NEWSLETTER 2011

Tax IQ

TAX PLANNING UPDATE

- Further Reforms To GST Grouping Rules
- Exposure Draft Released: Minor Amendments To Tax Laws
- Clarifying GST Rules Around Residential Property
- Self Managed Super Funds Can Still Invest In Collectables And Personal Use Assets
- Internet Trading Project For Small-To-Medium Enterprises
- Bookkeeping Fraud On The Rise
- Lump Sum Accrued Leave Entitlements Not Paid Under Pre-Existing Salary Sacrifice Arrangement – Heinrich And Commissioner Of Taxation (2011) AATA 16
- Appeals Update:
  - Mini Ciabatte Is a Cracker for GST Purposes
  - Amended Assessments Arising From Illegally Obtained Information Still Valid Assessments
- ATO Warning – Identity Crime And Fraudulent Tax Returns
- SMSF Regulation – The ATO Is Targeting Loans And In-House Assets
- GST Compliance
- Tax Certainty For Trusts Is Good News For Business
- Burning the Midnight Oil...
  - Work-Related Expenses and the Adult Industry
- The Pendulum Has Swung
- Scams Continue
- Tax Smart Questions and Answers

PLUS

BONUS ISSUE

CAPITAL GAINS TAX – MINIMISATION STRATEGIES

THESE TIPS WILL HELP BUSINESS OWNERS AND INVESTORS SAVE HUNDREDS – IF NOT THOUSANDS OF DOLLARS. THIS ISSUE COVERS "WHATS NEW" IN 2011 RELATING TO ATO INTERPRETIVE DECISIONS, TRUSTS, SMALL BUSINESS, DECEASED ESTATES TRICKS AND TRAPS, DEVELOPERS AND MUCH, MUCH MORE!...........

ISSUE # 0050

GET SMART WITH TAX SMART...

CONTENTS

NEWSLETTER
TAX PLANNING UPDATE

- Further Reforms to GST Grouping Rules 2
- Exposure Draft Released: Minor Amendments To Tax Laws 2
- Clarifying GST Rules Around Residential Property 2
- Self Managed Super Funds Can Still Invest In Collectables and Personal Use Assets 3
- Internet Trading Project For Small-To-Medium Enterprises 3
- Bookkeeping Fraud on the Rise 3
- Lump Sum Accrued Leave Entitlements Not Paid Under Pre-Existing Salary Sacrifice Arrangement 4
- Appeals Update 4
- ATO Warning - Identity Crime and Fraudulent Tax Returns 5
- SMSF Regulation - The ATO Is Targeting Loans and In-House Assets 5
- GST Compliance 6
- Tax Certainty for Trusts Is Good News for Business 6
- Burning the Midnight Oil 7
- The Pendulum Has Swung 7
- Scams Continue 7
- Tax Smart Question and Answers 8

PLUS

BONUS ISSUE
CAPITAL GAINS TAX - MINIMISATION STRATEGIES

- Share Transactions 12
- Characterise Your Gains 12
- Share Traders 12
- Crystallising Capital Losses and Wash Sales after Partial Recovery in the Stock Market 12
- Transferring Shares or Business Real Property into A SMSF 13
- CGT Issues For Beneficiaries - Asset Disposal 13
- Super Is Super 14
- Dealing with Large Capital Gains 14
- Family Members and the Sole and Principal Residence 14
- Small Businesses Concessions 15
- Improved Access to CGT Small Business Concessions 18
- The Accidental Developer - A Really Fine Line 19
- You're Stuck In Bad Company 20
- New Australians and CGT 20
- Trust in Trusts 21
- One Good Deed 21
- Timing Is Everything 21
- Halving Tax on Shares 22
- Maintaining CGT Records 22
- Increased ATO Focus on Losses 23
- If You Have To Pay The Capital Gains Tax - Pay It And Be Done With It! 23
- ATO Interpretative Decisions Released in the Last 12 Months 23
- Deceased Estates - CGT Basics 24
- House Swapping 24
- Unit Trusts And CGT Event E4 25

FURTHER REFORMS TO GST GROUPING RULES

On 20th January, 2011 Assistant Treasurer, Bill Shorten, released draft legislation to make further reforms to the goods and services tax (GST) grouping rules.

According to Mr Shorten;

- The measures in the draft legislation will result in more principle based and simple GST grouping rules and allow GST grouping of non operating holding entities, thus reducing compliance costs for businesses;.
- These changes also clarify that specific contribution amounts, calculated under an indirect tax sharing agreement must, if requested, be provided to the Commissioner of Taxation;
- The measures are to apply from 1st July, 2011;

Public consultation on the legislative design of these measures was undertaken in 2009. A number of changes were made following stakeholder feedback including:

- Grandfathering of the existing GST grouping membership rules until 1 July 2012 to assist entities in transitioning to the new principle-based rules

- Expanding the scope of the non-operating holding companies measure to also include non operating holding trusts.

“These measures build on the first tranche of reforms to the GST grouping rules that became effective from 1 July 2010 and which greatly increased the flexibility for entities to group," Mr Shorten said.

The draft legislation and explanatory memorandum is available at www.treasury.gov.au and consultation closed on 16th February, 2011.

EXPOSURE DRAFT RELEASED: MINOR AMENDMENTS TO TAX LAWS

On 28 January, 2011, Treasury released for public comment an exposure draft and draft explanatory memorandum containing proposed minor amendments to the taxation laws.

The amendments seek to ensure the law operates as intended, by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. The amendments also include minor improvements to the tax laws. Some of the amendments address issues raised through the Tax Issues Entry System (TIES).

More significantly amendments include:

- Ensuring that the temporary resident provisions in Subdivision 768-R of ITAA 1997 operate as originally intended,
- Providing the Commissioner of Taxation with a discretion to extend the main residence exemption from CGT, and
- Allowing the nomination of controllers of discretionary trusts for the purposes of the CGT small business concessions.

The closing date for submissions was Friday 18th February, 2011.

CLARIFYING GST RULES AROUND RESIDENTIAL PROPERTY

The Commonwealth Government has moved to clarify how residential property is treated under the GST, following a Full Federal Court decision last year that found GST was not payable on the full value added to premises by developers in some circumstances.

On 27th January, 2011 the Assistant Treasurer, Bill Shorten, announced the Government will amend the GST law to ensure that it achieves the intended policy outcome for the GST treatment of residential premises. He also released a discussion paper on the design of the proposed amendments for public comment.

The Court found in *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46 that the sale, by developers, of newly constructed residential premises that had been subject to development lease arrangements, were input taxed when sold to home buyers and investors.

The Court's decision also means that, in some cases, the sale of newly constructed strata-titled residential premises will be input taxed rather than taxable. In addition, applying the decision in other circumstances may result in existing residential premises that have previously been sold being treated as taxable rather than input taxed.

According to Mr Shorten:

- The GST provisions dealing with real property were designed to ensure that GST is payable on the full value added to land once it enters the GST system. It was also designed to ensure the sale of newly constructed residential premises by GST-registered builders and developers are subject to GST,
- These amendments will restore the policy intention, safeguard revenue and provide certainty for stakeholders,
- The amendments will ensure that new residential premises constructed under development lease

arrangements since 3 October 2007 are treated as taxable supplies, rather than input taxed supplies, where the premises are sold by developers to home buyers or investors. This amendment will contain a transitional provision to ensure that taxpayers who have entered into arrangements on a basis consistent with the Court's findings, prior to this announcement over newly constructed residential premises, are not disadvantaged,

- From 1 July 2000, the amendments will ensure that the granting of individual strata lot leases over newly constructed residential premises is not sufficient by itself to make future supplies of the premises input taxed. Therefore, the subsequent sale of the newly constructed strata-titled premises will be taxable supplies of new residential premises,
- Also from 1 July 2000, any change in property title arrangements, such as the subdivision of surrounding land or registration of a strata plan title over existing residential premises, will not result in the premises once again becoming new residential premises and being subject to GST if they are subsequently sold.

Copies of the discussion paper can be obtained from the Treasury website www.treasury.gov.au.

SELF MANAGED SUPER FUNDS CAN STILL INVEST IN COLLECTABLES AND PERSONAL USE ASSETS

Self Managed Superannuation Funds (SMSF) will continue to be allowed to invest in collectables and personal use assets like artwork or stamps, provided they are held in accordance with tightened legislative standards.

On 1st February, 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation, Bill Shorten MP, released draft legislation that will allow the Government to make regulations about how SMSFs can make, hold and realise investments in collectables and personal use assets.

Significantly in last Federal Election both sides of politics made election commitments to allow people with self-managed super funds to continue to invest in art and other personal use assets.

According to Mr Shorten:

- The Government is tightening the rules, so people can't claim they are, for example, 'collecting' high-end sports cars, paying reduced tax and then actually driving around in those vehicles;
- The new rules will ensure these investments do not give rise to a personal benefit for SMSF trustees, but rather are held for the purpose of providing retirement benefits;
- Associated draft regulations that set out the rules that will apply to SMSF investments in collectables and personal use assets will be released for public comment following consultation with relevant stakeholders on their design; and
- This measure forms part of the Government's 'Stronger Super' reform package. Further information on these reforms, as well as the draft Bill and associated explanatory material, is available at strongersuper.treasury.gov.au.

INTERNET TRADING PROJECT FOR SMALL-TO-MEDIUM ENTERPRISES

During February and March 2011, the ATO will be contacting tax agents and business contacts of companies and trusts where both of the following apply:

- Who are in the $2 million to $100 million annual turnover market
- Who have indicated in their 2009 income tax return that they sold goods or services via the internet

The ATO will call to obtain information from entities trading through the internet - specifically those trading on the internet with international entities. In particular, the ATO wishes to find out more about the nature and purpose of their internet trading. This includes:

- The main countries with which they trade
- The payment and delivery methods they use
- The type of goods and services they trade in
- The percentage of their total income that is derived from internet trading.

This information will help the ATO establish how effective the internet trading label on the income tax return is.

This survey is not part of the ATO's data matching program.

BOOKKEEPING FRAUD ON THE RISE

The Association of Accounting Technicians (AAT) issued a media release on 28th January, 2011 highlighting the need for business owners to ensure the bookkeeper they engage is ethical and appropriate.

Business owners are urged to require the bookkeeper they engage to do their account keeping to be registered as a BAS agent under the Tax Agent Services Regime.

An additional qualification is that the bookkeeper is also a member of a professional account keeping association such as the AAT. The AAT was established in Australia in 2002 and

is supported by the major accounting bodies which include the Institute.

LUMP SUM ACCRUED LEAVE ENTITLEMENTS NOT PAID UNDER PRE-EXISTING SALARY SACRIFICE ARRANGEMENT - HEINRICH & COMMISSIONER OF TAXATION (2011) AATA 16

The AAT affirmed a private ruling that a lump sum received in regard to accrued annual and long service leave entitlements could not be treated for taxation purposes as if it had been paid under a pre-existing salary sacrifice arrangement.

The applicant resigned from his employment for medical reasons. His entitlements to accrued annual and long service leave for his years of service were paid out to him as a lump sum. Five years before resigning, the applicant had entered into a salary sacrifice agreement to forgo part of his salary to make superannuation contributions but this arrangement did not include annual and long service leave entitlements.

Later after accepting the lump sum payment, the applicant sought a private ruling that the entitlements paid to him were not part of his assessable income on account of being covered by an effective salary sacrifice arrangement did not include annual and long service leave entitlements.

Later after accepting the lump sum payment, the applicant sought a private ruling that the entitlements paid to him were not part of his assessable income on account of being covered by an effective salary sacrifice arrangement. However, the AAT held that the applicant had in fact received the payout of his unused leave entitlements such that s83-10 and s83-80 of the ITAA 1997 were attracted at that time, triggering taxation in accordance with the operation of those provisions.

APPEALS UPDATE

Mini Ciabatte is a cracker for GST purposes - Lansell House 1999: Lansell House Pty Ltd v FCT (2011) FCAFC 6 (Full Federal Court; Bennett, Edmonds and Nicholas JJ

We covered this case last year when it was heard by the Federal Court.

On 31st January, 2011 the Full Federal Court dismissed the taxpayer's appeal from the decision of Sundberg J, who held that a product known as Mini Ciabatte was a "cracker" within item 32 of Clause 1 of Schedule 1 to the GST Act 1999. Given the cracker finding (as opposed to bread), it is not GST-free as a "food" within s38-2 of the GST Act.

Amended Assessments Arising From Illegally Obtained Information Still Valid Assessments - Kevin Denlay V Commissioner of Taxation (2010) FCA 1434; Mirja Denlay V Commissioner of Taxation (2010) FCA 1435

In December the Federal Court (Logan J) dismissed the taxpayers' appeal and held that amended assessments raised by the Commissioner, based on information obtained by a third party illegally, were nonetheless valid assessments, and not tainted with jurisdictional error due to conscious maladministration of the Income Tax Assessment Act 1936 (ITAA 1936), Income Tax Assessment 1997 (ITAA 1997) and the Taxation Administrative Act 1953.

A third party had obtained the source documents illegally and based on this information the Commissioner had issued to the taxpayers notices of amended assessments for the 2002 to 2007 income years. The information leading to the assessments was obtained by ATO officer whilst overseas from a Mr Kieber, formerly employed by the LGT Group in Liechtenstein. Mr Kieber unlawfully copied the information in violation of Liechtenstein privacy laws.

The use of the stolen information by ATO officers was said by the taxpayers to be in contravention of s400.9 of the Criminal Code 1995. On that basis, it was alleged, the Commissioner's use of the information in the process of assessment was impermissible under ITAA 1936 and constituted conscious maladministration as described in FCT v Futuris Corporation Ltd (2008) HCA 32, claiming that each of the amended assessments should be quashed.

The taxpayers' submissions were rejected. It was held that s400.9 must be read subject to s10.5 of the Criminal Code, which provides that a person is not criminally responsible for an offence if the conduct constituting the offence is justified or excused by or under a law. Reference was made to s26 ITAA 1936 which, it had been said, "makes lawful that which would otherwise be unlawful" FCT v Australia and New Zealand Banking Group Ltd (1979) HCA 67.

Key extracts from the judgement include:

Para 94: "What s 263 does is to make lawful conduct which would otherwise be unlawful under Australian law. The potential for a source of information to be abroad casts light upon what Parliament must have intended by the "universal expression" of the access (s 263) and breadth of assessing information base (s 166) stated in the ITAA36 which Parliament intended the Commissioner to enjoy for the purposes of that Act and the ITAA97. For the purposes of Australian law, the Commissioner is intended to enjoy full and free access for the purposes of the ITAA36 and the ITAA97 abroad also. That this expression of Australian parliamentary intent would afford

the Commissioner no defence in a foreign court under a foreign law in respect of a trespass is no reason in an Australian court to read down the generality of language of the section in terms of its effect under Australian law. That the information which comes into the Commissioner's possession may have its origin in a secret numbered account, perhaps protected by foreign secrecy laws or other foreign criminal sanctions is nothing to the point so far as the Commissioner is concerned in the making of an assessment. That is the purpose revealed by considering the width of income which falls for assessment and the intended access and information base Parliament intends the Commissioner to enjoy for the purposes of administering our income tax legislation."

Para 96: "It seems an unlikely intended result, again when one has regard to the breadth of what constitutes assessable income for Australian income tax law, the breadth of access and assessing information base intended and what would or could be the fate of the proceeds if there were a contravention, that Parliament ever intended that s 400.9 would operate in a way that the Commissioner or any other Commonwealth officer would commit a federal offence if he or she received abroad from a foreign source information relevant to the making of an Australian income tax assessment, even in circumstances where it was reasonable to suspect that this information was the proceeds of a foreign indictable offence. Absurd results in the construction of statutes are to be avoided. Were it necessary, and, in light of the conclusion which I have reached having regard to income tax legislation alone it is not, I would on this additional basis find that there was no contravention of s 400.9 proved because that section did not, in the circumstances, have any relevant application to the Commissioner and his officers from the very moment the LGT documents were received from Mr Kieber until the making of the assessment."

The taxpayers' applications were dismissed: Kevin Denlay v FCT (2010) FCA 1434 (Federal Court, Logan J, 17 December, 2010).

ATO WARNING - IDENTITY CRIME AND FRAUDULENT TAX RETURNS

Identity crime is a serious problem in Australia. The Australian Bureau of Statistics estimates that identity crime costs the economy over $1 billion per year.

Evidence suggests that tax agents are being used to unknowingly lodge fraudulent income tax returns on behalf of clients - both living and deceased - whose identities have been stolen, borrowed or brought.

This year the ATO has expanded their use of risk models to have detected potentially overstated or fraudulent claims for refunds which has added two days to the processing time for all returns. As of 14th November, the ATO had identified over 25,000 returns worth more than $113 million that believed to be potentially fraudulent or include overstated refund clams. These figures include nearly $26 million in claims that are potentially related to identity crime. Last year 93% of returns stopped for further review were confirmed to be over-claimed or fraudulent.

Tax Agents have been advised that if they notice suspicious behaviour from a new client, it is recommended they take extra precautions to ensure such clients are legitimate, by:

- Confirming their identity by conducting proof of identity checks
- Checking any irregularis with their employer - for example, that they issue hand written payment summaries to their employees.

If the tax agent can't confirm the client's claims are authentic, they are advised to decline to prepare or lodge the person's tax return.

TARGETING LOANS AND IN-HOUSE ASSETS

An integral part of the regulatory framework for self-managed super funds (SMSFs) is that every fund must be audited annually and approved auditors must lodge an auditor contravention report (ACR) where appropriate.

In selecting cases for audit this year, the ATO will focus on funds with repeated contraventions around loans and in-house asset (IHA) rules.

Contraventions around loans to members or financial assistance will feature heavily in the tax office's ACR compliance work. For a payment of money to a member to be considered a loan, there must be an intention by both parties at the time of payment that the money will be repaid. Where the ATO find that an early access breach has occurred, in addition to any action the ATO takes against the fund, the trustee (or trustees) will be assessed personally for the amounts and may incur a tax liability.

Breaches of IHA rules will also feature prominently in the ATO's program this year. In following up past reports of IHA rule breaches, the ATO has found in most instances that trustees have effectively been using their retirement benefits to support related businesses and are clearly exceeding the 5% limit. A significant number of the funds the ATO classified as non-compliant last financial year had breached IHA rules. Classifying a fund as non-compliant is not a decision the ATO takes lightly.

Non-complying funds lose access to concessional tax treatment and are taxed at the highest marginal tax rate

(currently 45%). Also the ATO taxes their total assets (less any member contributions for which no tax deduction has been claimed) at the highest marginal tax rate. The ATO continues to tax them at this higher rate until they reinstate their complying status.

For more information, refer to In-house asset and transitional rules.

GST COMPLIANCE

On 8th February, the ATO announced they were targeting GST compliance.

In the 2010 Budget, the ATO received specific funding to look closely at GST compliance, and will be implementing a dedicated program over the next four years to deal with some 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 will be 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 the 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 and share registries,
- Verifying refunds by phoning or visiting businesses and contacting their parties to substantiate claims,
- Taking firm action with those businesses that don't work with the ATO or meet agreed debt arrangements,
- Comparing businesses to small business benchmarks for their industry to select business 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 result of efforts will be:

- Better controls to protect the GST system,
- An increased capability to detect GST fraud.

The intention is 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.

TAX CERTAINTY FOR TRUSTS IS GOOD NEWS FOR BUSINESS

The federal government's review into the taxation of trusts is the most significant attempt at trust tax reform in the last decade, according to the Institute of Chartered Accountants in Australia (the Institute).

“A review into the taxation of trusts is a courageous and important move by the federal government,” said the Institute's Tax Counsel, Yasser El-Ansary, following the Assistant Treasurer's announcement today.

The Institute called for a review into the taxation of trusts in its January 2010 pre-budget submission and the report into Australia's Future Tax System made the same recommendation in May 2010.

“The taxation of trusts is a highly complex area of the law, but because there are more than 400,000 trusts across Australia - particularly in the small to medium-sized enterprises market segment - any uncertainty that prevails in this area for extended periods of time can have a widespread and damaging impact on the activities of numerous businesses,” Mr El-Ansary said.

Mr El-Ansary said a major overhaul of the taxation of trusts is necessary in order to restore confidence and provide certainty to millions of Australian taxpayers, their advisers and the Australian Tax Office.

“The process outlined by the government strikes the right balance between addressing immediate priorities and preparing for longer-term structural reforms aimed at resolving a number of contentious issues which have arisen