

Directors

Lawrence Myers
Gideon Metzger
Brian Turtledove

Associates

Renu Ben
Adam Frare

TAX UPDATE

February 2011

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Application of Commissioner's Discretion to Disregard Division 7A - Tax Ruling TR 2010/8

Under the Division 7A legislation the Commissioner has the discretion to disregard the operation of Division 7A or allow the resulting penalty dividend to be fully franked if the reason Division 7A is triggered is due to an 'honest mistake' and 'inadvertent omission'.

This ruling discusses the meaning of 'honest mistake' and 'inadvertent omission'. The onus is on the taxpayer to demonstrate, on the balance of probabilities, that an honest mistake or inadvertent omission has occurred. The ruling contains a number of examples to assist taxpayers.

GST Treatment of New Residential Premises – Consultation Paper

Treasury has released a consultation paper seeking comment on proposed amendments to the GST legislation concerning residential premises. Under the legislation it is intended that new residential premises are taxable supplies whereas the subsequent sale of residential premises are input taxed supplies.

The paper specifically aims at amending the law in light of a recent Full Federal Court case (Gloxinia Investments) in which 'new' residential premises which were developed under development leases were treated as input taxed supplies when finally sold to the public. In addition the case casts doubt over the Commissioner's opinion that a mere subdivision or strata titling of residential premises does not create new residential premises.

The paper proposes to correct these issues by amending the definition of 'new residential premises'. The proposal is for retrospective amendment, in particular covering development leases entered on or after 3 October 2007 with transitional arrangements. Amendments in relation to strata titling etc are proposed to be back dated to 1 July 2000.

No Trust Resettlement – Commissioner of Taxation v Clark, Full Federal Court

This case concerned a taxpayer's ability to apply prior year capital losses against a capital gain made by the trust. The case centred mainly on whether the trust had changed to such an extent that the trust which originally incurred the losses was the same trust which derived the capital gain (i.e. whether a resettlement of the trust had occurred).

The majority of the court held in favour of the taxpayer finding that there was sufficient continuity within the trust over time. In making that decision the judges noted that for a trust to remain the same there has to be continuity in the trust property and membership of the trust but not strict continuity.. 'speaking more generally: there had to be a continuum of property and membership, which could be identified at any time, even if different from time to time'. Accordingly, despite there being a change in unit holding and significant changes to the assets and liabilities of the trust (during the relevant period the trust was essentially stripped of all its assets and liabilities until only the settled sum remained), the court held that the trust had shown sufficient continuity. As such no resettlement occurred and the prior year capital losses could be applied against the current year capital gain.

T 9250 6566

F 9250 6588

info@mbpadvisory.com.au
mbpadvisory.com.au

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Draft Division 7A Tax Determinations

TD 2010/D9

Division 7A applies to loans, payments etc made by a private company to a shareholder/associate of a shareholder as well as loans made by a trust which has an unpaid present entitlement (UPE) to a private company.

This draft determination discusses the factors the Commissioner will consider when determining the amount of a UPE which is deemed to arise between a trust and a company who are part of an arrangement to provide funds to a shareholder/associate via a series of interposed trusts.

Importantly, if the Commissioner is satisfied that the transactions were not designed to avoid the application of Division 7A, the amount of the UPE the company is deemed to be entitled to will be limited to the lesser of any UPEs between the interposed trusts and the amount of the UPE to which the private company is actually entitled.

TD 2010/D10

Division 7A also applies to loans, payments etc made by a private company via interposed entities.

This draft determination discusses the factors the Commissioner will consider when determining the amount of a deemed payment or loan that a company is taken to make to a shareholder/associate as part of such an arrangement. The Commissioner will consider a number of factors including the amounts lent or paid between the chain of entities and whether any of those loans have been put under a complying loan agreement.

Both draft determinations contain examples which may assist taxpayers in applying the legislation.

Grain Handling Co-operative Exempt from Income Tax – Commissioner of Taxation v Co-operative Bulk Handling Limited, Full Federal Court

In this case the Full Federal Court has confirmed the taxpayer's continued eligibility for tax exempt status. The taxpayer was first established in 1933 for the purpose of establishing, maintaining and conducting systems for the bulk handling of grains.

Over a number of years the taxpayer was exempt from income tax as an 'association established for the purpose of promoting the development of Australian agricultural resources that is not carried on for the profit or gain of its individual members'. The Commissioner contended that the taxpayer no longer remained eligible for the exemption as the phrase 'development of agricultural resources' is confined to the growing of grain itself, not its distribution, and that the members of the taxpayer (which were all growers) derive a gain from the taxpayer in the form of cost effective handling of their grain.

The majority of the court dismissed the Commissioner's arguments finding that 'development of agricultural resources' extends beyond the mere cultivation of land. The entire activities of the taxpayer improve the quality of grain and enhance the reputation of grain grown in W.A.

The taxpayer benefited all participants in the WA grain industry not just growers. There was no 'individual' member who benefited solely by reason of their membership in the taxpayer. The constitution of the taxpayer does not allow for any profits or surplus assets to be distributed to members. Accordingly the Court upheld the taxpayer's tax exempt status

Court Confirms Private Ruling on Tax Impact of Redemption of Units- Colonial First State Investments Limited v Commissioner of Taxation, Federal Court

In this case the taxpayer, a retail unit investment fund (Retail Fund), held units in a related wholesale unit trust (Wholesale Fund). The Retail fund requested a private ruling from the Commissioner concerning the tax outcomes of a number of amendments it proposed to make to the Wholesale Fund's constitution. The amendments were being made to alleviate what it saw as unfairness in the tax outcomes for unit-holders (who may hold their investments for more or less than 12 months) which resulted from the existing manner in which the fund allocated payments to investors redeeming their units.

The private ruling contained 6 questions which the Commissioner answered in the negative, unfavourably for the taxpayer. The Court's decision, which was an appeal from the Commissioner's disallowance for an objection on the private ruling, largely confirmed the Commissioner's view.

All questions involved the application of the complex income tax assessment provisions for trusts. The following points from the case were of note:

- » In regard to whether the amended deed of the Wholesale Fund was a fixed trust (that is all interests in the income and capital of the trust are vested and indefeasible) the court agreed with the Commissioner. The existence of a power which allowed unit-holders to modify, repeal or replace the constitution of the unit trust by special resolution meant that the rights to income and capital were not fixed.
- » The taxpayer's attempt to stream long term gains to long term unit holders, and short term gains to short term investors, did not work as the trust's constitution did not contain a clause which permitted capital gains to be included in trust income, a concept from the High Court case in Bamford (2010).

Update on Self Education Deductions Post Anstis Case

- » Treasury has announced that the income tax legislation will not be amended retrospectively to deny deductions against Youth Allowance for prior years following the decision in Anstis (in which the student was allowed deductions incurred in earning youth allowance income)
- » The ATO recognises that its views expressed in Taxation Ruling TR 98/9 are contrary to the decision of the High Court and will be amending the ruling accordingly.
- » The ATO will be writing to eligible taxpayers or their tax agents to notify them that the ATO will amend their assessments to include a tax deduction of \$550 for study expenses per year for the 2007, 2008, 2009 and 2010 income years
- » For 2010 returns yet to be lodged and future returns, taxpayers can self access and should keep receipts to determine their entitlement to self education deductions.