

TAX UPDATE

August 2011

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Tax reform: Government releases Tax Forum discussion paper

On 28 July 2011, the Government released a discussion paper in the lead-up to the Tax Forum to be held in October 2011. The discussion paper outlined a range of ideas that were raised in the Henry Review and are likely to be discussed at the Tax Forum. Discussion questions raised in the paper include opportunities to further simplify taxpayers' interactions with the personal tax system; to improve the rules for superannuation during the drawdown phase; to lower the company tax rate; the implementation of a symmetrical treatment of tax losses; the replacement of stamp duties on property conveyances with reformed land taxes and the greater harmonisation of State payroll taxes.

Discussion paper: CGT reforms to ease business restructures

As part of the 2011-12 Budget, the Government announced that it would improve the operation of the company loss recoupment rules by simplifying the Continuity of Ownership Test (COT) in certain circumstances and removing some minor technical defects. Treasury has now released a consultation paper dealing with the proposed changes.

Broadly, the ordinary COT will be modified so that the loss company is not required to trace ownership through an entity that is a complying superannuation fund, a complying approved deposit fund, a first home savers account trust, a special company or a managed investment scheme. Further, the concessional tracing rules under the modified COT will also be extended so that they apply where:

- an entity is interposed between relevant stakeholders and the loss company; or
- the interposed entity demerges; or
- the interposed entity is a foreign listed company that issues bearer depository receipts.

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Discussion paper: 50% tax discount for interest income

On 11 May 2010 the Treasurer announced that the Government would provide individual taxpayers with a 50 per cent tax discount for interest income. The Assistant Treasurer, Bill Shorten has now released a discussion paper outlining that proposal.

In the 2012-13 income year, individuals will be entitled to a tax discount equal to 50 per cent on up to \$500 of interest income received. From 1 July 2013, individuals will be entitled to a tax discount equal to 50 per cent on up to \$1,000 of interest income received each year. The discount will apply to interest received from deposits held with any bank, building society or credit union, as well as interest on bonds, debentures and annuity products. It would also apply to interest income received both directly and indirectly (such as via trust or managed investment scheme) by individuals.

The measure would apply to net interest income and would involve the reduction of the amount of eligible interest income received by the amount of expenditure incurred in relation to that income before applying the discount.

Exposure Draft: Developments in "Not For Profit" sector

The Assistant Treasurer has also released for public consultation proposed legislation that will restate the 'in Australia' special conditions for tax concession entities by ensuring that:

- Income tax exempt entities must generally be operated principally in Australia and for the broad benefit of the Australian community; and
- Deductible gift recipients must generally be operated solely in Australia and for the broad benefit of the Australian community.

Exposure Draft: Countering Fraudulent Phoenix Activity

The Government has released for public consultation exposure draft legislation on countering fraudulent phoenix activities by company directors. This was first raised in the 2011-12 Budget.

Fraudulent phoenix activity involves the deliberate liquidation of a company to avoid paying liabilities - including employee entitlements, such as superannuation, and taxes. The business then 'rises' and continues operating through another corporate entity, controlled by the same person or group of individuals, often with a similar name and free of the previous debts.

The Government will address these issues through three measures in the tax law by:

- extending the director penalty regime to make directors personally liable for their company's failure to pay employees' superannuation guarantee amounts;
- allowing the Australian Taxation Office to immediately pursue directors under the director penalty regime where the company's unpaid PAYG withholding and superannuation guarantee liability remains unpaid and unreported three months after the due date;
- providing the Commissioner with the discretion to reduce a director's and/or their associates' entitlement to PAYG withholding credits relating to withholding payments made from the company.

Draft Taxation Ruling TR 2011/D3: Superannuation income streams commencement and cessation

This draft ruling considers when a superannuation fund income stream (i.e., pension) commences and ceases. However, of more importance is the proposed treatment to a member's pension upon death of the member.

According to the draft ruling, unless the rules of the superannuation fund provide for an automatic transfer of the pension to a dependent beneficiary, the pension of the deceased member ceases on death.

Currently, there is no requirement either under the superannuation legislation or the regulations for an automatic transfer. Rather, a deceased member's pension continues to exist upon the exercise of the trustee's discretion to pay a pension to the dependent beneficiary. It is only when the dependent beneficiary commutes the pension, exhausts the capital supporting the pension or dies that the pension ceases to exist.

The consequence of cessation is that the concessional tax treatment of the pension ceases from that point, such that income derived from the assets supporting the pension account, including capital gains from the sale of those assets, is taxable at that point.

Given the retrospective application of this ruling (once finalised) from 1 July 2007, it may be prudent for superannuation fund trustees to review the way death benefits are handled including whether pensions are established with nominated dependent beneficiaries in the superannuation deed.

AAT Case [2011] AATA 479, Re Greenhatch and FCT

This case concerns the ability to stream capital gains to specific beneficiaries and confirms that the amount of capital gains to be included in working out the 10% personal superannuation deduction rule is the grossed up amount.

In the 2008 income year, the taxpayer was a beneficiary of a trust and was presently entitled to a share of the trust's capital gain, being a discounted gain of \$112,340. This was an amount that was specifically 'streamed' to the taxpayer. The taxpayer also claimed a deduction for personal superannuation contributions. In working out whether the taxpayer satisfied the 10% rule, the taxpayer included the grossed up amount of his discounted capital gain (i.e., \$112,340 doubled) in his assessable income.

The Commissioner, on the other hand, applied a proportionate approach and contended that the capital gain attributable to the taxpayer was a smaller amount, representing a share of the total income derived by the trust. The Commissioner then applied that amount grossed up, in working out whether the taxpayer's salary and wages was less than 10% of his assessable income.

The AAT held that the capital gain that was attributable to the taxpayer was the entire \$112,340 (i.e. amount specifically streamed to the beneficiaries) and it was that amount (grossed up) that was to be included in the taxpayer's assessable income for the purpose of the 10% rule.

Note that on 29 June 2011, capital gains and franked distributions flowthrough provisions were amended to enable effective streaming. These rules were discussed in the July 2011 edition of Tax Update.

Draft Fact Sheet: Taxation treatment of dividends in light of the changes to the Corporation Act 2011

Previously, under the Corporation Act, a company could only pay a dividend 'out of profits'. However, effective from 28 June 2010, section 254T of that Act was amended to allow dividends to be paid out of an amount other than profits subject to certain solvency tests. The change to section 254T raises issues as to the taxation treatment of such dividend payments.

According to the factsheet, a dividend that is sourced directly or indirectly from a company's share capital account would be regarded as an unfrankable distribution for taxation purposes. In determining where a dividend is sourced requires an examination of the company's balance sheet, and accounting records at the time the distribution is made,