



2011



NEWSLETTER

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SPECIAL BONUS ISSUE

BUDGET ANNUAL REVIEW

EACH MAY THE AUSTRALIAN GOVERNMENT BRINGS OUT NEW CHANGES AND OPPORTUNITIES FOR OUR SUBSCRIBERS. IN THIS "SPECIAL" BONUS EDITION WE BRING YOU THE ECONOMIC OUTLOOK, ALL THE KEY HIGHLIGHTS AND WHAT IT MEANS TO YOU!

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KEY HIGHLIGHTS

- No Changes To Personal Income Taxes Except The One Off Impact Of The Flood Levy
- Removal Of The Low Income Tax Offset For Minors On Earned Income
- Changes To Fringe Benefits Tax Treatment Of Motor Vehicles
- Dependent Spouse Tax Offset Phased Out
- Reforms For Charities
- More Help For Australian Small Business
- Improving Tax Fairness And Compliance
- Superannuation Changes

TAX FORUM IN OCTOBER TO BUILD ON REFORM AGENDA

On two days in October, the Government looks forward to hosting approximately 150 representatives of community groups, businesses, unions, and governments, as well as academics and tax practitioners, at a forum to discuss ways to build on the ambitious tax reform agenda.

The Tax Forum will be held at Parliament House in Canberra on Tuesday 4th October and Wednesday 5th October. More details will be announced and invitations will be issued in the coming months, and a discussion paper will be released in the middle of the year to help foster the debate.

The Government is implementing a substantial tax reform agenda to strengthen and broaden the economy, and maximise the opportunities of the mining boom by cutting small business taxes, boosting super and building more regional infrastructure.

The forum will continue the decade-long conversation started with the release of Australia's Future Tax System (AFTS) Review last year. It will focus on the broad sweep of topics in the Review, with sessions to discuss personal tax, transfer payments, business tax, state taxes, environmental and social taxes, and system governance.

The Government looks forward to engaging with the community and hearing what the representatives of millions of Australians have to say about building on the ambitious tax reform agenda. Participants and the general public will also be able to make submissions and comments, which can be uploaded onto a dedicated website, prior to the Tax Forum.

The Tax Forum will assist the Government in prioritising an agenda for further tax reform.

In response to the AFTS Review, the Government last year announced a comprehensive plan to get a fairer return for the nation's non-renewable resources and promote growth across the economy. The Government also announced measures to simplify tax for small business and individual taxpayers, and reward savings outside of superannuation through a tax discount on interest income.

These are significant reforms, but in the years ahead Australia will continue to face important decisions to ensure our tax system shares prosperity fairly and maximises the opportunities that will flow from the growth of our neighbouring economies in this, the Asian Century.

The Tax Forum will help identify those reforms that have broad agreement across the community, and will also provide

valuable insight into the competing priorities that must be weighed against one another in a fiscally-constrained environment.

Significantly the Government has made it very clear there are parts of the AFTS Review they won't be implementing, and that the GST rate won't be increased, but a broad and constructive discussion is expected.

The Tax Forum will be followed by a debate in Parliament to give all MPs and Senators the chance to have their say on these significant issues for Australia's future prosperity.

Tax Smart Comment

We will be brief because this has been covered in past issues. In our view there is no genuine tax reform without everything being on the table.

Increasing the rate of GST while further reducing income tax is worthy of consideration. The trouble is neither side of politics has the political will to do so.

DECISION IMPACT STATEMENTS

Commissioner of Taxation V White; Commissioner of Taxation V White (No. 2)

The ATO has released a Decision Impact Statement (DIS) concerning the decisions of the Federal Court in Commissioner of Taxation V White (2010) FCA 730 and Commissioner of Taxation V White (No. 2) (2010) FCA 942.

There have been a number of these cases over the past ten years some of which we have covered. If a fat man in a loud suit ever utters the words "employee incentive share trust" our advice is to run a mile....

Possibly of more relevance if the second decision where the Court held that the Administrative Appeals Tribunal (AAT) had failed to address former section 226H of the Income Tax Assessment Act 1936, and that the taxpayer had not discharged the onus of proving that his tax agent was not reckless in filing the taxpayer's tax returns for the relevant income years. The initial penalty of 50% therefore applied. The ATO agrees with the conclusions of the Court and considers that these decisions will not have any implications on any rulings or practice statements.

Sent and Commissioner of Taxation (2011) AATA 198

Here the AAT set aside the objection decisions, finding that around \$7.2 million of an \$11.6 million payment made to a trust was assessable income of the applicant.

The application was the CEO of Primelife Corporation Limited ("Primelife"). In November 2001 the applicant's employment arrangements with Primelife were changed and his accrued, emerging and future bonus entitlements were extinguished by Primelife paying \$11.6 million to the Primelife Executive Share Trust in December 2001. The funds were consideration in the purchase of 5 million Primelife shares. It was evident that the plan was to transfer control of the trust to the applicant at the end of a deferral period.

The AAT found that around \$7.2 million of the bonus entitlements cancelled were attributed to services already provided by the applicant. Consequently this amount was assessable as income derived. The AAT did however conclude that the balance of the \$11.6 million, being in regard to future bonus entitlements, was not an amount of income that had been derived or an amount otherwise assessable.

The AAT then considered the Commissioner's argument that Part IVA of the Income Tax Assessment Act 1936 would apply in respect of the amount not otherwise assessable. The AAT held that the dominant purpose of the scheme was other than to obtain a tax benefit.

Further the AAT held that the penalty was properly assessed at the 25 per cent level for failure to adopt a reasonably arguable position in respect of the aforementioned \$7.2 million portion.

We understand that both the taxpayer and the Commissioner have lodged notices of appeal to the Federal Court against the AAT decision.

'MISREADING' LED TO TAX LAW COMPLEXITY

One of Australia's leading authorities on tax quoted extensively in the Sydney Morning Herald says tax avoidance cases have been made needlessly complicated because judges have misinterpreted the law.

Supreme Court judge Tony Pagone, a tax specialist before coming to the bench, said courts were becoming bogged down in hypothetical rather than dealing with the facts.

Significantly Tax commissioner Michael D'Ascenzo has also complained the approach taken by the Federal Court has distorted the application of part IVA of the Tax Act, which deals with anti avoidance provisions.

In a paper delivered to the South Australian convention of the Tax Institute in April, Justice Pagone traced the source of the problem to a single sentence in a 2004 High Court case called Hart.

In that judgment, High Court judges Bill Gummow and Ken Hayne held that working out whether tax avoidance was involved "requires comparison between the scheme in question and an alternative postulate".

"I think it's basically been misread," Justice Pagone said. "I think there's a different way of reading the legislation which doesn't produce the problem."

In his view the Federal Court did not reject his simpler approach to the problem.

A good example of how the current interpretation made the law more complex could be found by looking at agricultural tax avoidance schemes where investors took out loans that were far in excess of the amount of money they tipped in.

In these schemes, popular in the 1980s and '90s, the loan never actually had to be repaid but was nonetheless claimed in full as a tax deduction.

"Did I enter into that for tax avoidance? And you look at it and say, 'S--t, what else does it do apart from avoid tax?'" Justice Pagone said.

"If I want to invest in agricultural products, would we do it in that way?"

"And you look at it and say no, if I wanted to invest in cows I would have invested in cows."

"That's the way it used to be done. But with this new approach you say, if I hadn't entered into that scheme, what else would I have done?"

"And the 'what else would I have done' is a completely open-ended inquiry into anything your imagination and the facts permit."

In his paper, Justice Pagone said taxpayers "may not be able to take too much comfort" from Federal Court tax victories by AXA Asia Pacific and Noza Holdings.

"The outcome in both was achieved by complex, and to some extent (if not largely), artificial analysis about necessarily hypothetical circumstances which did not occur," he said. "The ability of the commissioner to rely upon something which did not happen would not have happened, but which nonetheless might reasonably be expected to happen be likely in the future to become a more significant Achilles heel for taxpayers."

Judges would be relying more on a "smell test" that could be "frequently disturbingly unpredictable".

We acknowledge Ben Butler's excellent article.

Part IVA causes considerable and often complex debate but Justice Pagone's comments are in our view direct and to the point.

SELF-MANAGED SUPER FUNDS INVESTING IN COLLECTABLES AND PERSONAL USE ASSETS

On 24 March 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation introduced legislation into Parliament that will allow self-managed super funds (SMSFs) to continue to invest in collectables and personal use assets provided they meet legislative standards.

The proposed amendments will ensure investments in collectables and personal use assets by SMSFs do not give rise to a personal benefit for SMSF trustees, but are held for the sole purpose of providing retirement benefits.

SMSF trustees must comply with any rules set by the regulations in relation to investments in collectables and personal use assets, in addition to the rules such as in-house assets rules that apply to some or all other assets.

This measure, if passed by parliament, will apply to all new investments from 1 July 2011 and all existing holdings of collectables and personal use assets will have until 1 July 2016 to comply with the new standards.

This measure was initially announced by the Government in the 2010 election campaign and again on 16 December 2010 as part of the 'Stronger Super' reforms.

The amendments will:

- Require a collectable or personal use asset held by an SMSF to be stored in a premises that is not owned by a related party of the SMSF
- Create penalties for non-compliance with the rules set out in the regulations.

8.4 MILLION AUSTRALIANS TO BENEFIT FROM MORE SUPER

A better return from the finite resources owned by all Australians will also help secure the financial future of 8.4 million Australian workers.

The revenues from the new resource taxation regime, announced today by Treasurer Wayne Swan, will go towards

building superannuation savings.

Assistant Treasurer and Minister for Financial Services and Superannuation, Bill Shorten, said "The Government's *Stronger, Fairer, Simpler* reforms, announced on 2 May 2010, will deliver substantial improvements in retirement savings and a fairer distribution of taxation concessions, ensuring more Australians can enjoy a comfortable retirement."

- This means an extra \$108,000 in superannuation savings at retirement, for a 30 year old worker earning \$65,000 today.
- More retirement savings will also mean a stronger economy. The Government's reforms will provide more national savings to invest in nation-building infrastructure.
- Australia's total superannuation savings are estimated to increase to \$6.2 trillion by 2036, including \$550 billion from the Government's superannuation reforms.
- The revenue from the Mining Rent Resource Tax (MRRT) will help offset the loss of taxation revenue from increasing incentives to save through superannuation.

Mr. Shorten said;

"It is clear from the recent profit announcements by BHP Billiton (\$11 Billion), Rio Tinto (\$14 billion) and other big miners that the time is right for the MRRT, which taxes the enormous profits of those companies - profits made by digging up the resources owned by all Australians - and gives it back to all of us through more regional infrastructure, business tax cuts and, of course, better superannuation."

"The Government's historic superannuation reforms include increasing the Superannuation Guarantee to 12 per cent from 1 July 2013. The Guarantee age limit will also rise from 70 to 75."

The Government will also contribute to the super savings of low income earners from 1 July 2012.

"We'll ensure effectively no tax is paid on super guarantee contributions made on behalf of low income earners, by providing a contribution of up to \$500 annually to individuals on adjusted taxable incomes of up to \$37,000," he said.

"As previously announced, workers aged 50 and over with superannuation balances below \$500,000 will be able to make up to \$50,000 in annual, concessional superannuation contributions."

More information on the Government's superannuation reforms is available at www.futuretax.gov.au.

TARGET GST COMPLIANCE

In the 2010 Budget, the ATO received specific funding to look closely at GST compliance, and they will be implementing a dedicated program over the next four years to deal with some specific compliance issues.

The focus will be on:

- The timely lodgement of activity statements
- Verifying GST refund claims
- Identifying and dealing with those that deliberately avoid GST
- Addressing aging GST debts and those who deliberately use debt as a way of avoiding their tax obligations.

The ATO are continuing to expand their ability to identify non-lodgers and detect businesses that over claim entitlements, deliberately under report or omit income and use cash transactions to hide income.

This is done by:

- Using a mix of pre due date SMS and letter reminders around lodgement
- Contacting taxpayers that have one or two activity statements overdue
- Increasing our focus on taxpayers that have multiple activity statement obligations outstanding
 - this includes telephony based lodgement enforcement, default assessment and in some cases, prosecution action
- Matching sales and high value transactions to activity statements and using information on asset transactions (for example in the property industry) from state revenue offices, land titles offices and share registries
- Verifying refunds by phoning or visiting businesses and contacting third parties to substantiate claims
- Taking firm action with those businesses that don't work with us or meet agreed debt arrangements
- Comparing businesses to small business benchmarks for their industry to select businesses for audit - businesses that do not report within their range may not be recording or paying tax on all their transactions, especially cash transactions
- Using benchmarks to calculate default assessments where

a business provides insufficient or unreliable information or has not met their lodgement requirements

- Using new risk filters and risk models to detect incorrect or fraudulent refund claims on activity statement credits.

For those choosing to disregard the law and work outside the tax system, there will be serious consequences including interest, penalties and potential prosecution.

The ATO aim to:

- Have better controls to protect the GST system
- Have an increased capability to detect GST fraud.

This will help ensure that businesses doing the right thing are not disadvantaged by unfair practices and that everyone pays their fair share of tax, ensuring a level playing field.

DECISION IMPACT STATEMENTS ISSUED IN APRIL 2011

Commissioner of Taxation V Gloxinia Investments Pty Ltd ATF Gloxinia Unit Trust (2010) FCAFC 46.

This Full Federal Court decision concerned the GST treatment of the sale of strata-titled home units:

- Constructed by a developer on its own account
- On lands already held by the developer by virtue of an existing long-term lease granted to the developer by a local council; and
- Whereby the developer's existing long-term leasehold interest in the land, upon completion of construction of the home units, will be converted into individual 99 year strata lot of leases.

Commissioner of Taxation V Luxottica Retail Australia Pty Ltd (2011) FCAFC 20.

This Full Federal Court decision concerned the calculation of the taxable value of spectacle frames when sold at a discounted price conditional upon the purchase of a complete pair of prescription spectacles.

International Business Machines Corporation V Commissioner of Taxation (2011) FCA 335

In this case the Federal Court found that the full amount of payments made under a software licence agreement (SLA) were royalties as defined in the US Treaty. As a result these payments were subject to royalty withholding tax.

The payments were made in the relevant years by an Australian resident IBM company (IBMA) to non-resident companies pursuant to the SLA. The ATO position was that the full amount of payments were liable to withholding tax under s128B of the ITAA 1936 as royalties pursuant to Article 12(4) of the Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the US Treaty) in Schedule 2 of the International Tax Agreements Act 1953.

The applicants argued that a portion of the payment was for distribution rights granted independently of the grant of intellectual property (IP) rights under the SLA and as such not subject to royalty withholding tax.

However, the court did not accept this concluding (at paragraph 52):

“Taking the whole of the SLA into account, it is in my view clear that the SLA grants to IBMA such IP rights as are necessary for distribution of the relevant products by IBMA. It is not a distribution agreement which confers distribution rights independently of the grant of IP rights. The detail of the SLA concerns the definition of IP and IP rights. There is no such detail with respect to distribution rights.”

As a result, all of the payments under the SLA were royalties as defined under the US Treaty and subject to withholding tax.

Commissioner of Taxation V Wentworth District Capital Limited (2011) FCAFC 42

We have covered this case in past issues and the Full Federal Court has upheld the decision of the primary judge that Wentworth District Capital Limited (WDCL) was an association established for community service purposes within the meaning of s50-10 of the ITAA 1997, meaning its income was exempt from income tax for the relevant years.

Wentworth, a town in rural NSW had for many years as its only bank, a branch of Westpac which closed in 1996. Without a bank there were adverse commercial consequences for the town and in 1998 members of the Wentworth community incorporated WDCL which entered into arrangements with Bendigo Bank Ltd with the bank provided banking services in Wentworth through premises, staff and equipment provided by WDCL.

The Commissioner submitted that although the trial judge correctly accepted that the provision of face-to-face banking for reward could not amount to a community service purpose, the trial judge erred when he held that the facilitation of WDCL of face-to-face banking for reward in these circumstances amounted to a community service.

However, the Full Court concluded that the trial judge had not erred for the following reasons:

- The main or dominant purpose for which WDCL was established was a community service
- The community service purpose was the facilitation of face-to-face banking services which provided a substantial benefit to the community.
- There was no blurring of purpose and benefit and it was a 'service'.

UNDERSTANDING TAX-EFFECTIVE INVESTMENTS

With the end of the financial year upon us, the ATO has published a timely guide. The quick checklist at the end of the guide is excellent and outlines the essentials.

- Always get independent advice from someone not associated with the investment.
- If your adviser is a tax agent, you can check they are a registered agent with the Tax Practitioners Board. Visit www.tpb.gov.au and:
 - download a current list
 - use the online search database.
- The salesperson selling you the investment must hold an Australian Financial Services licence, issued by the Australian Securities and Investments Commission (ASIC). You can check licence details free with ASIC by:
 - visiting their website at www.moneysmart.gov.au
 - phoning their info line on 1300 300 630
- By law, you must be given either a product disclosure statement (PDS) or a prospectus for the investment. If you haven't been provided with a current PDS or prospectus you should contact ASIC by:
 - email to infoline@asic.gov.au
 - phone on 1300 300 630
- ATO taxpayer alerts provide warnings about some of the tax scheme arrangements you might be offered. You can check alerts on our website at www.ato.gov.au/investing
- Many tax-effective investments have an ATO product ruling. A product ruling provides you with legally binding assurance that the tax deductions set out in the ruling will be available provided the scheme is carried out as described in the product ruling. You can find out if the scheme has a ruling by contacting the ATO on 1800 177 006 or speaking to an independent tax adviser.