

HALL CHADWICK 

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1 INCOME TAX pg 2

- 1.1 Changes in company tax rate: ATO compliance approach for FY2016, 2017 and 2018
- 1.2 Single Touch Payroll: ATO writing to employers
- 1.3 ATO attacks trust splitting: TD 2018/D3
- 1.4 PCG 2018/3: ATO finalises guidance on its compliance approach to determining private use of cars
- 1.5 Rus v FCT: Largely vacant land not an active asset
- 1.6 TD 2018/3: Application of Division 7A to loans by private company through interposed entities
- 1.7 Motor vehicle expenses: Set rate per kilometre

1 INCOME TAX

1.1 Changes in company tax rate: ATO compliance approach for FY2016, 2017 and 2018

Draft PCG 2018/D5 was issued on 25 July 2018, and sets out the ATO's compliance and administrative approach for corporate tax entities that have faced practical difficulties in determining their corporate tax rate for imputation purposes in FY2016, FY2017 and FY2018.

By way of background, the following reduction in tax rate was applicable in each year:

- 28.5% applied in FY2016 to small business entities that were carrying on a business with aggregate turnover of <\$2M. Franking % remains at 30%.
- 27.5% applied in FY2017 to small business entities that were carrying on a business with aggregated turnover of <\$10M. Franking % is reduced to 27.5% for these entities.

At time of publication, 27.5% applied in FY2018 to a base rate entity that is carrying on a business with aggregate turnover of <\$25M. Proposed *Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017*, once enacted, will remove the "carrying on business" requirement and apply the reduced tax rate to a corporate tax entity that has derived no more than 80% of its assessable income from base rate entity passive income.

The Commissioner stated in the PCG that he would adopt a "*facilitative approach to compliance in relation to the application of the carrying on a business test. This means the Commissioner will not allocate compliance resources specifically to conduct reviews of whether a corporate tax entity have applied the correct rate of tax or frank at the correct rate in FY2016 and FY2017*". This approach will not apply where:

- a. The Commissioner becomes aware that a corporate tax entity's assessment of whether they are carrying on a business in FY2016 or FY2017 was "plainly unreasonable";
- b. The corporate tax entity has entered into
 - i. Any artificial or contrived arrangement affecting characterisation of the company as carrying on a business or not;
 - ii. A tax avoidance scheme whose outcomes depends on the characterisation of the company as carrying on a business or not;
 - iii. Arrangements designed to conceal ultimate

beneficial or economic ownership of any connected/affiliated entities.

For entities that have incorrectly franked their dividends to 30% (where a lower rate applied due to the lower tax rate), they may inform their members of the correct franking credit without reissuing the distribution statement. The Commissioner said that he would not impose penalties on the corporate tax entity for giving a member an incorrect distribution statement as long as it gives written notice to each of its members showing the correct amount of franking credit. The notice should be provided in the same way as the distribution statement was provided (electronically or mail).

The changes to corporate tax rate and franking have been a source of complexity. Please contact Hall Chadwick if you require assistance.

1.2 Single Touch Payroll: ATO writing to employers

The ATO reported that it is writing to employers who started Single Touch Payroll (STP) before 1 July 2018, and providing them with information how their employees' payment summary for 2017-18 may change with STP. The ATO are advising employers who have used STP before 1 July 2018 that:

- They are not required to provide their employees with payment summaries for the information they report through STP. Some employers may choose to provide payment summaries for the first year of STP reporting.
- Income statements will replace payment summaries.
- Employees' income statements are available through pre-filing and myGov. A tax agent can access them through Client reports in the Tax Agent Portal.
- The income statement has three categories: Tax ready, Not tax ready and Year-to-date. Only tax ready income statements are complete and will be available through pre-filing.

1.3 ATO attacks trust splitting: TD 2018/D3

The Commissioner has issued a Draft Taxation Determination, TD 2018/D3, indicating that CGT Event E1 occurs when a trust is created over CGT asset, with a capital gain calculated as the capital proceeds (or its market value if no proceeds are received) less the asset's cost base. The practice is commonly known as "trust splitting".





A “trust split” occurs when the parties of an existing trust functionally split the operation of the trust so that some of the trust assets are controlled by and held for the benefit of one class of beneficiaries, and other trust assets are controlled and held for the benefit of others. This usually happens to family discretionary trust for the purpose of allowing different parts of the family group to have autonomous control over their own part of the trust assets.

TD 2018/D3 provides a single example where the Commissioner would consider a trust split to give rise to a CGT Event E1, with all or most of the following features below:

- The trustee of an existing trust is removed as trustee of part/some of the trust assets and a new trustee is appointed to hold those assets.
- Control of the original trustee is changed such that control passes to a subset of the beneficiaries of the original trust. The new trustee is controlled by a different subset of beneficiaries.
- Different appointors are appointed for each trustee.
- The rights of indemnity of the trustees are segregated such that each trustee can only be indemnified out of the assets held by that trustee.
- The expectation is that the new trustee will exercise its powers in respect of the assets it holds independently of the original trustee to benefit the subset to the exclusion of others. The original trustee will also exercise its powers in respect of the assets held by it independently of the new trustee to benefit a different subset again to the exclusion of others. This is so whether the range of beneficiaries that can benefit from particular assets is expressly limited.
- The rights, obligations and powers of the trustees and beneficiaries remain governed by the one deed.
- The original trustee and new trustee keep separate books of account.

In such an arrangement, the ATO considered that the trust split causes new rights and obligations to be created and transferred to the new trustee. These new rights and obligations amount to the creation of a new trust and cause a CGT Event E1 to happen.

The operation of CGT Event E1 and trust splitting is complex, and the ruling is proposed to apply both retrospectively and prospectively. Please contact Hall Chadwick for advice if affected.

1.4 PCG 2018/3: ATO finalises guidance on its compliance approach to determining private use of cars

Under subsection 8(2) and 47(6) of the *Fringe Benefits Tax Assessment Act 1986*, a fringe benefit is an exempt benefit where the private use of eligible vehicles by current employees during a fringe benefits tax year is limited to work-related travel, and other private use that is “minor, infrequent and irregular”.

An employer who satisfies the criteria set out below may elect to apply PCG 2018/3, would not need to keep records of their employee’s use of the vehicle to demonstrate that the private use of the vehicle is “minor, infrequent and irregular”, and the Commissioner will not review if the employer can access the car-related exemptions for the employee.

An employer is allowed to rely on PCG 2018/3 where:

- a. it provides an eligible vehicle to a current employee
- b. the vehicle is provided to the employee for business use to perform their work duties
- c. the vehicle had a GST-inclusive value less than the luxury car tax threshold at the time the vehicle was acquired
- d. the vehicle is not provided as part of a salary packaging arrangement and the employee cannot elect to receive additional remuneration in lieu of the use of the vehicle
- e. the employer has a policy in place that limits private use of the vehicle and obtain assurance from their employee that their use is limited to use as outlined in subparagraphs (f) and (g) of this paragraph
- f. the employee uses the vehicle to travel between their home and their place of work and any diversion adds no more than two kilometres to the ordinary length of that trip, and
- g. for journeys undertaken for a wholly private purpose (other than travel between home and place of work), the employee does not use the vehicle to travel
 - i. more than 1,000 kilometres in total, and
 - ii. a return journey that exceeds 200 kilometres.

PCG 2018/3 applies from 1 April 2018, with Draft PCG 2017/D14 applying for the 2017-18 FBT year.

1.5 Rus v FCT: Largely vacant land not an active asset

In *Rus*, a taxpayer asserted that their sale of largely vacant land was an active asset and they were eligible to apply the small business CGT concessions to the capital gain on disposal of the land.

The land was a 16 hectare block held individually by the taxpayer, of which 15 hectares was vacant land. The land

area contained two houses and a shed. The two houses were occupied by the taxpayer and her children as their main residence. The shed was used as office premises for a plastering company operated by the taxpayer.

The taxpayer contended that all of the land was used in the plastering business and was therefore an active asset. The Tribunal ruled that unlike a business of primary production or agriculture, the plastering business did not involve the exploitation of vacant land, nor did the existence of vacant land contribute to the business activities of the company. This was despite the taxpayer's submission that the value of the land has been used as security for a \$1.6M line of credit for the business.

This case highlights the complex operation of the small business CGT concessions. Clients wishing to access the small business CGT concession should always contact Hall Chadwick for advice prior to applying the concession.

1.6 TD 2018/3: Application of Division 7A to loans by private company through interposed entities

Under section 109T, there is a deemed dividend where a private company makes a payment/loan to an entity (the target entity) if:

- a. The private company makes a payment/loan to an interposed entity;
- b. A reasonable person would conclude (having regard to all the circumstances) that the private company made the payment/loan solely or mainly as part of an arrangement involving a payment or loan to the target entity; and
- c. The interposed entity makes a loan to the target entity, or another interposed entity makes a loan to the target entity.

TD 2018/3 considers whether this could apply where the payment/loan made by the private company was an ordinary commercial transaction and determine this does have application, unless the payment/loan is already treated as a Division 7A dividend to the first interposed entity.

TD 2018/3 provided 7 examples. Examples 1 to 5 indicating when s109T would apply and Example 6 and 7 indicating where no deemed dividend would arise.

In Example 6, Private Company Z paid a fully franked dividend of \$100,000 to Z Family Trust. The Z Family Trust made Mrs. Z presently entitled to 100% of the trust income (being the fully franked dividend). Mrs. Z directs the trustee of the Z Family Trust to make a payment to her husband, Mr. Z of \$100,000. In this example the Commissioner would have regard to the fact that Mrs. Z paid income tax at her marginal rate and the fund was

retained within the immediate family unit, and reduce the amount of the deemed payment to nil.

In Example 7, Private Company X paid a fully franked dividend of \$100,000 to X Family Trust. The X Family Trust uses the \$100,000 dividend to make an interest free loan to Mr. X, but makes Private Company Y presently entitled to 100% of the trust income being the fully franked dividend of \$100,000. Private Company Y converts its unpaid present entitlement from X Family Trust into a complying Division 7A loan. In this example, the Commissioner would reduce the amount of the notional loan by the relevant amount that is subject to a complying Division 7A loan.

Compliance with Division 7A is becoming more complicated, and taxpayers should ensure they contact their Hall Chadwick advisor to determine if arrangements entered into with corporate entities have Division 7A application.

1.7 Motor vehicle expenses: Set rate per kilometre

The ATO issued a determination on 11 July 2018 to increase the cents per kilometre deduction rate to 68c/km (up from 66c/km) for claiming work-related motor vehicle expenses for income years commencing from 1 July 2018.

Employers should be aware that in determining the exempt component of wages for the purposes of payroll tax, it is however the prior year's rate (i.e. 66c/km) that is applicable. States and territories in Australia provide that motor vehicle allowances paid or payable to an employee to compensate them for any business use of their own private vehicle above the exempt component is subject to payroll tax. The exempt component is calculated using the formula: $E = K \times R$, where:

E is the exempt component

K is the number of business kilometres travelled during the financial year

R is the exempt rate.

The exempt rate is the rate prescribed under the income tax legislation for calculating a deduction for car expenses for a large car using the cents per kilometre method in the **financial year immediately preceding** the financial year in which the allowance is paid or payable, hence if an employer wishes to ensure the reimbursement is exempt from payroll tax, the 66c/km rate will still need to be paid.

Find out how we can help, contact your **local office**

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