the vendor is generally intended to be based on the profitability of the business.

The treatment set out in the ATO's draft ruling requires vendors to pay tax on an amount that they have not yet received (or may never receive) and potentially miss out on the CGT discount in relation to earn-out payments.

NOTE

Taxpayers intending to acquire or dispose of a business or asset subject to an earn out payment should seek advice from their tax advisor as to the tax consequences of such an earn-out.

Primary Production Trusts

The ATO has withdrawn its tax ruling in relation to the averaging of income derived by primary production trusts in response to the High Court's decision in *FC of T v. Bamford Ors; Bamford Anor v. FC of T* [2010] HCA 10; 2010 ATC 20-170; (2010) 84 ALJR 266.

This ruling was withdrawn, effective from 30 June 2010.

With the withdrawal of this ruling it is now unclear whether beneficiaries of these trusts will be taken to have carried on a business of primary production in an income year during which the trust is in a nil income or loss position.

As a result, taxpayers who conduct a primary production business through a trust (or beneficiaries) should seek advice from their tax

advisor on how the withdrawal of this ruling may affect their tax obligations.

Superannuation

Research on community attitudes into superannuation

The Minister for Financial Services and Superannuation recently released the results of a national survey conducted by independent market research company Colmar Brunton into community attitudes towards superannuation.

Among other findings, the research established that Australian taxpayers find superannuation complex, and are generally "confused and disenchanted". The frequency of reform in this area has also caused concern.

As increasing numbers of taxpayers establish self managed super funds (SMSFs) to obtain the tax advantages that may be gleaned from this form of investment for retirement, the complications and compliance burden faced by taxpayers increases on a yearly basis.

In addition, the potential consequences of breaking the rules in either setting up, maintaining or winding up a SMSF are significant.

If you are considering setting up or changing any of the particulars in relation to your SMSF, please ensure you obtain tax advice from their tax advisor in relation to your plans.

Superannuation Guarantee Surcharge

Employers should consider the impact that an increase in the Superannuation Guarantee Surcharge may have on their business as the current Government has made this issue one of their priorities.

ATO warns of deviant behaviour by SMSFs

The ATO is targeting the provision of financial assistance by an SMSF to its members through an unrelated trust (such as by way of investing funds in a trust which

trust will then use the funds to on-lend to a member of the SMSF).

The ATO has warned that such activity may result in the funds being non-compliant and subject to tax at the rate of 45%.

The penalties for such behaviour are also significant:

- Trustees of super funds who provide financial assistance in this way face penalties of up to \$220,000 and/or jail terms of up to 5 years for individuals.
- Corporate trustees face fines of up to \$1.1 million.

NOTE

Superannuation is complex and confusing. Please see your tax advisor to obtain tax advice on dealings with your super fund if you are unsure about the consequences.

The ATO is policing the provision of financial assistance by SMSFs to members, either directly or through intermediate entities.

Government's SMSF endorsement welcomed

The government response to the Cooper Review recommendations confirms that the SMSF sector is well administered and managed and forms a vital function in the creation of retirement benefits for Australians. The need for additional regulation of the sector is therefore seen to be minimal.

The government indicated that the existing 5% limit on in-house asset ownership will remain and has reconfirmed that personal-use assets and collectables may be held subject to more stringent rules previously announced. The limited recourse borrowing arrangements currently available to SMSFs will remain with a review in two years.

The government has accepted recommendations directed at increasing the knowledge and competency of SMSF service providers. These include development of a mandatory specialist knowledge component of Regulatory Guide 146 and the

requirement that auditors be registered by ASIC (although auditor supervision would rest with the Tax Office).

Cooper Review recommendations rejected by the government included the recommendation that the Tax Office be empowered to issue binding rulings in respect of SMSFs. This outcome is particularly disappointing as the binding ruling process, would have provided certainty for trustees who are required to interpret legislation and regulations which can often prove difficult even for professional advisers.

Compliance Activities – Cash Economy and Benchmarking

The ATO has renewed its focus on businesses operating in the cash economy.

Benchmarks are used by the ATO to identify businesses that may be operating in the cash economy. The ATO benchmarks are financial indicators, such as the cost of goods sold margin, achieved by other businesses in the same industry.

Businesses that fall outside the benchmark for their industry may receive a letter asking for the relevant taxpayer to provide reasons.

While these benchmarks are drawn over a wide range, it is foreseeable that honest taxpayers who do not engage in fraudulent activities will still be sent such letters, especially where the business does not fall squarely into a specific business category, or the business operates in a geographical area which is not representative of the average population over which the benchmark is drawn.

Such letters are in some instances being sent directly to taxpayers rather than tax agents.

NOTE

Businesses that receive letters in relation to falling outside the ATO's benchmarks for their industry should seek advice from their tax advisor in formulating their response.

Compromised TFNs

The Commonwealth Ombudsman recently released his report on the ATO's treatment of taxpayers with complaints about compromised Tax File Numbers (TFNs).

The report considered 8 case studies of situations in which the taxpayer's TFN had either been compromised or incorrectly linked by the ATO to another person's TFN.

The Ombudsman noted in his report that "the action taken by the ATO to deal with these complaints was unreasonable. Our investigations have shown a systemic failure by the ATO to properly recognise and respond to the issues faced by taxpayers".

NOTE

If you are concerned that your Tax File Number may have been compromised, please contact either your tax advisor or the ATO.

Smile for the quarter

Q. What does Father Christmas suffer from if he gets stuck in a chimney?

A. Santa Claustrophobia!

* * * *

On the Sunday before Christmas, Reverend Billy Graham was walking down the street on his way to see a parishioner. However, he wanted to post a parcel urgently so he asked a young boy where he could find the post office. When the boy had directed him, Reverend Graham thanked him and said, 'If you'll come to the Church this evening, you can hear me telling everyone how to get to heaven.'

The boy replied, 'I think I'll give your sermon a miss. If you don't even know your way to the post office, how will you lead me to heaven?'

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