

TAX UPDATE

August 2010

These Tax Notes include commentary on the following topics:

- » Part IVA Applied to Scheme for Claiming Superannuation Deductions - Trail Bros Steel & Plastics Pty Ltd v Commissioner of Taxation, Full Federal Court
- » Unrealised Gains were Trust Income - Clark v Inglis, NSW Supreme Court of Appeal
- » GST Margin Scheme and Anti-avoidance - AAT Case [2010] AATA 497, Administrative Appeals Tribunal
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Part IVA Applied to Scheme for Claiming Superannuation Deductions - Trail Bros Steel & Plastics Pty Ltd v Commissioner of Taxation, Full Federal Court

The taxpayer in question is a family company which employed two sons. Each employment contract signed in 1996 required the taxpayer to pay superannuation contributions to a superannuation fund. By 30 June 1997 a change in tax legislation introduced the age based limits for deducting employer superannuation contributions. In response, the employment contracts were varied so that the taxpayer made payments to an employee welfare fund created in June 1997. Payments of \$210,000 in 1997 and 1998 were claimed as deductions. The Commissioner disallowed the deductions on the basis that they were non-deductible or Part IVA applied to disallow the deductions.

Whilst payments to employee welfare trusts are generally deductible, on appeal the Full Federal Court was required to consider Part IVA in relation to what amount of tax benefit, if any, was obtained by the taxpayer. The key component of Part IVA discussed in this case was whether there was a tax benefit derived by the taxpayer that would not have been available if the scheme had not been entered into. This required the Court to consider what alternative transactions the taxpayer could have undertaken.

The Court stated that the onus is on the taxpayer to provide evidence of any alternate transactions it could have undertaken. It was concluded that in the absence of the scheme the taxpayer would have only paid superannuation contributions up to the age base deduction limits. Accordingly the tax benefit was the difference between the \$420,000 originally claimed as a deduction and the reasonable alternative being the deductions limited by the age based limits totalling \$75,604 over the 2 years in question.

Unrealised Gains were Trust Income - Clark v Inglis, NSW Supreme Court of Appeal

This case involved a discretionary trust created by Dr Inglis which held share investments. The shares were recorded at market value with the gains on revaluation treated as income and distributed (but no paid) to Dr Inglis. This resulted in a significant amount owing by the trust which was left to his estate after his death. The trust deed did not define income however it contained a clause which permitted the trustee to treat capital items as income. No express determinations had been made by the trustee in that regard.

The Court of Appeal had to consider 2 main issues:

- » Whether the trustee could treat the increase in market value as trust income and distribute it to Dr Inglis
- » Whether the trustee made determinations to include the market value increases as trust income

On the first issue the court concluded that the market value approach is a method permitted by the accounting standards and principles. The Court noted that if the MV approach is adopted it would be inappropriate to treat increases in value of investments as anything other than income.

As the Court held the unrealised gains were income according to accounting principles, it was held that the trustee wasn't required to make express determinations to exercise its power under the deed to specifically include the unrealised gains as income.

The Court noted, however; that the trustee had accepted the financial statements which were prepared each year with the unrealised gains recorded as income. This acceptance of the financials was a clear act of the trustee which had the same effect as a determination declaring the inclusion of gains as income.

As a result the amount owing from the trust was a valid asset of the deceased estate

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GST Margin Scheme and Anti-avoidance - AAT Case [2010] AATA 497, Administrative Appeals Tribunal

In this case the taxpayer was the representative member of a GST group which carried on a business of property development.

In 1998 one of the group companies acquired a parcel of land. In 2003 and 2004 under varying terms, the apartments were transferred to other members of the GST group. In 2004 and 2005, the apartments were on sold to third parties and the margin scheme was applied to calculate the GST liability.

The main issues to be considered by the Tribunal were whether the margin on the supplies to end purchasers was calculated correctly, and whether Division 165 anti-avoidance applied.

The AAT had to separately consider sales made pre and post March 2005 as a change in legislation at that time saw the introduction of a particular provision affecting the subsequent use of the margin scheme by a GST group member.

For the sales made pre March 2005 the Tribunal held that the appropriate acquisition price to be used in calculating the margin was the price at which the land was acquired from the other GST group member in 2004/2005. Despite the companies being members of the same GST Group, the GST Act does not have a single entity concept which would allow the Commissioner to interpret the phrase 'your acquisition' within the margin scheme provisions, as being an acquisition made by another entity.

For the post March 2005 sales, the new legislative provision applying to GST group members and the margin scheme was relevant. Under that section the margin was to be calculated based on a valuation of the property at July 2000.

For the sales made prior to March 2005 the AAT agreed with the Commissioner concluding that the GST anti-avoidance rules applied as a GST benefit was obtained by the scheme which involved the transfer of the properties between group members prior to their sale to third parties. The GST benefit was the reduced margin calculated using the higher acquisition price in 2004 or 2005 as opposed to the valuation at July 2000 the original company would have had to use if it had sold the properties directly.

Timing of Benefits Paid by Cheque or Promissory Note - SMSFD 2010/D1

This draft SMSF Determination describes whether benefits paid via cheque or promissory note may be considered 'cashed' at the time they are issued by the fund.

Benefits to members are only considered 'cashed' under the SIS Regulations on the date the benefit is 'paid', which involves an actual distribution of benefits from the fund to the member.

According to the Determination a cheque or note is considered cashed at the time it is issued by the fund if:

- » The money is payable immediately
- » The trustee takes all reasonable steps to ensure money is paid promptly (generally within a few business days)
- » and the money is actually paid (i.e cheques are banked and honoured)

Extension to Tax Office Small Business Relief Measures

The Commissioner has announced that the Tax Office will extend the measures to assist small businesses originally announced last year. Businesses having difficulty paying their tax debts should contact the ATO early for help. The package of measures was originally intended to expire on 30 June 2010, but would now run until 30 June 2011. The extension of the Small Business Assistance Package will mean that eligible businesses with a turnover of \$2m or less will continue to have access to:

- » a 12-month GIC-free payment arrangement; and
- » a deferral of activity statement payment due dates.

Bills Update

The calling of the Federal Election means that any Bills that were still before Parliament have now lapsed. Tax related Bills which have lapsed include Tax Laws Amendment (2010 Measures No 4) Bill 2010 and the Research and Development Tax Incentive Bills which were to introduce revised R&D incentives intended to apply from 1 July 2010.

Discretionary Trust Assets Accessed by Family Court - Kennon v Spry, Full Court of the Family Court

Whilst not a tax law case, this case concerned a rather protracted series of litigation over a divorce settlement and whether assets of a discretionary trust could form part of the pool of marriage assets.

Dr Spry created a trust in 1968. He married in 1978. In 1998, when his marriage was in difficulty, Dr Spry varied the trust to exclude himself and his wife as beneficiaries. In January 2002, Dr Spry divided the income and capital of the trust between new trusts he set up for his daughters. Mrs Spry filed for divorce in 2003.

In 2005, the Family Court set aside the 1998 variation and the 2002 transfers of assets. In that first decision the net assets pool of the marriage was assessed at \$9.818m with Dr Spry entitled to 52% and Mrs Spry 48%. The Court ordered Dr Spry to pay his ex-wife \$2.182m after taking into account assets already in her possession. The Court considered that the steps taken in relation to the Trust in 1998 and 2002 were designed to remove assets from the reach of his wife and the Family Court. Dr Spry appealed to the Full Court of the Family Court and then to the High Court, both unsuccessfully. Dr Spry refused to access the funds of the trust in order to meet his family law obligations which led to further litigation when Mrs Spry lodged an enforcement application on Mr Spry.

Dr Spry argued that the assets of the trust could not be part of the pool of marriage assets noting that as he was not a beneficiary of the trust, it would be a breach of trust to access the funds to pay off his family law liability. The Court rejected the argument, stating that without the 1998 variation and the 2002 transfer of funds, Mrs Spry would have had a right to due administration of the trust and to due consideration as a beneficiary. As Mr Spry was the trustee and therefore had the ability to distribute to his wife, the trust property was property of the marriage over which the Family Court could make orders.