

TAX UPDATE

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New Legislation - Bill No. 8

Tax Laws Amendment (2011 Measures No. 8) Bill 2011 has been introduced into Parliament. Of particular note are the amendments seeking to deter companies from engaging in phoenix activities. Relevant amendments include directors being personally liable for unpaid superannuation guarantee amounts, and the ability of the Commissioner to recover director penalties, such as penalties for unpaid superannuation or unpaid PAYG liability, without issuing penalty notices where company debts remain unpaid after 3 months. Directors/ associates may be personally liable to PAYG withholding non-compliance tax (PAYGW NCT) where amounts withheld from employee wages and directors' fees have not been remitted to the ATO.

The PAYGW NCT is calculated as the lower of the relevant year's outstanding PAYG withholding liability for all employees and directors, and the director/ associate's personal PAYG withholding credits relating to the company. If the director/ associate is not entitled to any PAYG withholding credit from the company, there is no personal liability.

In order for an associate to be liable for PAYGW NCT, the associate must also have known, or could reasonably have been expected to know, that the company had not remitted withheld PAYG amounts to the Commissioner, and had not taken reasonable steps to counteract this (there is no similar argument available for directors). Alternatively, an associate will also be liable if the Commissioner is satisfied that the associate was treated more favourably than other employees.

The Commissioner can only begin proceedings to recover the PAYGW NCT, and any related GIC, where the individual has been issued a notice regarding the PAYGW NCT. The notice must be served within two years of the individual's assessment.

Small Business CGT Concessions - Commissioner of Taxation v Byrne Hotels Old Pty Ltd, Full Federal Court

This case discussed whether real estate agent commission, accounting fees and legal fees incurred in relation to the sale of a hotel business could be included as liabilities in order to access the Small Business CGT concessions.

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The taxpayer had originally included liabilities arising from real estate commission, accounting fees and solicitor's fees in the calculation of their net asset value. This resulted in a value below the then \$5 million Maximum Net Asset Value test (MNAV), allowing them to access the Small Business CGT concessions on the sale. The Commissioner denied these liabilities and, together with including net amounts of people connected with the taxpayer, calculated a revised net value of CGT assets which exceeded the MNAV test.

On appeal from the Administrative Appeals Tribunal, the Full Federal Court determined that although the liability had not yet crystallised, the real estate agent commission should be included due to the exclusive agency contract that the taxpayer had entered into with the real estate agent. The Court also determined that part of the solicitor fees could be a liability even though the invoices were dated after the CGT event, as the work related in part to WIP completed prior to the event. A similar reason was given for the inclusion of the accounting fees, with the full amount included as the entire invoice related to work completed prior to the event. The Court therefore remitted the case back to the AAT to determine what proportion of the solicitors' fees was completed prior to the event.

Charity and Charitable Purpose

Tax Ruling TR 2011/4 discusses the meaning of 'charitable'. It also explains the Commissioner's view with regards to the features that distinguish a charitable institution from a charitable fund, when an institution or fund will be considered charitable, and determining whether the purpose of an institution or fund is charitable.

Charitable purposes under common law are grouped under the 'four heads of charity' as: the relief of poverty, the advancement of education, the advancement of religion, and other purposes beneficial to the community.

The Government also recently released a Consultation Paper seeking public input into how to implement the introduction of a statutory definition of charity. This is in order to provide a single definition of charity for all purposes and levels of government, and to provide certainty for Not-For-Profits. The paper refers to the draft ruling TR 2001/D2 (which was the precursor to TR 2011/4) and how it bases its definition on common law as per above. The paper discusses possible elements for the definition as well as how the Charities Bill 2003 could be refined in order to take into account changes in Australian common law and policy, and overseas models.

Breach of SIS ACT by Trustees - Olesen v Parker, Federal Court

This case concerned monetary penalties imposed due to numerous contraventions of the Superannuation Industry (Supervision) Act (SIS Act) by husband and wife trustees of a self-managed superannuation fund (SMSF).

Over the 2005-2008 financial years, the trustees breached a number of the superannuation rules with regard to the SMSF. The initial breach was of the 5% in-house asset test as the trustees made loans to, and an investment in, related companies. Preparation of a written plan to dispose of the excess in-house assets was then required. However this was not completed, therefore constituting another breach. The trustees were also required to obtain payment of interest on these loans. Their failure to do so resulted in a breach of the requirement to deal with the companies at arm's length. In addition, these breaches triggered a breach the sole purpose test, which states that the purpose of the fund must solely be for the provision of retirement benefits for the members of the fund.

The Court ruled that the trustees were aware of their obligations, yet repeatedly breached the Act. Monetary penalties of \$35,000 for the husband, \$15,000 for the wife, and \$5,000 as repayment of the Applicant's legal expenses were therefore imposed.

Loans and Interest Deductibility - AATA 628, Re Areffco and FCT, Administrative Appeals Tribunal

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This case concerned a company which reported loans in 1997 and 1998 totalling \$4.75 million dollars borrowed from an overseas bank, and claimed related interest deductions.

On assessment, the Commissioner disallowed the interest deductions on the basis that the loans were not legitimate. This was due to the lack of expected loan documentation and personal guarantees, the unusual interest rates used and failure of the bank to enforce the loan terms despite long periods of payment defaults. The ATO argued that due to the uncommercial appearance of the 'loans' and the fact that the amounts lacked any specific repayment obligations they were not loans, and the full amount received was therefore not a loan, but a receipt of income. This was in addition to the disallowance of the interest deductions. The Commissioner also ruled that the company had intentionally disregarded the tax law, and had engaged in fraud or evasion, and therefore was also liable for penalties in addition to the increased tax.

The AAT held that although the loans appeared unusual, they were not so unusual as to contradict their existence and substance as legitimate loans. Therefore, due to their characterisation as loans, the Tribunal also concluded that the interest expenses were deductible as they represented Areffco's cost of funds.

Objections Against Income Tax Assessments – TR 2011/5

This ruling explains what constitutes a valid objection against an income tax assessment. It discusses specific areas of valid objections, in particular: the limitations on objection rights, the ability to raise multiple objections against an assessment, and the ability to appeal against an objection decision. The ruling also discusses the ability to amend assessments both before and after an objection decision has been made.

Default Assessments for Non-lodgers

The ATO has announced to tax professionals that from 3 November 2011 default assessment warning letters will be sent to clients with overdue returns where evidence exists that taxable income was received in the relevant financial years. The letters will specify a date by which the return must be lodged, otherwise a default assessment will be made. Failure to lodge penalties and administrative penalties of at least 75% may be incurred.

Source of Share Sales for Private Equity Fund Leveraged Buy-outs - TD 2011/24

The ATO has confirmed that in the case of a leveraged buy-out of Australian shares by private equity funds, source is not determined by where the purchase and sale contracts are executed, but by having regard to all the facts and circumstances of the particular case. The Commissioner also outlined factors he will consider in determining the source including: the activities undertaken by the fund/on the fund's behalf in making any improvements to the Australian corporate group; the nature of any agreements between the entities; and the form and substance of purchase payments.

'No Goodwill' Incorporated Professional Practice and Market Value of Shares – TD 2011/26

This determination confirms that the Commissioner will accept that the goodwill of a 'no goodwill' incorporated professional practice can be treated as \$Nil when applying the market value substitution rule. The dealings are required to be at arm's length and related to the natural 'ebb and flow' of natural person practitioner-shareholders. The determination also outlined a number of features that must be displayed for the incorporated professional practice to qualify as a 'no goodwill' company.

