

THE REPORT

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Tax News, Views & Clues

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MONTHLY REPORT

Interposed Entity Elections

Readers will recall that the trustee of a discretionary trust will often make a family trust election. The benefit of doing so is that tax losses are typically easier to carry forward and utilise, and beneficiaries may have greater access to franking credits arising on trust distributions of dividend income.

Where a family trust election is made, any distributions of income or capital outside of a defined family group (including certain family owned entities and charities) attract family trust distribution tax at the top marginal rate. So, the trustee's distribution flexibility is strictly limited to family members and family entities.

Another trust or a company can make an interposed entity election (IEE) so that it is included in the family group and can receive distributions without penalty tax. An entity that makes an IEE is subject to the same distribution restrictions as the family trust.

However, the making of an IEE does not assist a trust with utilisation of its tax losses (if any) and does not allow beneficiaries greater access to franking credits.

Therefore, where a trust is required to make an IEE to be included in a family group because of another trust's family trust election, that trust should also consider making a family trust election. That way, it takes on no additional restrictions, but benefits in relation to tax loss and franking credit utilisation.

- **TIP:** The Tax Office has provided a one-off opportunity for tax-payers to lodge retrospective elections. Taxpayers who are required to lodge a tax return for the 2004 income tax year will be required to provide details of their election when they lodge that return. Taxpayers not required to lodge a 2004 return were required to provide details of the election and declaration within two months of the end of the 2004 income year.

GST Treatment of Tax Law Partnerships

The Tax Office has recently released a ruling regarding the GST treatment of transactions carried out by tax law partnerships (TLPs). The ruling focuses on the leasing of co-owned properties by TLPs and the GST implications for the individual partners.

The ruling explains that a TLP is an association of natural persons in receipt of ordinary or statutory income jointly and that a TLP is formed from the time that the persons jointly commence an activity from which income is, or will be, received jointly.

Once a TLP comes into existence, it is a GST entity separate from its partners. Consequently, a TLP may carry on an enterprise, make supplies or acquisitions and have assets and liabilities.

The ruling has a wide application and has the potential to affect any persons jointly holding property. Many detailed examples of TLPs including property syndicates, family member partnerships and situations involving a single lease agreement are also discussed.

Please contact us for further information.

Superannuation Tax Reduction Strategies

The Tax Office has recently confirmed that several commonly used superannuation tax reduction strategies will not attract the anti-avoidance provisions of the law. Two of the strategies that are allowable under the law include:

- an individual taxpayer withdrawing an Eligible Termination Payment (ETP) from their superannuation fund and then re-contributing a similar amount to the same fund or another fund (e.g. a spouse's fund) for the purpose of establishing a superannuation pension; and
- an individual taxpayer making a large undeducted contribution to their superannuation fund before they receive an ETP.

Both strategies take advantage of the law's concessional ETP treatment. The first strategy reduces the assessable portion of the annual pension while the second reduces the amount of the tax payable on the ETP.

- **CAUTION:** The Tax Office has warned superannuation contributors to beware of promoters offering early access to superannuation funds to pay for homes, cars, boats and to pay off loans. The Tax Office believes these arrangements are an attempt to get around laws that preserve and encourage superannuation savings.

Taxpayer's Redundancy not Bona Fide

A recent Administrative Appeals Tribunal (AAT) decision has held that payments received by a taxpayer upon retirement were assessable in full, as the amounts were not paid in respect of a bona fide redundancy.

The taxpayer was an officer in the Tax Office legal division for over 35 years. Due to an imminent internal restructure of his division and changes in his position description, the taxpayer chose not to apply for a new position and instead instigated proceedings to be offered a severance payment (package).

Broadly, terminations will qualify for concessional treatment if an employee's dismissal is a bona fide redundancy. A bona fide redundancy usually occurs where the actual type of work carried out by the employee is no longer required, or is no longer required at that site. The termination of employment must not be due to the performance of the employee.

Under the taxpayer's employment agreement, a voluntary redundancy may be offered in the event that the employee's services can no longer be effectively used. The taxpayer applied this clause to his situation as he argued that a new position in the restructured division wouldn't fully utilise his skills.

Based on the Tax Office's evidence, the AAT found that the divisional restructure would not have made the taxpayer's skills redundant and that his position was not excess to the Tax Office's requirements.

Accordingly, the AAT rejected the taxpayer's appeal on the grounds that the taxpayer's termination of employment was due to his intention to retire and not because his position or his skills were redundant due to the restructure.

Taxpayer Challenge Successful

The Federal Court has recently held in favour of a taxpayer who challenged the validity of her amended income tax assessments on the basis that the amendments were excessive.

The taxpayer had only lodged one tax return in five years. After a tax audit, the taxpayer received amended assessments for the income years 1994–99.

Throughout this time, the taxpayer was involved in a series of complex property and investment transactions with her de facto partner. The taxpayer transferred money into her de facto partner's private investment company for an annual fixed rate of return.

For each relevant year, the tax audit calculated the total amounts gained by the taxpayer from her de facto partner in excess of the transferred amount and deemed each receipt to be assessable income. The taxpayer argued that the amounts assessed were excessive on the grounds that each receipt was not solely made up of investment returns.

The Court found that the amounts gained by the taxpayer in excess of the fixed rate of return and other dividends were payments for domestic expenses and child maintenance. The Court ordered that each assessment be set aside and re-calculated accordingly.

CGT a Major Focus for ATO in 2004/05

The Tax Office has announced that capital gains tax (CGT) will be a major area of focus in its 2004/05 compliance program. All taxpayers, from individuals, to small and large businesses, stand to be affected. Major areas of increased CGT scrutiny include:

- The Tax Office believes that some legal practitioners may not fully consider the implications of CGT and CGT record keeping when advising clients.

- Real property transaction data matching is already in place and the Tax Office plans to expand its operations with several state revenue offices in order to ensure that capital gains are being correctly disclosed by taxpayers.
- The incorrect use of Small Business CGT concessions by micro-businesses and small and medium enterprises will be examined.
- The sale of ‘high value/high growth’ properties will be scrutinised where signs of deliberate evasion may be present.

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