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Trust Entitlements and Loans: Tax Office Issues Guidance

The Tax Office has released its keenly awaited guidance on the tax treatment of trust entitlements and loans. The guidance, known as a practice statement, explains how the Tax Office will apply its ruling on when a private company with an unpaid present entitlement makes a loan to the trust estate which generated the entitlement. The Commissioner of Taxation said he was aware of the importance of this issue to businesses, particularly small businesses, which use a trust structure.

The Commissioner said the practice statement provides practical ways for businesses to work towards a compliant structure with minimal impact on their cash flows or how they operate. He said that where businesses had made mistakes in the past, the practice statement provides several options for private companies to self-correct.

TIP: The opportunity to self correct is available for a limited time only. Please contact our office if you think you may be affected.

Tax Office Highlights Common PAYG Instalment Errors

The Tax Office has been calling selected business operators in the \$2 million to \$100 million annual turnover range to discuss instances where the pay-as-you-go (PAYG) instalment amount received for the quarter under review is significantly different to the PAYG instalment amount received in a previous quarter.

The Tax Office has noted common errors that preparers make when completing PAYG instalment details on business activity statements – for example, instalment income amounts being adjusted rather than instalment rates varied.

TIP: if you are experiencing difficulty with correctly completing your instalment activity statements, please contact our office.

SMSFs and Private Companies Investing in Trusts: Tax Office Warning

The Tax Office has warned self-managed super funds (SMSFs) not to invest in trusts with the intention of making funds available for lending to members. The warning comes in a taxpayer alert which describes an arrangement where an SMSF invests money in an unrelated trust that then on-lends the funds to an SMSF member or relative. The Tax Office says such arrangements attempt to circumvent strict rules prohibiting SMSF trustees from lending money or providing financial assistance to a member or a relative using the resources of the fund.

In another similar taxpayer alert, the Tax Office warned private companies against investing in trusts with the intention of making funds available for lending to shareholders. The taxpayer alert describes an arrangement where a private company invests funds in an unrelated trust that then on-lends the funds to a shareholder or an associate of a shareholder. The Tax Office warns the arrangement may be an attempt to circumvent tax rules which are aimed at preventing private companies from making tax-free distributions of profits to shareholders or their associates.

Self-education Expenses for Youth Allowance Recipient Deductible

The High Court unanimously dismissed the Commissioner of Taxation's appeal and held that a taxpayer was entitled to a deduction for expenses incurred in deriving income from receiving Youth Allowance. The Full Federal Court had previously dismissed the Commissioner's appeal and held that self-education expenses incurred by the taxpayer in deriving Youth Allowance were allowable deductions.

Declaration of Trust over Land Sold, so No Personal Tax Liability

A taxpayer has been successful in obtaining a declaration from the Supreme Court of Western Australia that a valid trust had been created over a property he had originally bought in 1990 under his own name. The trust had been declared in favour of a family trust at the time of the land's subdivision five years later. As a result, the Commissioner of Taxation could not argue that the taxpayer was personally liable for capital gains tax on one of the lots sold in 2006. Instead, the profit had been included in the family trust's tax return in that year and had been offset by the trust's carried forward losses.

Subsidy Paid for Loss-making Contracts Assessable as Income

In a recent case, the Administrative Appeals Tribunal ruled that a taxpayer in the waste disposal business was assessable on a "subsidy" paid to it by a competitor in connection with the taxpayer assuming unprofitable waste disposal contracts that it acquired from the competitor under an agreement. Even though the transaction was a one-off, the Tribunal found it was assessable as ordinary income as the agreement was entered into in the ordinary course of the taxpayer's business with a view to making a profit.

Employing your Spouse? Ensure There's an "Employment Relationship"

Two recent cases before the Administrative Appeals Tribunal dealt with the scenario of a husband employing his wife to assist with looking after rental properties. The question before the Tribunals was whether there was a "genuine employment relationship". As the two cases show, if it is found that there was no employment relationship in the circumstances, the taxpayer would not be entitled to deductions for salary or wages, fringe benefits, and superannuation contributions paid in relation to "employing" the spouse. Rather, the outgoings would be considered to be private or domestic in nature.

TIP: it is not against the law to employ your spouse. However, the arrangement must be genuine and this requires examining the totality of the relationship when characterising it. As demonstrated by the cases, one cannot transform an existing domestic relationship simply by calling it a different name, or by adopting some aspects of an employment relationship.

Increasing Adjustments in BASs as Debts Remain Unpaid

In another case, the Administrative Appeals Tribunal held that three taxpayers were required to reverse earlier claims for input tax credits in their later Business Activity Statements. As the taxpayers accounted for GST on an accruals basis, the credits were attributed to the tax period in which the tax invoices were received. However, those invoices remained unpaid after 12 months. Under the GST legislation, if an invoice remains outstanding after 12 months, a recipient is required to reverse any input tax credits previously claimed. The Tribunal noted there was little evidence of the invoices being paid, and therefore affirmed that the taxpayers had an increasing adjustment.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.