INSTITUTE OF PUBLIC ACCOUNTANTS®

2018 BALI TAX RETREAT

29 – 30 NOVEMBER

THE TRANS RESORT, SEMINYAK

#IPABALI18
IPAWESTERNAUSTRALIA
IPAACCOUNTANTS
IPAACCOUNTANTS
PUBLICACCOUNTANTS.ORG.AU/BALI2018

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax aspects of choosing a business structure

Peter C. Adams
November 2018

Overview of key considerations

NON- TAX CONSIDERATIONS IN CHOOSING BUSINESS STRUCTURE

- limited/unlimited/joint and several liability of the owners;
- duties and potential liability of officers (eg directors) or other parties (eg trustees)
- formation costs;
- registration and annual return requirements;
- continuing administrative costs (eg secretarial work, filing fees); and
- flexibility – in relation to directing returns to different owners (or beneficiaries in the case of a trust) and issuing, redeeming and transferring interests in the entity.

Overview of key considerations (cont.)

KEY TAX CONSIDERATIONS IN CHOOSING BUSINESS STRUCTURE

- rate of tax;
- flow through of losses;
- consequences of transferring or redeeming interests in the entity;
- flexibility with income splitting;
- loss of concessional CGT treatment (eg on disposal of active assets of a small business) upon making distributions;
- stamp duty consequences on original documentation, method of transferring assets into structure and transfer of property as part of reorganisation;
- availability of rollover relief under CGT and capital allowances rules if assets are transferred;
- Liability of directors / officeholders – changes 30/6/12 – SGA & PAYGW

Overview of key considerations (cont.)

KEY TAX CONSIDERATIONS IN CHOOSING BUSINESS STRUCTURE

- ability to offset losses against profits of another entity, through consolidation;
- ability to achieve other efficiencies and benefits by inclusion in consolidated group;
- method of financing – debt or equity, redeemable or non-redeemable shares or units, convertible notes etc in terms of method and form of returning profits;
- CGT consequences on distribution, sale or release, anti-avoidance provisions (eg thin capitalisation and value shifting) and saleability;

Overview of key considerations (cont.)

KEY TAX CONSIDERATIONS IN CHOOSING BUSINESS STRUCTURE

- use of multiple entity structure – holding and subsidiary companies, corporate or non-corporate trustees, holding vehicles, subsidiaries or branches in listed or non-listed countries, tax havens or tax treaty countries; and
- anti-avoidance rules that are specific to each type of entity, e.g. Division 7A loans (private companies), Section 100A reimbursements (trusts), etc

INSTITUTE OF PUBLIC ACCOUNTANTS®

Sole Proprietors

KEY TAX CHARACTERISTICS

- ❑ Not a separate legal entity – no asset protection
- ❑ Controls and manages business and responsible for all debts and liabilities
- ❑ Use **individual TFN** for lodging ITR – sole tax responsibility
- ❑ Taxed as individual taxpayer at marginal tax rates

INSTITUTE OF PUBLIC ACCOUNTANTS

Sole Proprietors

KEY TAX CHARACTERISTICS

- ❑ Cannot claim tax deduction for money they draw from their business – not "salary" paid to employee
- ❑ Spriggs / Ridell case – "employment" part of the business carried on – planning
- ❑ Limitation - deductibility of super contributions – 10% rule
- ❑ 50% CGT discount available subject to asset held for at least twelve (12) months
- ❑ SBE CGT concessions available – no "connected entity" application (although "affiliate" applicable)

INSTITUTE OF PUBLIC ACCOUNTANTS

Sole Proprietors

KEY TAX CHARACTERISTICS

- ❑ Potential for PSI Regime to apply even if no Personal Service Entity (PSE)
- ❑ Potential for non-commercial loss deferral rules to apply - requires satisfaction of one or more tests or ATO discretion to utilise losses
- ❑ Generally two-year amended review period, unless complex multiple business operations

Sole Proprietors (cont.)

PERSONAL SERVICES INCOME (PSI) REGIME

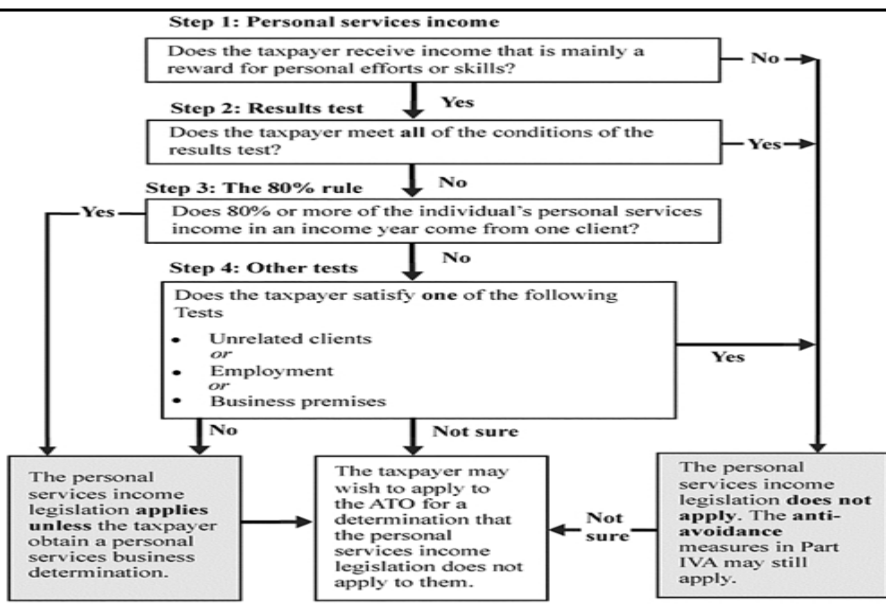
- Risk if sole trader derives personal services income (PSI)
- Applicable if business derives personal services income (PSI) that is not a personal services business (PSB)
- PSI is income gained mainly as reward for personal efforts or skills of an individual
- PSI is included in assessable income of individual whose personal efforts or skills generate the income at marginal rates – no alienation of income

Sole trader - Personal Services Income (PSI)

- Part 2-42 ITAA 97

- Is there an employment relationship. If so the PSI rules do not apply
- Is personal services income being earned (s 84-5 ITAA97 and TR 2001/7) directly or via an entity
  - mainly ie over 50% from personal services
  - not from the supply of goods, use of an asset or business structure

- The PSI rules only apply where personal services income is being earned and a personal services business (as defined) is not being carried on



Sole Trader - Personal Services Income

- If caught by PSI rules, individuals cannot deduct the following against their PSI (see TR 2003/10)
  - Deductions an employee could not claim (s 85-10(1) ITAA97), unless they relate to:
    - Gaining work
    - Insuring against loss of income or earning capacity
    - Engaging a non-associate to perform work
    - Engaging an associate to perform principal work
    - Workers' compensation premiums etc
    - GST
  - Rent, mortgage interest, rates or land tax for the individual's or their associate's residence (s 85-15 ITAA97)
  - Salary/wages paid to associates, unless performing principal work (s 85-20 ITAA97) – becomes tax free income for the recipient
  - Superannuation contributions for associates, unless superannuation guarantee for performing principal work (s 85-25 ITAA97)

INSTITUTE OF PUBLIC ACCOUNTANTS®

Sole Proprietors (Cont.)

LOSSES

- ❑ Losses c/fwd and deductible by taxpayer's against assessable income in the normal course
- ❑ Offset against exempt income first before applied against assessable income
- ❑ Non-commercial loss rules may apply to limit entitlement to losses

INSTITUTE OF PUBLIC ACCOUNTANTS®

Sole trader - Non-Commercial Losses

- Non-commercial losses (Div 35 ITAA 97)
  - Losses quarantined to non-commercial business activity
  - Exceptions:
    - Primary production or professional arts business if other assessable income is less than $40,000
    - Taxpayer's adjusted taxable income is under $250,000 and a commerciality test is satisfied
      - assessable income test (s 35-30 ITAA 97)
      - real property test (s 35-40 ITAA 97)
      - other assets test (s 35-45 ITAA 97)
      - profits test (s 35-35 ITAA 97
    - Commissioner exercises discretion on basis of
      - Special circumstances
      - Lead time

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Sole trader - Personal Super Contributions

- Deductible if (div 290-C ITAA 97, TR 2010/1)
  - Taxpayer made contribution in year deduction is claimed
  - To a complying superannuation fund
  - For purpose of providing superannuation for taxpayer
  - The contributor has given the superannuation fund a valid notice of the intention to claim a deduction (NAT 71121)

NOTE

- 10% EMPLOYMENT INCOME RULE ABOLISHED
- DIV 293 TAX APPLIES IF ATI > $250k

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Sole trader - Personal Super Contributions

For the year ended 30 June 2018:

Age at Previous 30 June	Concessional Cap	Non-concessional Cap	Bring-forward Cap*
N/A	$25,000	$100,000	$300,000
N/A	$25,000	$100,000	$300,000
N/A	$25,000	$100,000	N/A

* The bring-forward cap allowed people under 65 years of age to make a larger one-off contribution every 3 years. It is automatically triggered if contributions exceed the non-concessional cap (s 292-85 ITAA97). Entitlement to bring-forward also subject $1.6m cap.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Small business tax offset

- With effect from 1 July 2015, individual taxpayers with business income from an unincorporated business that had an aggregated annual turnover of less than $2m were eligible for a small business tax discount
- The discount was originally delivered as a 5% tax offset through the end of year tax return capped at $1,000

INSTITUTE OF PUBLIC ACCOUNTANTS®

Small business tax offset

- With effect from 1 July 2016, the discount would be available for individual taxpayers with business income from an unincorporated business that had an aggregated annual turnover of less than **$5m** (i.e. an increase in the access threshold from $2m to $5m).
- With effect from 1 July 2016, the discount was also increased from 5% to 8%, capped at $1,000.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Small business tax offset

Treasury Laws Amendment (Lower Taxes For Small and Medium Businesses) Bill 2018

- This Bill increases the Small Business Income Tax Offset to 13% from 1 July 2020 and 16% from 1 July 2021
- However this offset remains capped at $1,000.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Partnerships - Definition

At general law:

- Relationship between persons carrying on a business with a view to making profit
- No separate legal entity – joint and several liability

Definition of a Partnership

- s 995-1 ITAA 97 and TR 94/8
- **General law partnership**
  - *an association of persons carrying on business as partners*
  - Contractual relationship between partners, not a separate legal entity
  - Each partner can bind the partnership
  - Partners are jointly and severally liable
- Tax features
  - Can split income and losses using salaries and agreements
  - Must lodge partnership tax return

Partnership: definition

For tax purposes (s. 995.1 ITAA 1997)

- Association of persons carrying on business as partners or in receipt of ordinary income or statutory income jointly but does not include a company
- Definition of partnership is broader than at general law as it may exist even where there is no partnership agreement

Definition of a Partnership

- s 995-1 ITAA 97 and TR 94/8
- **Statutory / tax law partnership**
  - *an association of persons ... in receipt of ordinary income or statutory income jointly*
  - Typically husband and wife who jointly own assets and receive passive income
- Tax features
  - Must split income according to ownership interest (*FCT v McDonald* [1987] FCA 200)
  - Not required to lodge a return

Taxation of Partnerships

- ❑ Must determine partnership net income (or loss) (s 90 ITAA 1936)
- ❑ Must submit a tax return (Form P) (s 91)
- ❑ Partners must include their share of the partnership net income (or loss) in their own tax return (s 92)
- ❑ Note – net loss is proportionately available to partners directly - not retained in partnership

6.5 - Net Income

- Calculated as if partnership was a resident individual taxpayer (s 90 ITAA 36)
  - Eg trading stock is calculated at the partnership level
  - Eg depreciation is claimed as a deduction at the partnership level
  - Note – exception for primary production write-off for capital expenditure on land-care operations, fencing, water facilities – directly available to individual partner.

- Adjustments to income for tax purposes
  - Interest on partners' drawings

Partnership Net Income

Expense / Loss adjustments for tax purposes:

- ❑ No deduction allowed for past losses – losses available to partners
- ❑ No deduction allowed for salaries paid to partners
- ❑ No deduction allowed for interest paid on partners' (loan) capital
- ❑ Partners' salaries and interests are part of the profit sharing

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Other Issues

- ❑ Issues with partnerships
  - ❑ trading stock – calculated at the partnership level
  - ❑ Depreciation – claimed as a deduction at the partnership level.
  - ❑ capital gains tax – taken at the individual level
  - ❑ CGT event K7 anomaly
  - ❑ Small business CGT concessions available but partnership is connected entity if stakeholding is 40% or more – disadvantage for $6m NAV test but potential advantage for active asset test

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Distribution to Partners

- ❑ Partners include their share of partnership profit or loss in their own tax return
- ❑ Distribution follows partnership agreement
- ❑ Where there is no partnership at general law, partners cannot assert a division of profit that would require an partnership agreement to be valid (FCT v McDonald)
- ❑ e.g. husband & wife owning a property jointly cannot decide to split profit 75 % -25 %

Changes in Partnership Interests

- ❑ At general law, when a partner retires or a new partner is admitted , the old partnership is dissolved and a new partnership is formed.
- ❑ Tax Consequences :
  - ❑The old and new partnerships must lodge separate tax returns
  - ❑There is a notional disposal/ acquisition of interests between partners

Changes in Partnership Interests

- Remaining partners acquire a share of the retiring partner’s interest OR/AND
- Existing partners sell a share of their interest to the new partner
- Under CGT rules, the partners individually make a capital gain / loss for the notional disposal of their interest in each partnership CGT assets
- Partners can elect to disregard the profit on the notional disposal of their interest in trading stock and depreciating assets – effective “roll-over”

Changes in Partnership Interests

- **Trading stock**
  - Deemed sale by old partnership and purchase by new partnership (s 70-100 ITAA 97)
  - Sale takes place at market value unless:
    - All old and new partners elect to use tax value (written agreement)
    - Old partners comprise 25% of new partnership
- **Depreciable assets**
  - Balancing adjustment event occurs (s 40-295(2) ITAA 97)
  - Termination value is market value (s 40-300 item 5 ITAA 97)
  - Rollover relief (s 40-340(3) ITAA 97)

Changes in Partnership Interests

- **Work in progress**
  - Receipt for WIP is assessable (s 15-50 ITAA 97)
  - Payment for WIP is deductible in year recoverable debt arises (s 25-95 ITAA 97)

- **Bad debts**
  - May not be deductible to new partnership as not included in assessable income (s 25-35 ITAA 97)

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Joint Ventures

- ❑ “Joint Venture" is generally understood to mean an association of 2 or more persons acting together for specific commercial purpose but not in partnership

- ❑ Commonly used in mining industry for purpose of operating a mine and processing the output to be shared amongst joint venturers
- ❑ Also used by property developers
- ❑ No joint and several liability

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Joint Ventures (cont.)

ADVANTAGES OF JOINT VENTURES

- Not required for joint venture to lodge income tax returns - each joint venture participant lodges a separate tax return and may adopt different tax treatment
- JVs can each claim their own deductions and make their own elections re trading stock, depreciation, etc.
- Whereas partners share in net profits or losses of partnership, JVs share costs but do not share profits
- **JVs <u>share in the product or output</u> of the business activity (not profit)**

INSTITUTE OF PUBLIC ACCOUNTANTS®

Joint Ventures (cont.)

ADVANTAGES OF JOINT VENTURES

- JVs not jointly liable for liabilities of joint venture (ie other JVs) – liabilities incurred on own account
- JVs may have different purposes and characteristics which can have different tax outcomes under income tax laws:
  - For example, 2 parties - residential property developer (RPD) and land owner (LO), undertake a joint venture to develop land.
  - PD is carrying on business, LO is not.
  - LO wants to sell land for gain.
  - Each party could take a predetermined number of houses on completion
- JVs can assign interests in arrangement - no dissolution and/or reformation of JV

INSTITUTE OF PUBLIC ACCOUNTANTS®

Joint Ventures (cont.)

CONSIDERATIONS TO FORMING JOINT VENTURES

- ❑ Each of JVs be made responsible for transacting with its own share of the product of JV
- ❑ Each of JVs be a tenant-in-common of assets of JV in the same proportion as the legal interest of each of JVs
- ❑ Clear distinction as not partnership arrangement but JV
- ❑ Each of JVs be liable for its own actions and JVs not jointly liable for debts of JV
- ❑ Each JV enter into a separate agreement with management company (MC) - MC enter into separate agreements with 3rd parties as agent for each of JVs separately

Taxation of Trusts

- ❑ Not a separate legal entity either at common law or for tax law purposes
- ❑ Only treated as notional separate entity in determining "net income" of trust for tax purposes
- ❑ Definition:

It is a relationship which exists between an owner of an asset (the trustee) and another person (the beneficiary) in which the trustee is obligated to the beneficiary for the benefits of owning that asset (the trust property)

INSTITUTE OF PUBLIC ACCOUNTANTS®

Trust Relationship

- Four key elements:
  1. Trust property
  2. A trustee (individual or company)
  3. Beneficiaries
  4. An obligation for the trustee to deal with the trust property under the term of the trust deed
- A trust is not a legal entity at common law

INSTITUTE OF PUBLIC ACCOUNTANTS®

Types of Trusts

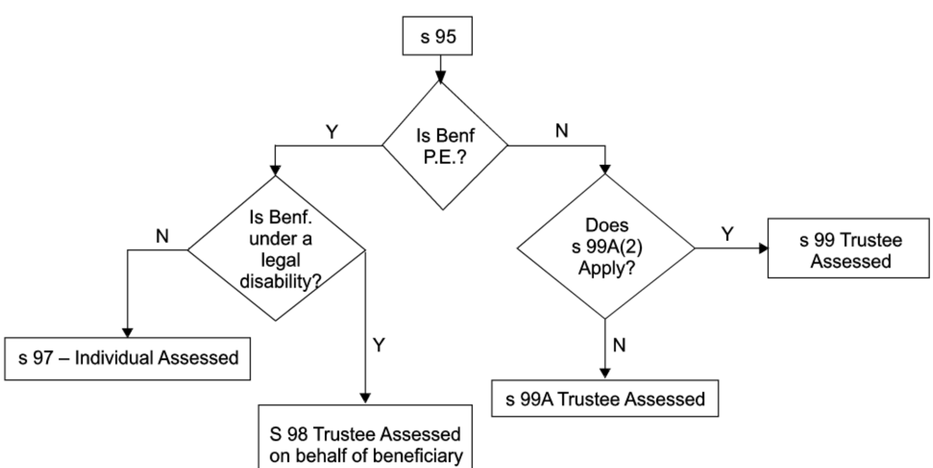
- Deceased estates – express trust
- Testamentary trust – created by testament / will
- Inter vivos trusts (between living beings)
- Discretionary trusts : entitlements of beneficiaries to trust distributions are at the discretion of the trustee
- Fixed trusts : fixed entitlements pre-determined in the trust deed (e.g. unit trust - entitlements are determined by no. of units held in trust capital)

INSTITUTE OF PUBLIC ACCOUNTANTS®

Taxation of Trusts

- Trustee is required to lodge a tax return (form T) for the trust estate
- The Net Income of the trust must be determined (s. 95 ITAA 1936).
- Only profits may be distributed from a trust
- Trust losses are "trapped" in the trust, i.e. they can only be offset against trust income.
- As a general rule, the trustee is not taxed on the trust income (s. 96)

Taxation of trusts – Current regime



Trusts - Trust Cloning be s

- Trusts have limited lifespan (except in SA) and vests at end of term with CGT effect
- Maximum vesting period 80 years
- CGT events E1 and E2 – transfers to and from trusts
- E1/E2 trust cloning abolished but replaced by CGT roll-over mechanism
- Similar effect but requirements more restrictive requiring beneficiaries to be the same before and after transfer

INSTITUTE OF PUBLIC ACCOUNTANTS®

Trusts – CGT and other tax issues

- General application of CGT rules
- Entitlement to CGT Discount – conduit process
- Small business CGT concessions – discretionary trusts
- Implications of CGT event E4 – fixed trusts
- Trust losses – stringent tests to utilize tax losses
- Discretionary trusts - flow through of franking credits
- Issues with trust as shareholder in company
- Streaming of capital gains and franked dividends allowed – streaming of other income questionable
- Trust distribution timeframe to trigger present entitlement – 30 June

INSTITUTE OF PUBLIC ACCOUNTANTS®

Trust Losses

- Trust losses are “trapped” in the trust and cannot be distributed to beneficiaries

- Losses can be applied in future years if tests are satisfied, depending on the type of trust:
  - Fixed Trust – 50% stake test AND income injection test
  - Non-Fixed Trust – 50% stake test (not for discretionary trust) AND pattern of distribution test AND control test AND income injection test
  - Family Trust (FT election made) – income injection test

INSTITUTE OF PUBLIC ACCOUNTANTS®

Trust compliance with anti avoidance rules

- The ATO has advised it is reviewing selected trusts’ compliance with sections 100AA and 100AB of the Income Tax Assessment Act 1936. These anti-avoidance rules are designed to prevent trustees using tax-exempt entities to shelter the trust’s net income.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Update – ATO Guide on reimbursement agreements

- Section 100A ITAA 1936 can apply where a beneficiary is made presently entitled to trust income that is intended to be directed to another person. The effect of the application of section 100A is that the trustee is made taxable on the distribution at the top marginal rate, currently 47% with the Medicare levy.
- It appears from the ATO Guide that the ATO is interpreting section 100A more broadly than it has in the past.

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Nature of Companies

Companies are separate legal entities
(Salomon v Salomon Ltd)

Consequences : from a tax point of view,

- Companies will lodge a separate tax return
- Companies will be taxed separately from their owners and pay income tax

IPA INSTITUTE OF PUBLIC ACCOUNTANTS®

Levy and Collection of Tax

- Standard tax rate is a flat 30 % with no tax-free threshold
- Companies self-assess their tax liability
- Companies must lodge tax return Form C
- Must attach to return information explaining how taxable income was derived
- Under the PAYG system, companies must pay income tax instalments every quarter.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Reduction in company tax rate

- The Government intends to reduce the company tax rate to 25% over the next 11 income years.
- It is proposed that this will be phased in, depending on the company's aggregated annual turnover as follows:

INSTITUTE OF PUBLIC ACCOUNTANTS®

Reduction in company tax rate

Income year	Threshold (< $)	Rate (%)
2015-16 (current year)	2m	28.5
2016-17	10m	27.5
2017-18	25m	27.5
2018-19	50m	27.5
2019-20	100m	27.5
2020-21	250m	27.5
2021-22	500m	27.5
2022-23	1bn	27.5
2023-24	all companies	27.5
2024-25	all companies	27
2025-26	all companies	26
2026-27	all companies	25

INSTITUTE OF PUBLIC ACCOUNTANTS®

Reduction in company tax rate

- The Government intended to reduce the company tax rate to 25% over the next 11 income years.
- It is proposed that this will be phased in, depending on the company's aggregated annual turnover as follows:

INSTITUTE OF PUBLIC ACCOUNTANTS®

Reduction in company tax rate

Income year	Threshold (< $)	Rate (%)
2015-16	**2m**	**28.5**
2016-17	**10m**	**27.5**
2017-18	**25m**	**27.5**
2018-19	**50m**	**27.5**
2019-20	100m	27.5
2020-21	250m	27.5
2021-22	500m	27.5
2022-23	1bn	27.5
2023-24	all companies	27.5
2024-25	all companies	27
2025-26	all companies	26
2026-27	all companies	25

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Update

Corporate tax rate cut for larger companies

Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017

- This bill has been introduced into the House of Representatives.
- It amends the Income Tax Rates Act 1986 to progressively extend the lower 27.5% corporate tax rate to all corporate tax entities by the 2023-24 financial year and further reduce the corporate tax rate in stages so that by the 2026-27 financial year, the corporate tax rate for all entities will be 25%.
- This follows the legislated reduction in corporate tax rates for entities with annual aggregated turnover of under $50 million.
- This bill is the Government's second attempt to legislate those tax cuts for larger companies.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Update

Enterprise Tax Plan: small business over-franking in 2016-17 income year because of tax rate change - PCG 2017/D7

- If a corporate tax entity fully franked a distribution during its 2016-17 income year before the Treasury Laws Amendment (Enterprise Tax Plan) Act 2017 (the amending Act) became law on 19 May 2017, the amount of the franking credit on the distribution statement provided to members may be incorrect.
- This is because the franked distribution would likely be based on the 30% corporate tax rate, when the entity's tax rate for that income year may in fact be 27.5% because of the law change.
- This draft Guideline sets out a practical compliance approach that corporate tax entities may choose to use to inform members of the correct amount of franking credit attached to their distribution.
- The approach may reduce compliance costs for corporate tax entities by providing an alternative to seeking an exercise of the Commissioner's discretion to allow amendment of distribution statements.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Update – November 2017

Qualification for lower corporate tax rate

Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017

The government has announce a bill that amends the Income Tax Rates Act 1986 to provide that a corporate tax entity will not qualify for the lower 27.5 per cent corporate tax rate if more than 80 per cent of its assessable income is income of a passive nature; and Income Tax Assessment Act 1997 and Income Tax Rates Act 1986 to make consequential amendments**.**

INSTITUTE OF PUBLIC ACCOUNTANTS®

Capital Gains Tax

- Income tax on capital gain - no separate tax
- Post 20 September 1985 - CGT applies
- Pre-CGT asset in company- majority underlying interest - test day (5 yrs)
- Post 21 September 1999 - no indexation or averaging - discount method (50% individuals), Companies no discount
- Asset purchased prior to 21 September 1999, can still use indexation.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Pre CGT – Assets and Shares

- Designed to bring pre – CGT assets within the CGT regime
- Section 149-30 – assets owned by the company, 50% of shareholders
- Test day – 5 years and must be assessed within 6 months.
- Abnormal trading in companies shares can create a problem for public companies

INSTITUTE OF PUBLIC ACCOUNTANTS®

Pre CGT Status

- Pre CGT shares in a company – cannot use the company to avoid income tax by selling post-CGT assets in the company
- CGT event K6
- Section 104-230 - If post CGT assets acquired greater than 75% of net value of the company, then CGT liability occurs when the pre-CGT shares are sold.

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Losses

- Companies are entitled to carry-forward losses and offset them against future profits subject to particular conditions:
- There must be continuity of ownership between the time when the loss was incurred and the time when it is recouped OR
- The company must be carrying on the same business as when it incurred the loss
- Company can choose whether to deduct losses
- Loss carry-back rules no longer available

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Losses - Continuity of Ownership Test

S165-12 ITAA 1997

Company must demonstrate that there were shareholders who:

- Had more than 50 % of voting power at all time during the ownership test period AND
- Had rights to more than 50 % of dividends at all times during the ownership test period AND
- Had rights to more than 50 % of capital distributions at all time during the ownership test period

Tax Losses - Same Business Test

S165-13 ITAA 1997

- Only applies if failed continuity of ownership test
- Test is strictly applied : same business does not mean "similar" business- (Avondale Motors)
- Change of name, address and clientele and break in continuity of business are acceptable (AGC advances)

Bad debts

A company cannot claim a deduction for bad debts unless it satisfies

- The continuity of business test (s165-123) OR
- The same business test (s165-126)

Tests are similar to tests for company losses

Tax Update – October 2017

Business Continuity Test

LCG 2017/D6 Draft Law Companion Guide 2017/D6 discusses amendments to the business continuity test.

- The 'business continuity test', recently introduced into the company loss rules, retains the existing 'same business test' and introduces a new 'similar business test'.
- Under this new test, a company will be able to utilise tax losses made from carrying on a business against income derived from carrying on a similar business following a change in ownership or control.

Tax Update – October 2017

Business Continuity Test

LCG 2017/D6 Draft Law Companion Guide 2017/D6 discusses amendments to the business continuity test.

There are four factors to be taken into account:

- 1) The first factor considers the extent to which the assets used to generate assessable income throughout the business continuity test period were the assets used in the business carried on at the test time.
- 2) The second factor compares the extent to which the current activities and operations from which assessable income is generated were also those from which assessable income was generated previously.
- 3) The third factor compares the current identity of the business with that of the business carried on before the test time.
- 4) The fourth factor requires an assessment of the extent to which the changes to the business resulted from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the business.

Dividend Distributions

Dividends are defined in s 6(1) ITAA 1936:

- Distributions in money or property by a company to its shareholders
- Any amount credited by a company to its shareholders
- Does not include payments representing returns of capital (redemption or cancellation of shares)

Taxation of Dividend Distributions

- Dividends received by shareholders are assessable income – s. 44(1) ITAA 1936
- Shareholder must be on the share register or be beneficially entitled to the dividend- Patcorp Investments

Simplified Imputation System

Basic principles of the Australian imputation system:

- Any tax paid by the company is treated as an advance tax payment on behalf of the shareholders
- Thus shareholders will include the dividend in their taxable income but will also be entitled to a credit for the amount of tax that the company has paid.

Simplified Imputation System (continued)

How the system works :

- The process of attaching a tax credit to a dividend distribution is called "franking"
- Only certain distributions are "frankable" – the basic requirement is that the profits being distributed must have been taxed at company level
- Thus "franked" distributions are "after-tax" distributions
- Only a "franked" distribution gives an entitlement to a tax credit for the shareholder

INSTITUTE OF PUBLIC ACCOUNTANTS

Simplified Imputation System (continued)

- A shareholder who receives a franked dividend must "gross-up" the dividend amount before including it in his/her AI
- "grossed-up" amount = dividend received + amount of "imputed tax paid"
- Shareholder is entitled to a "franking credit" equal to the amount of "imputed tax paid"

INSTITUTE OF PUBLIC ACCOUNTANTS

Franking Rules

- Companies can frank to any percentage – benchmark rule
- Benchmark Rule - all dividend must be franked to same percentage during income year
- Penalty for breach - franking percentage differential - to stop companies retaining franking credits

INSTITUTE OF PUBLIC ACCOUNTANTS®

Franking Account

- Credits from PAYG instalments
- Pays income tax - credit
- Receives a fully franked dividend – credit for franking attached to dividend
- Debit from using franking credits
- Franking deficit tax

INSTITUTE OF PUBLIC ACCOUNTANTS®

Anti-Avoidance Measures

- Part IVA, ITAA 36 - tax avoidance
- Cannot trade franking credits or stream dividends
- 45 day holding period - must hold shares at risk for more than 45 days in order to claim franking credits and 90 days for Preference shares
- De minimis rule – 45 day (90 day) only applies if more than $5,000 value of tax offset claimed using franking credits

INSTITUTE OF PUBLIC ACCOUNTANTS®

Deemed Dividends – Division 7A

- If private company pays amount to associated person or makes loan or forgives debt that associated person has with company, amount is deemed to be dividend (Division 7A)
- Consequence of Div 7A application - recipient of amount is deemed to have received an unfranked dividend, i.e. is not entitled to franking credit
- New changes re using of company assets
- ATO Ruling TR 2010/3 re Trust UPEs
- Board of Taxation (BOT) recommendations to improve effectiveness of Div 7A
- Federal budget 2016 – Government undertaking to adopt BOT recommendations

INSTITUTE OF PUBLIC ACCOUNTANTS®

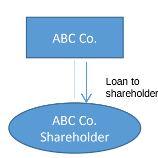
Deemed Dividends – Div 7A

- Definition of loans includes provision of financial accommodation

- Note exception to div 7A for loans that comply with s 109N ITAA 36
  - In writing
  - Interest rate over benchmark rate (5.20% for year commencing 1 July 2018: TD 2015/15)
  - Term does not exceed maximum (25 years for real property mortgage, 7 years otherwise)

Step One - Has the private company made a "loan" to an entity during the current year? (continued)

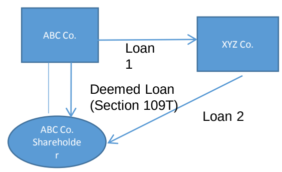
Direct loan to shareholder



- Loan can be repaid or converted to arm's length loan before tax return due date
- If not repaid or converted, loan becomes Div 7A deemed dividend

Step One - Has the private company made a "loan" to an entity during the current year? (continued)

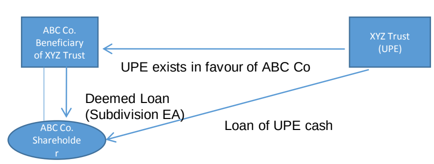
Interposed entity loans – Section 109T



- Deemed loan arises as a result of interposed entity loan
- Deemed loan is repaid or converted to arm's length loan before tax return due date
- If not repaid or converted, deemed loan becomes Div 7A deemed dividend

Step One - Has the private company made a "loan" to an entity during the current year? (continued)

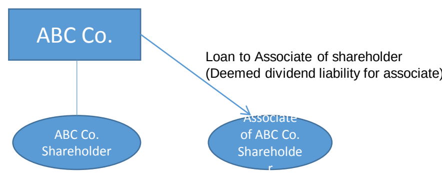
Interposed entity loans – Section 109UB / Subdivision EA



- Deemed loan arises due to UPE in XYZ Trust and loan to ABC Co. shareholder
- Deemed loan is repaid or converted to arm's length loan before tax return due date
- If not repaid or converted, deemed loan becomes Div 7A deemed dividend
- With effect from 1/7/09 interposing additional trust(s) to separate the UPE holder and lender of loan will not avoid the operation of Subdiv EA

Step Two - Is the entity to which the loan has been made a shareholder or associate of a shareholder?

- Div 7A applies to loans for current or past shareholders if reasonable to assume loan is made because of shareholding relationship
- Div7A does not apply to loans for future shareholders
- Loan to associate imposes Div 7A liability on associate not shareholder



Step Two - Is the entity to which the loan has been made a shareholder or associate of a shareholder? (continued)

- An associate of an individual includes:
  - relative of individual;
  - partner of individual;
  - trust where individual, or an associate benefits under the trust; and
  - company in which individual (either alone or together with associates) holds a majority voting interest.

- An associate of a trust includes:
  - entity that benefits under the trust; and
  - entity which is an associate of another entity which benefits under the trust.

- An associate of a company includes:
  - partner of the company or a partnership in which the company is partner;
  - trust where company, or an associate of company, benefits under the trust; and
  - entity which holds a majority voting interest in the company (either alone or together with associates).

Deemed Dividends – Div 7A

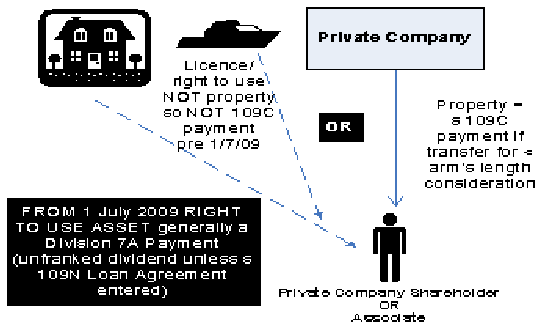
- The amount of a particular Div 7A dividend is proportionately reduced if the total of all Division 7A dividends taken to be paid by the private company for the income year exceeds the “distributable surplus” of the company for that year - s 109Y
- Distributable surplus = Net assets + Division 7A amounts − Non-commercial loans − Paid-up share value − Repayments of non-commercial loans
- The Commissioner has a discretion to substitute a different amount where the net assets are significantly undervalued or overvalued. In exercising this discretion, the Commissioner can take into account the value of the company’s assets not shown in the company’s accounting records (TD 2009/5)

*Division 7A Payments - H*as the private company made a payment to an entity during the current year?

Section 109C(3) provides that "payment" means:

- a payment to the extent that it is to the entity, on behalf of the entity or for the benefit of the entity;
- a credit of an amount to the extent that it is:
  - to the entity; or
  - on behalf of the entity; or
  - for the benefit of the entity; and
- a transfer of property to the entity
- Deemed payments through interposed entities
- Trust payments under Subdivision EA
- Payments are convertible into loans from 1 July 2006.
- From 1/7/09 use of assets are treated be Div 7A payments

Step One - Has the private company made a payment to an entity during the current year? (continued)



Step One - Has the private company made a payment to an entity during the current year? (continued)

Use of company assets by shareholders/associates – Exclusions:

- $300 minor benefit exclusion
- Business real property exclusion
- Main residence exclusion
- “Otherwise deductible” exclusion

Div 7A Update - TR 2014/5

- When a private company pays money or transfers property to satisfy a court order in matrimonial property proceedings, the Ruling states
  - **Money or property to be paid or transferred to a shareholder** - to the extent paid out of the private company profits and is an ordinary dividend, it is assessable income of the shareholder under s 44
  - **Money or property to be transferred to an associate of a shareholder** - the payment of money or transfer of property is a payment for the purposes of s 109C(3). In addition, s 109J does not prevent the payment from being treated as a dividend under s 109C(1)
  - **Dividends frankable** – payments that amount to ordinary dividends are frankable. Where dividend is taken to be paid to an associate of a shareholder under s 109C is franked, that associate is treated as being a shareholder

INSTITUTE OF PUBLIC ACCOUNTANTS®

R & D Incentive

- Eligibility
  - Registered for R&D activities with AusIndustry
  - Notional deductions over $20,000 from
    - expenditure on R&D and/or
    - decline in value of tangible depreciating assets used in R&D
- Incentive
  - 43.5% refundable tax offset where aggregated turnover < $20m
  - 38.5% nonrefundable tax offset where aggregated turnover > $20m
- These rates now only apply to R&D expenditure up to $100m – R&D expenditure in excess of $100m will be subject to a tax offset at the company rate (currently 30%).

INSTITUTE OF PUBLIC ACCOUNTANTS®

Tax Consolidation

- Introduced where a group of companies
- To reduce compliance costs - one tax return, BAS, and PAYG instalment payments
- Intra-group transactions ignored
- Losses, franking credits and foreign tax credits pooled
- Utilisation of joining entity losses subject to “available fraction”
- CGT not applicable in moving assets, shares
- Potential to step-up cost base of joining entities’ assets

BUSINESS STRUCTURE					
	Sole trader	**Partnership**[1]	**Discretionary trust**	**Unit trust**	**Private company**
Understandability	High	Medium	Medium/low	Low	Low/medium
Set-up costs	Low	Low	Medium	Medium	Medium/high
Record-keeping requirements	Yes and onerous substantiation provisions	Yes - onerous substantiation provisions	Yes, but substantiation rules do not apply	Yes, but substantiation rules do not apply	Yes, but substantiation rules do not apply
Liability for debts	Sole trader personally liable	Partners jointly severally liable	Trustee may be liable	Trustee may be liable	Ordinarily limited to the company
Income streaming	No	No	Usually – see the trust deed	No	Yes, subject to the dividend and capital streaming rules
Utilisation of losses	Offset against individual's income from other sources	Losses reduce partner's other income	Losses offset against future trust income	Losses offset against future trust income[2]	Losses offset against future company income[2]
Super contributions	Deductible but subject to caps	Deductible but subject to caps	Deductible to employer but counts towards employee's cap	Deductible to employer but counts towards employee's cap	Deductible to employer but counts for employee's cap

CGT on sale of assets	CGT payable by individual	Partners liable	Beneficiaries liable	Beneficiaries liable	Gains taxed in the company's hands at the company rate
Distribution of CGT indexation amounts or other CGT exemptions	Not applicable	No distribution required.	Subject to trust deed - amounts may free	Subject to trust deed.- it reduces unit's cost base	Distribution is a dividend. Limited flow-through of CGT exemptions.
CGT retirement exemption	Yes	Yes	Yes - check the "significant individual" requirements	Yes, but check the "significant individual" requirements	Yes, check the "significant individual" requirements
CGT rollover relief	To a company	To a company	To a company	To a company[2]	To another company[2]
CGT small business rollover relief	Yes	Yes	Yes	Yes	Yes

INSTITUTE OF PUBLIC ACCOUNTANTS

Conclusion

Wrap up
Questions

INSTITUTE OF PUBLIC ACCOUNTANTS

NSW/ACT DIVISION
Level 10, 210 George Street
Sydney NSW 2000 Australia
T +61 2 8262 6000
F +61 2 9251 5201
E nswdivn@publicaccountants.org.au
PUBLICACCOUNTANTS.ORG.AU

Thank you