client alert | explanatory memorandum

March 2016

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 17 February 2016.

Tax relief for small businesses that restructure on the way

The *Tax Laws Amendment (Small Business Restructure Rollover) Bill 2016* was introduced in the House of Representatives on 4 February 2016. It amends the ITAA 1997 by inserting new Subdiv 328-G, to provide an optional rollover for small business owners who change the legal structure of their business on the transfer of business assets from one entity to another. The effect of the rollover is that the tax cost/s of the transferred asset/s roll over from the transferor to the transferee.

The rollover is in addition to existing rollovers where an individual, trustee, or partner transfers assets to, or creates assets in, a company in the course of incorporating their business.

Eligibility

The optional rollover will be available where a small business entity transfers an active asset of the business to another small business entity as part of a genuine business restructure, without changing the ultimate economic ownership of the asset.

The rollover will apply to gains and losses arising from the transfer of active assets that are CGT assets, depreciating assets, trading stock or revenue assets between entities as part of a genuine restructure of an ongoing business.

Genuine restructure

The transfer of the asset/s must be part of a "genuine" restructure of an ongoing business (as opposed to "inappropriately tax-driven schemes").

Whether a restructure is "genuine" is a question of fact determined with regard to all of the facts and circumstances. Relevant matters include whether it is a bona fide commercial arrangement undertaken to enhance business efficiency, whether the transferred assets continue to be used in the business and whether it is a preliminary step to facilitate the economic realisation of assets.

Also, a "safe harbour" rule provides that the restructure is "genuine" for three years after the rollover if:

- there is no change in the ultimate economic ownership of any of the business's significant assets (other than trading stock);
- those significant assets continue to be active assets; and
- there is no significant or material use of the significant assets for private purposes.

Entities that can access the rollover

To be eligible for the rollover, each party to the transfer must be either:

- a "small business entity" for the income year during which the transfer occurred;
- an entity that has an "affiliate" that is a small business entity for that income year;
- "connected" with an entity that is a small business entity for that income year; or
- a partner in a partnership that is a small business entity for that income year.

("Small business entity" takes its usual meaning, as defined in Subdiv 328-C.)

Likewise, the rollover applies to "passively held" assets of a small business that may, for example, be held in an entity other than the one carrying on the business (eg an "affiliate" or a "connected entity" that is a small business entity).

Ultimate economic ownership

The transfer must not have the effect of changing the ultimate economic ownership of transferred assets in a material way. The ultimate economic owners of an asset are the individuals who, directly or indirectly, beneficially own an asset. Ultimate economic ownership of an asset can only be held by natural persons. Therefore, where a company, partnership or fixed trust owns an asset, the natural person owners of the interests in these interposed entities will ultimately benefit economically from that asset.

If more than one individual is an ultimate economic owner of an asset, there is an additional requirement that each of the individuals' shares of that ultimate economic ownership be materially unchanged, maintaining the same proportionate ownership in the asset.

Discretionary trusts may be able to meet the requirements for ultimate economic ownership "on their facts" (eg where there is no practical change in which individuals economically benefit from the assets before and after the rollover, there will not have been a change in ultimate economic ownership on the facts).

Otherwise, a discretionary trust may meet an alternative ultimate economic ownership test, whereby every individual who had ultimate economic ownership of the transferred asset before the transfer and every individual who has ultimate economic ownership of the transferred asset after the transfer must be members of the family group relating to the family trust.

Eligible assets

Where a party to the transfer is itself a small business entity, the asset being transferred must be a CGT asset that is an "active asset" (as defined in s 152-40).

Where a party to the transaction is an affiliate or connected entity with a small business entity, the asset must be an active asset that satisfies s 152-10(1A), which, among other things, requires that the relevant small business entity carries on business in relation to the asset.

Where a party to the transaction is not a small business entity, but is a partner in a partnership that is a small business entity, the asset must be an active asset and an interest in the asset of the partnership.

Other

Both the transferor and the transferee of the assets must be residents of Australia. The transferor and transferee must both choose to apply the rollover. The rollover will not apply to a transfer to or from an exempt entity or complying superannuation entity.

Effect of the rollover

The rollover provides tax neutral consequences for a transfer by "switching off" the application of the existing income tax law – but only for the purpose of the transfer, and not for the purposes of GST, FBT or stamp duty.

The rollover provides that the transfer takes place for the asset's "rollover cost" – which is the transferor's cost of the asset for income tax purposes, such that the transfer would result in no gain or loss for the transferor. The transferee will be taken to have acquired each asset for an amount equal to the transferor's cost just before the transfer.

CGT assets

For the transfer of a CGT asset, the tax law will apply under the rollover as if the asset had been transferred for an amount equal to the cost base of the asset. Further, pre-CGT assets transferred under the rollover will retain their pre-CGT status in the hands of the transferee.

Note that in respect of the availability of the CGT discount to the transferee, the time period for eligibility for the CGT discount will recommence from the time of the transfer.

Trading stock

Assets that are trading stock of the transferor will be held as trading stock by the transferee. The transferee will inherit the transferor's cost and other attributes of the assets as the transferor just before the transfer.

To the extent that the asset is trading stock of the transferor, the rollover cost will be the cost of the item for the transferor at the time of the transfer; or if the transferor held the item as trading stock at the start of the income year, the value of the item for the transferor at that time.

Revenue assets

The rollover cost is the amount that would result in the transferor not making a profit or loss on the transfer. The transferee will inherit the same cost attributes as the transferor just before the transfer.

Depreciating assets

Rollover relief will be available for depreciating assets (under s 40-340) where a rollover under the new measures would be available in relation to the asset if the asset were not a depreciating asset. As a result, the transferee can deduct the decline in value of the depreciating asset using the same method and effective life as the transferor used.

Membership interests

Where membership interests are issued in consideration for the transfer of an asset/s, the cost base of those new membership interests is worked out based on the sum of the rollover costs and adjustable values of the

rollover assets, less any liabilities that the transferee undertakes to discharge in respect of those assets, divided by the number of new membership interests.

The rollover does not require that market value consideration, or any consideration, be given in exchange for the transferred assets.

However, an integrity rule ensures that a capital loss on any direct or indirect membership interest in the transferor or transferee that is made subsequent to the rollover will be disregarded, except to the extent that the taxpayer can demonstrate that the loss is reasonably attributable to something other than the rollover transaction. This rule also applies where a transfer of value from an entity results in the creation of tax losses on later disposal of the membership interests.

Note that restructuring to obtain timing advantages or other significant tax benefits in relation to membership interests and other interests in the entities involved in the transaction may, in particular cases, mean that the "genuine" restructure requirement is failed.

Small business concessions

Where the transferor has previously chosen to apply a small business rollover under Subdiv 152-E, and a replacement asset is transferred under this rollover, the transferee is taken to have made the choice for the purposes of CGT events J2, J5 and J6.

For the purpose of determining eligibility for the 15-year CGT exemption for small businesses, the transferee will be taken as having acquired the asset when the transferor acquired it.

Date of effect

The amendments apply to:

- transfers of depreciating assets, where the balancing adjustment event arising from the transfer occurs on or after 1 July 2016;
- transfers of trading stock or revenue assets, where the transfer occurs on or after 1 July 2016; and
- transfers of CGT assets, where the CGT event arising from the transfer occurs on or after 1 July 2016.

Source: Tax Laws Amendment (Small Business Restructure Rollover) Bill 2016, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5606%20Recstruct%3Abillhome, still before the Senate at the time of writing.

Trust ABNs to be cancelled if no longer carrying on business

The ATO has advised that the Registrar of the Australian Business Register (ABR) will begin cancelling the ABNs of approximately 220,000 trusts, where there is evidence they are no longer carrying on an enterprise.

Trust ABNs will be cancelled in February 2016, where information available indicates that for the last two years the trust has not lodged BASs and/or trust income tax returns. Exclusions to these ABN cancellations apply for trusts that are registered with the Australian Charities and Not-for-profits Commission or are non-reporting members of a GST or income tax group.

The ATO says entities will receive a letter if their ABN has been cancelled. The letter will include the reason for the cancellation, and a phone number to ring to have the ABN reinstated immediately if the entity does not agree with the decision. The ATO also notes that if an entity's ABN is cancelled and neither the entity nor its tax representative receives a letter, it could mean the entity's contact details are not up to date on its ABN record.

Source: ATO website, "Cancellation of trust ABNs", 22 January 2016, https://www.ato.gov.au/Tax-professionals/Newsroom/Your-practice/Cancellation-of-trust-ABNs/.

Car expense deduction changes

The Government has simplified car expense deductions for individuals from 1 July 2015.

Prior to 1 July 2015, there were four methods for claiming car expenses:

- cents per kilometre – capped at 5,000 km;
- logbook – unlimited kilometres;
- 12% of original value; and
- one-third of actual expenses.

To simplify the rules, from 1 July 2015 the Government has abolished the 12% of original value and one-third of actual expenses methods. The cents per kilometre method (with the existing 5,000 km cap) and the logbook method (with unlimited kilometres) remain.

The cents per kilometre method has been simplified to use a standard rate of 66 cents per kilometre for the 2015–2016 income year, rather than a rate based on the engine size of the car. The Commissioner of Taxation will set the rate for future income years.

Withholding tax for car allowances

Employers should be aware that the ATO has set the approved pay as you go (PAYG) withholding rate for cents per kilometre car allowances at 66 cents per kilometre from 1 July 2015.

Employers should withhold from any amount above 66 cents for all future payments of a car allowance. Failure to do so may result in employees having a tax liability when they lodge their tax returns.

Employees who have been paid a car allowance from 1 July 2015 at a rate higher than the new approved amount should consider whether they need to increase their withholding to avoid any tax liability at the end of the year.

Source: ATO, "Car expense substantiation methods simplified", 17 December 2015, https://www.ato.gov.au/general/new-legislation/in-detail/direct-taxes/income-tax-for-individuals/car-expense-substantiation-methods-simplified/.

Travellers with student debts need to update contact details

Australians with a Higher Education Loan Programme (HELP) debt and/or a Trade Support Loans (TSL) debt who are moving overseas for longer than six months need to provide the ATO with their overseas contact details within seven days of leaving the country. This requirement follows recent legislative changes.

ATO Assistant Commissioner Graham Whyte said that affected people can provide the ATO with international contact details using online services (eg an ATO account linked to myGov).

"Don't worry if you don't know your new international residential address yet. Just provide us with your best contact address while you're away, like your parents', and update your contact details when you're settled. The most important thing is that you're still able to receive correspondence from us while you're overseas", Mr Whyte said.

From 1 July 2017, anyone living overseas and earning above the minimum repayment threshold will be required to make loan repayments, just as they would if they were living in Australia.

"We will be in touch closer to the time with more information about how to report income and make loan repayments", Mr Whyte said. "For now, all travellers with a HELP and/or TSL debt need to do is update their details and factor in potentially making repayments from 1 July 2017", he added.

Further information is available on the ATO website at *https://www.ato.gov.au/Individuals/Study-and-training-support-loans/Overseas-repayments/*.

Source: ATO, "Square away with the ATO before you ship off overseas", 9 February 2016, https://www.ato.gov.au/Media-centre/Media-releases/Square-away-with-the-ATO-before-you-ship-off-overseas/.

Small business tax concession refused as threshold test failed

The Federal Court has confirmed that the face value of a debt of $1.1 million owed to a taxpayer had to be taken into account, under the maximum net asset value test, for the purposes of determining if the taxpayer qualified for the CGT small business concessions. This was despite the taxpayer's claim that the debt was statute-barred from recovery under relevant state legislation and therefore had a nil value. As a result of the Court's confirmation, the debt amount was included in the test and the taxpayer failed to qualify for the concessions.

Background

The taxpayer was both a beneficiary and the trustee of a family trust that held units in a unit trust which operated a finance broking business. The unit trust sold the business in the 2008 income year for a capital gain of $500,000, to which the taxpayer was entitled. The taxpayer argued that in determining whether the "maximum net asset value" (MNAV) test was satisfied, a debt of $1.1 million owed to the family trust (a connected entity), resulting from a loan it made to him, had a nil value and was not to be taken into account under the MNAV test. He argued this on the basis that the debt was "statute-barred" from recovery under the six-year statute of limitations in s 35(a) or 42(1) of the *Limitation of Actions Act 1936* (SA) (the Act).

However, in *Re Breakwell and FCT* [2015] AATA 628, the AAT found that this was not the case, on the basis that the debt had been legally acknowledged by the trustee of the family trust as being recoverable (by way of signing the relevant balance sheets) and was legally in existence at the relevant time. Therefore, the AAT found that the face value of the debt was to be included in the MNAV test, and that the taxpayer failed to qualify for the concessions.

Before the Federal Court, the taxpayer first argued that the AAT wrongly determined the debt was recoverable and had wrongly found there was no acknowledgement contained in writing signed by the taxpayer or by his agent, as required by s 42(1) of the Act, to find that the debt was still in existence and not statute-barred from recovery. Alternatively, the taxpayer argued if this issue was not an appealable question of law, then the signing of the balance sheet could not amount to an acknowledgement of a debt for the purposes of s 42 of the Act, as it was at best an acknowledgement of an asset, and not of "a debt owing".

Decision

In dismissing the taxpayer's appeal and confirming that the amount of $1.1 million was to be included in the MNAV test (and therefore that the taxpayer failed to qualify for the concessions), the Federal Court first found that the statutory time limit in s 35(a) of the Act did not, by itself, have the effect of extinguishing the trust's claim in contract for repayment of the loan after six years. The Court found that while the section may "bar the remedy", it did not bar "the cause of action". Instead, the Court said s 35(a) (and similar legislation) acted to create a defence which could be raised by a debtor or defendant in an action against them and which, moreover, could be waived by a debtor or defendant.

The Court also found that s 48 of the Act allowed a court to extend such a limitation period – and that it was possible that an arm's-length trustee in this case would seek such an extension. The Court noted that it would be difficult to see how the taxpayer in this case, as a debtor-beneficiary of the trust, would raise the statute of limitation defence when, in his capacity as trustee of the trust, he also had fiduciary duties to act in the best interest of the trust.

Accordingly, the Court ruled that the family trust's claim against the taxpayer could not be regarded as statute-barred under s 35(a) of the Act (nor under s 38 of the Act) and that the debt owed to it could not be regarded as having no value. In addition, the Court found that the present case was an action by a trust to recover trust property, and that there was no limitation period in this case in accordance with s 32(1) of the Act.

Breakwell v FCT [2015] FCA 1471, Federal Court, White J, 22 December 2015, http://www.austlii.edu.au/au/cases/cth/FCA/2015/1471.html.

"Wildly excessive" tax deduction claims refused

A professional sales commission agent has been largely unsuccessful before the AAT in claiming deductions for work-related expenses, including home office expenses, various grocery items and overtime meal allowances.

Background

The taxpayer was a professional sales commission agent. His employer did not provide him with a dedicated office or workspace. In his 2010 to 2012 income tax returns, he claimed large deductions for home office expenses and work-related travel. Originally, the taxpayer claimed that 31.6% of his house (including the family living room, which he called the "meeting room", and a roof storage area) was being used solely for work purposes.

The taxpayer was audited on his 2010 tax return (where he claimed over $97,000 worth of expenses to reduce his taxable income to $21,000). When the matter came before the AAT in 2014, it disallowed numerous home office deductions and rejected his claim that his living room was a "meeting room", but allowed a home office percentage of 11.7% (see *Re Ogden and FCT* [2014] AATA 385).

The current case concerned the taxpayer's deduction claims in his 2011 and 2012 tax returns. His original claims (which changed throughout the course of the audit and AAT proceeding), totalled over $63,000 for 2010–2011 and over $53,000 for 2011–2012, which represented at least 30% of his employment income. The Commissioner disallowed various deductions and applied a 25% shortfall penalty for failing to take reasonable care.

When the matter came before the AAT, the claims that were still in dispute included the amount of the home office expenses, overtime meal allowances, "staff and client amenities" (including toilet paper, pocket tissues, Bega Stringers Cheese, Tiny Teddies and Weight Watchers Lamingtons), "business meals" for his accountant, a desk in his son's bedroom, sunscreen, sunglasses and $383 on a pair of RM Williams rubber-soled shoes, which the taxpayer claimed prevented his computer being damaged by static electricity. The taxpayer also claimed expenses spent on a Dora the Explorer pencil case, heart and star shaped stickers, depreciation on an outdoor patio setting and a $5,388 payment to his seven-year-old son for "secretarial assistance" (a claim which the taxpayer abandoned during the proceedings).

Decision

The AAT found that the taxpayer's home office claims were "wildly excessive", and that the taxpayer and his representatives failed to critically analyse how these claims helped produce the taxpayer's assessable income. In particular, the AAT said that the claim that the family living room was being used solely for work meetings "should never have been made", noting that the taxpayer's approach had been to find "some

relationship, no matter how remote" to his work in order to claim deductions. In relation to an initial claim for 31.6% of his home loan interest expenses, the AAT said it was "difficult to understand how a registered tax agent could allow such a claim to be made". The AAT found that the taxpayer's home office represented around 1.8% of the family home.

The AAT rejected everything claimed under "staff and client amenities", as it considered the products were overwhelmingly consumed by the taxpayer's family, thereby making the claims "outrageous and utterly unacceptable". The claimed meal allowances were also rejected in their entirety. Regarding expenses on the rubber-soled shoes, the AAT commented that it appeared to be yet another example of the taxpayer's evidence ranging from "the exaggerated to the implausible", and accordingly rejected the claim. The AAT did not seek to disturb heating and lighting expenses that the Commissioner had allowed, but noted that the taxpayer was "fortunate" to have been allowed these.

Considering the various deductions claimed, the AAT said a 25% administrative penalty appeared "somewhat generous" to the taxpayer. The AAT gave leave to the Commissioner to reconsider the penalty issues, and to consider whether to apply a 20% uplift, given the numerous statements made by the taxpayer and how they changed over time. It also noted that different levels of culpability may apply to different statements.

Re Ogden and FCT [2016] AATA 32, AAT, File Nos 2014/5943; 2014/5957; 2014/6763; 2014/6764, Frost DP, 29 January 2016, www.austlii.edu.au/au/cases/cth/AATA/2016/32.html.

GST credits not available for payments on behalf of super funds

The ATO has issued *GST Determination GSTD 2016/1* on whether employers can claim input tax credits for expenses paid on behalf of superannuation funds. The Determination notes that an employer may, for "administrative convenience", pay expenses on behalf of a fund, with the payment being reclassified as a superannuation contribution in the employer's accounts. However, the ATO's preferred approach is for all superannuation fund expenses to be paid directly out of the fund itself, and for superannuation contributions to be made directly to the fund.

GSTD 2016/1 provides that an employer is not entitled to an input tax credit if a superannuation fund makes an acquisition and the employer pays the expense on the fund's behalf. This is because the supply is made to the fund and not to the employer. However, the ATO notes that the fund may be entitled to claim a reduced input tax credit under the financial supply rules (Div 70 of the GST Act), provided the requirements of those rules are satisfied.

GSTD 2016/1 includes an example (reproduced below) where a superannuation fund engages a solicitor to provide legal advice and the employer sponsor pays the legal fees. As the supply (the legal advice) is provided to the fund, the employer cannot claim an input tax credit for the payment.

Example

Lazy Days Pty Ltd is the employer sponsor of the Lazy Days Superannuation Fund. Lazy Days Pty Ltd is registered for GST and employs 15 staff. The Lazy Days Superannuation Fund is registered for GST purposes.

The Lazy Days Superannuation Fund engaged a legal firm to provide advice about its activities. Lazy Days Pty Ltd pays the legal fees associated with this advice.

Lazy Days Pty Ltd is not entitled to an input tax credit as a result of paying for the advice provided to the Lazy Days Superannuation Fund. This is because the supply of the advice was made by the legal firm to the Lazy Days Superannuation Fund, which is a separate entity from Lazy Days Pty Ltd. Lazy Days Pty Ltd has not acquired anything for the payment and therefore has not satisfied the requirements in s 11-5 for making a creditable acquisition.

The Lazy Days Superannuation Fund may be entitled to a reduced input tax credit in relation to the payment if the requirements in Div 70 are otherwise satisfied.

The GST Determination applies both on and after its date of issue (27 January 2016).

MT 2005/1 and GSTA TPP 003 withdrawn

The GST Determination was not previously released as a draft. It replaces the previous ATO rulings on the topic, MT 2005/1 and GSTA TPP 003, both of which were withdrawn on and with effect from 27 January 2016. The Commissioner's views in GSTD 2016/1 are the same as those expressed in the withdrawn Miscellaneous Tax Ruling and GST Advice.

Source: ATO, GST Determination GSTD 2016/1, https://www.ato.gov.au/law/view/pdf/pbr/gstd2016-001.pdf.

Thomson Reuters would like to hear from you

Subscribers are invited to submit topics for articles for future publication. Information should be sent to:

Publisher – **Client Alert**

Thomson Reuters (Professional) Australia Limited ABN 64 058 914 668
PO Box 3502, Rozelle NSW 2039

Tel: 1800 074 333

Product Manager – Steven Jones

Email: SupportANZ@thomsonreuters.com

Website: www.thomsonreuters.com.au