

Trusts & Unpaid Present Entitlements

In this Issue

- Trusts and unpaid present entitlements
- Corporate losses – can I use them?
- Employee share schemes – will I be able to defer my taxing point?
- ATO Change Program – the ATO shut down
- Paid Parental Leave – impact on employers
- Small business entities – what concessions are available?
- Small business tax break – reminder



Over the last few months, there has been a lot of media attention on the ATO's crackdown on tax planning using trusts.

The latest target has been discretionary trusts with corporate beneficiaries. Specifically, the ATO has had concerns regarding trusts declaring distributions to corporate beneficiaries (ie companies) and leaving the amount unpaid (ie unpaid present entitlements).

The unpaid amount may remain in the trust and be used to purchase private assets which are used by the beneficiaries (eg a holiday house). Alternatively, the amount may be loaned by the trust to the beneficiaries.

The ATO were seeking to treat unpaid present entitlements as loans. Consequently, unless the loans satisfied certain requirements, the loans would be treated as deemed dividends for tax purposes.

The professional tax bodies were shocked by this suggested treatment. The general consensus was that the ATO's view represented a change in the interpretation and administrative practice of the ATO which is not consistent with the current treatment of unpaid present entitlements.

After extensive consultation with the Taxation Institute and other professional tax bodies, the ATO is reconsidering its position.

The outcome remains to be seen. However, the general perception is that this issue will be satisfactorily resolved with the ATO in the coming months.

However, even if the interpretation and administrative issues are resolved, the ATO may still seek a legislative change in this area to shut down the use of unpaid present entitlements to corporate beneficiaries.

Tip

If your company is entitled to distributions from a trust that have remained unpaid for any length of time, you should consider whether this structure is going to continue to be tax effective.



Market City Commercial Centre
Suite 6, Level 1
Cnr Bannister Road and South Street,
280 Bannister Road, Canning Vale, WA 6155
PO Box 1851 Canning Vale, WA 6970

Directors: Darren Brealey, Steven Quill, Zane Kenny, Martin Williams

Senior Accountants: Erica Grant, Mark Murphy, Jane Wan, Trish Murrell, Brenden Edwards, Joanne Snow, Matthew Gooden
Accountants: Lauren Garbutt, Fay Chai, Michelle Moe, Sandra Daff-Gibson, Neal Greene, Kurt Heyder, Brad Hitchcock, Karlyn Read, Alex Packer

Personal Assistants: Alex Anderson, Ashlee Morter

Administration Team: June Griffiths, Donna Brealey, Karen Gismondi, Sue Fee, Annika Lindgren, Courtney Dunne

Tel: 9256 2777 Fax: 9256 2766 Email: admin@bqk.com.au Web site: www.bqk.com.au



Brealey Quill Kenny Pty Ltd
A COMPANY



Corporate Losses – Can I Use Them?

Draft legislation has been released which will facilitate access to corporate losses for companies with shares that have unequal rights to dividends, capital distributions or voting power.

This legislation may apply to companies with multiple classes of shares (ie where the different classes of shares have unequal dividend, voting and/ or capital rights), such as a company with preference shares.

The draft legislation makes it clear when such companies can utilise revenue losses, capital losses and bad debt deductions.

The basic utilisation rules remain the same – that is, a company must satisfy either the continuity of ownership test or the same business test.

Broadly, to deduct a tax loss, the continuity of ownership test requires that shares with more than 50% of the voting, dividend and capital rights be owned by the same persons during the test period.

However, where a company has shares with unequal rights attached to them, the continuity of ownership test is modified by the draft legislation.

Where such a company fails the continuity of ownership test, the company can reapply the test disregarding debt interests (eg certain loans) and certain classes of shares.

If the test is still failed, it can be reapplied again based on the assumption that the remaining shares have fixed dividend and capital distribution rights for the purposes of applying the test.

Lastly, the continuity of ownership test is also modified so that if a company has shares with different voting rights, the voting power of those shares is tested solely by reference to the maximum votes that can be cast in relation to electing the company's directors or adopting and amending the company's constitution.

Tip

Businesses that previously were not entitled to use their tax losses may now have access to those losses. It might be worthwhile checking to see if this applies to your business

Employee Share Plans – Will I be able to defer my Taxing Point?

The draft legislation for the new employee share scheme rules is moving closer to being completed. The draft transitional rules have also been released.

The new rules will apply to shares or rights that are issued after 1 July 2009. However, where tax has been deferred in relation to shares or rights that were acquired prior to 1 July 2009, the new rules will apply (except in relation to the determining the tax time and refunds).

To recap, taxation will be upfront unless the conditions for deferral are satisfied. This will depend on the terms of the scheme itself.

Deferral has been limited to schemes where there is a 'real risk' of forfeiture. The latest explanatory material provides multiple examples in relation to what constitutes a real risk of forfeiture.



Some examples where you may be eligible for deferral (ie because there is a real risk of forfeiture) include:

- Employee share scheme (ESS) arrangements with your employer where you will receive shares in your employer company if you are still employed in 3 years time;
- ESS arrangement with your employer where you will receive shares in your employer company in one year, if the employer's market share has increased in 12 months time;
- ESS arrangements with your employer where you will receive shares if you are still employed in 3 years time or where you leave within 3 years for reasons beyond your control (eg redundancy or sickness); and
- certain salary sacrifice schemes offering no more than \$5,000 worth of shares.

Some examples where you are unlikely to be eligible for deferral (ie because there is no real risk of forfeiture) include:

- ESS arrangement with your employer, where you will receive shares in your employer company in three years, unless you are dismissed for fraud or gross misconduct;

- ESS arrangement with your employer, where your shares are forfeited if the company's value falls by 95 per cent during the next 12 months or your shares are forfeited if you request they be forfeited;
- ESS arrangement with your employer, where the shares are subject to forfeiture within the first few months of employment if the employee leaves but where the shares cannot be sold for the first 5 years of employment; and
- ESS arrangements with your employer where you will receive shares in 3 years time if you are still employed or if you retire (provided you are of retirement age and are leaving the workforce).

If the deferral conditions are satisfied, the deferred taxing point will be the earliest point at which:

- for shares – the ending of risk of forfeiture and restrictions on disposal;
- for rights – the ending of the risk of forfeiture and restrictions on exercise or disposal of the option and disposal of the underlying share acquired on exercise;
- cessation of employment; or
- 7 years.

For these purposes, a restriction on disposal must be a genuine restriction. Genuine restrictions might include:

- Certain contractual conditions of the employee share scheme that prevent disposal of shares; and
- Circumstances where disposal would constitute a criminal offence (eg a breach of the insider trading rules).

There will not be a genuine restriction on disposal merely if a company's internal share trading policy prevents disposal for a certain period.

WARNING

Careful attention should be paid to the transitional rules.

Did you acquire shares prior to 1 July 2009?

Yes

Did you pay tax upfront?

No

Do the new rules apply to you?

Yes – in some respects they do!

Most people think that if they acquired shares or rights prior to 1 July 2009 they don't have to consider the new rules but this is not the case.

Note: The new rules will not apply to such shares for the purposes of determining the tax time or refunds.

ATO Change Program

Many people may not be aware that the ATO is proposing to undertake a systems upgrade. This will involve a shut down of all the ATO systems.

Many people might not have considered what impact this may have on them or their businesses.

Some things to think about are:

- Refunds will not generally be able to be obtained during the shut down or for some time afterwards due to system back logs;
- Taxpayers will not be able to ring the ATO and obtain information; and
- Although tax agents will still be able to lodge documents (such as returns, BASs, activity statements etc) none of these documents will be able to be processed.

Tip

If you are expecting to receive a refund from the ATO in the early part of next year, lodge your returns as early as possible otherwise you might have to join the queue when the ATO comes back on line!

Paid Parental Leave – Impact On Employers

Although the Government's paid parental leave (PPL) scheme will not apply until 1 January 2011, employers should be aware of the impact this scheme will have on them.

The PPL scheme is designed to assist new parents of children born or adopted after 1 January 2011. An eligible person will receive PPL payments at the Federal minimum wage level (which is currently \$543.78 per week) for a maximum period of 18 weeks.

Many employers may think that this scheme will not impact them as it will be Government funded. Although the scheme will be Government funded, employers will be the "paymaster" of the PPL payments (ie employees will receive their PPL payments through their employers).

Employers will be responsible for receiving PPL payments from the Government and passing these amounts on to eligible employees where the employee has completed 12 months continuous service prior to the date of birth or adoption.

Not only will employers be the paymasters but they will also be responsible for providing certain information in relation to their employees to the relevant Government agencies. This will place an administrative burden on employers (particular those involved in small businesses). Employers need to be aware of the impacts of the new PPL regime on their businesses.

It should be noted that employers will not be obliged to make superannuation contributions, pay payroll tax or insurance or accrue leave in respect of the PPL payments.



Small Business Entities – What Concessions are Available?

Small businesses with an annual turnover of less than \$2 million may be eligible for a range of tax concessions, including the following:

- small business tax break;
- capital gains tax (CGT) exemption for assets you have held for at least 15 years;
- CGT 50 per cent active asset reduction;
- CGT retirement exemption;
- CGT roll-over for replacement assets;
- simpler depreciation rules (ie generally assets can be “pooled” for the purposes of determining depreciation deductions);
- simpler trading stock rules (ie in certain circumstances you can choose whether or not to do an end-of-year stock take);
- immediate deduction for certain prepaid business expenses;

- the entrepreneurs’ tax offset may reduce your tax payable by up to 25% where your business has a turnover of less than \$75,000;
- GST can be accounted for on a cash basis;
- GST input tax credits can be apportioned annually for assets used partly for private and partly for business purposes;
- you may be exempt from FBT for employee car parking; and
- Pay as you go instalments can be paid and worked out based on your business and investment income in your most recently assessed tax return.

Is my business eligible?

A business will qualify for the above concessions if the “aggregated turnover” is less than \$2 million.

Your aggregated turnover is the sum of your turnover and the turnover of any entities you are connected or affiliated with. Turnover includes all income earned in the ordinary course of business.

Business Tax Break - Reminder

If you are eligible for the small business tax break, time is fast running out!

Certain small businesses can claim a 50% tax deduction on the cost of eligible assets bought between 13 December 2008 and 31 December 2009 which are first used or installed by 31 December 2010. Other concessions may also be available for other time periods and other types of businesses.

Small businesses will only need to spend a minimum of \$1,000 per eligible asset in order to qualify for this special deduction.

Assets eligible for this allowance are new tangible depreciating assets and new expenditure on existing assets used in carrying on your business and for which you can claim a capital allowance deduction.

Tip

Taxpayers should consider whether they are eligible for the small business tax break and whether it might benefit their businesses.

Don't miss out! Act before 31 December 2009.

Christmas Cheer and the ATO

With the December festive season upon us, it's time to remind you again to be aware of some of the potential tax traps in spreading the season's festive goodwill.

A bit like an unwanted guest who turns up at your party without an invitation, the ATO has an interest in our office festive season events especially from a fringe benefits tax (FBT) point of view.

Christmas Parties and FBT

The potential FBT consequences of your Christmas party can be tricky because of the different ways FBT can impact on different types of costs and situations.

FBT problem depends on:

- Where and when you have your party;
- Who comes; and
- How much it costs.

We can't cover all the possibilities, but here are some outcomes for you to consider.



Celebrating on site

If you hold your party on a work day at your business premises and only your employees attend, costs such as food and drink are FBT exempt, regardless of what the cost is per head for each employee.

However, if you also invite your employees' associates (eg, family) and perhaps some clients then it gets a bit more complicated:

- What you spend on entertaining your employees' associates are taxable fringe benefits and you'll need to work out whether you have an FBT liability; and
- What you spend on your clients may be exempt from FBT altogether.

Tip

Food and drink provided to your clients is likely to be exempt from FBT whether it's at a social or business function on your businesses premises or away from it.

Celebrating offsite or not on a work day

If your party isn't held on a work day or on your business premises (eg, you head off to the local restaurant), the FBT alarm bells can really start to ring loud and clear.

However, if you can contain your costs by keeping them under \$300 per head - you may qualify for the FBT minor benefit exemption and may end up with a reduced or no FBT liability for your party.

Calculating whether you come in below the minor benefit threshold can be tricky.

The cost per head for each employee includes the cost of food and drink and other items like:

- The cost of transport to venues;
- Taxis home;
- The cost of any gifts you hand out at the party (eg, Christmas hampers); and
- If your employees' associates come along, the cost per head for each employee includes the cost for their associates.

A happy gift giving experience

Give some careful thought to how you give gifts to your employees at Christmas time;

- It's best to avoid handing out gifts at the office party if you are relying on the minor benefit exemption because the cost of the gift for an employee will directly affect how you calculate his or her cost per head;
- If you don't hand out gifts at the party but at some other time, it's possible that you may still be able to rely on the minor benefit exemption at that time if the value of each gift is less than \$300; and
- As an alternative, if the gifts you give are products that you would normally sell to members of the public, there is another exemption of \$1000 per annum for each employee that may apply (called an in-house exempt property benefit).

What's tax deductible?

Generally the cost of providing a Christmas party is income tax deductible only to the extent that it is subject to FBT. In working out what you can claim as a tax deduction, watch out for the following:

- Any costs that are exempt from FBT (eg, the exempt minor benefits and exempt property benefits noted above) cannot be claimed as an income tax deduction; and
- The costs of entertaining clients are not subject to FBT and are also not income tax deductible.



Important: 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 or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. This bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential.