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Estate Planning

Although it's unpleasant to think about, it's important to consider what would happen to your family and assets when you die. It is well worth spending a little time and taking professional advice to ensure your family is taken care of and your wishes respected. Most people think by preparing a will, their estate plan is complete. The truth is, good estate planning is much more than a will, it's about:

- Will your estate have sufficient funds to cover your debts?
- Will there be enough money to provide for your family's future needs?
- Do you have a current will?
- Could the will be challenged?
- Have you made provision for your family's immediate cash needs following your death?
- Have you considered the timing of the distribution of your capital and income bequests?

Testamentary Trusts

A Testamentary Trust is a trust established in someone's will. It comes into existence only when the person dies. They provide the appointed trustees of the will the opportunity to focus on "the right time" in distributing your assets. Rather than being distributed by the executor upon death, some or all of the assets pass to the trust for the benefit of a special group of beneficiaries named in the will.

Testamentary Trusts, if carefully drafted, can be used for a variety of purposes including the following:

- Minimise tax (both income and capital gains tax).
- Protect spendthrift beneficiaries from their own spending habits.

- Provide care for the mentally disabled.
- Properly structured and managed, they can provide protection from a former spouse in a family law dispute or protection of capital from claims by creditors of a beneficiary say if a beneficiary was in a high-risk occupation or business.

Whilst the concept of a Testamentary Trust is relatively straight forward it is important to seek professional advice from a suitably qualified financial advisor and solicitor to ensure the trust works effectively as part of a person's overall planning arrangements.

Should you require any further information in relation to estate planning please contact Gede Barone.

Tax Deductions for Donations with Associated Minor Benefits

Effective from 1 July 2004, individuals will be entitled to a tax deduction, in certain circumstances for the net amount of a donation made, to a deductible gift recipient, where the donation has an associated minor benefit. Deductions will be available for cash donations above \$250 where the value of the benefit received by the donor is not more than 10%, or \$100, whichever is less.

The Prime Minister, in making the announcement, gave an example of a fundraising dinner that costs \$1,000, but has a market value of \$100. Under this proposal, participants will be entitled to a \$900 tax deduction. Presently, no deduction is available for such donations.

Primary Producers – Farm Management Deposits

Legislative and regulatory amendments have been made to assist primary producers with respect to farm management deposits.

The definition of ‘financial institutions’ has been clarified to help primary producers determine if an institution can issue farm management deposits (application from 1 July 2003) and to deem certain entities to be financial institutions in relation to pre 1 July 2003 transactions. This will protect those that have made deposits with non-complying entities that have offered products described as farm management deposits. The ‘farm management deposit’ will retain the tax status provided transfers to an authorized deposit-taking institution are made within a specified period.

Regulations have been amended to assist primary producers who have been severely affected by drought. Those in ‘exceptional circumstances’ in declared areas may withdraw all or part of a farm management deposit within twelve months of making the deposit.

Superannuation

Superannuation Surcharge - Rate Reductions a Reality

The maximum surcharge rate will be reduced from 15% to 12.5% over three years.

Government Co-Contribution

If you make a superannuation contribution, and your income is \$27,500 or less, the Government will match your contribution up to \$1,000 per annum. The maximum government contribution is reduced by 8c per dollar of income up to \$40,000 where it phases out completely.

Self-Managed Funds Shareholding - Share Trader or Investor

An Australian Taxation Office newsletter provides some insight as to whether or not self managed funds can be regarded as share traders. The Tax Office considers that self managed funds are unlikely to meet the tests necessary to be share traders for tax purposes, however, each case will be assessed on its merits.

The criteria for consideration include:

- the volume, frequency and scale of activities;
- the existence of a systematic program of buying and selling in order to produce profits and;
- the intention of the trustees (in view of what is already their fiduciary duty).

Should the activities of the fund pass the above tests, the trustees must also demonstrate that other regulatory requirements are met. For instance, share trading must be in accordance with an appropriate investment strategy and the strategy must have regard to:

- investing in such a way as to maximize member returns taking account of the risk associated in holding the investment;
- appropriate diversification and the benefits of investing across a number of asset classes in a long-term investment strategy; and
- the fund’s ability to pay benefits as well as other costs as and when they fall due.

Superannuation Contributions Splitting

Legislation has been enacted to allow fund members to split both personal and employer contributions with their spouse.

The basic principles of the tax treatment of contribution splitting will be:

- that the amount split in favour of the receiving spouse will be paid to another fund or transferred to an account in the existing fund for the receiving spouse and that the transfer be treated as an ETP roll-over;
- that any surcharge liability that attaches to the contributions that have been split will remain payable.

Outline for Reasonable Allowances

The Australian Taxation Office has provided details of the Reasonable Allowance limits for the 2003-2004 year of income.

Employees who receive allowances up to the amounts considered reasonable by the Australian Taxation Office, and as specified in its ruling, do not have to substantiate actual expenses incurred. The ruling covers the following types of allowances:

- domestic travel, accommodation, food, drink and incidental expenses;
- overtime meal allowances paid under an award (\$19.75 is considered reasonable);
- expenses for employee truck drivers;
- overseas travel in relation to food, drink and incidental expenses (excluding accommodation);

The reasonable travel allowance amounts vary according to location, ie city or country and the Australian Taxation Office has outlined a broad range of travel destinations to cover most situations.

Should an employee claim a deduction that exceeds the reasonable amount specified by the Australian Taxation Office, the entire claim must be substantiated, not just the excess above this reasonable allowance.

Tax Obligations for Business Simplified

The Australian Taxation Office has announced new streamlined methods to make it easier for business to claim deductions for low cost items such as office supplies, crockery and small tools etc. A practice statement and a number of 'fact sheets' have been issued to clarify the taxation treatment of expenditure on low cost items for taxpayers carrying on a business.

The Taxation Office has acknowledged that categorising expenditure, as revenue or capital can be complex and time consuming when decisions have to be made across a wide cross section of low value purchases, often recorded on a single invoice. The new methods, the threshold rule and the sampling rule are designed to lessen the cost involved in making the distinction. Taxpayers who adopt one of these methods will be accepted as meeting the requirements of the laws.

The threshold rule applies to expenditure of \$100 or less in acquiring a tangible asset in the ordinary course of carrying on a business. It can be assumed the expense is of a revenue nature and deductible. This rule does not apply to expenditure on assets that are part of another composite asset.

The sampling rule is applicable to businesses that either have a low-value past or do not have systems that result in reliable individual identification and accounting of low cost items.

Statistical sampling will be accepted as an appropriate method to determine the proportion of total expenditure on low value items (ie costing less than \$1,000) that can be attributed to revenue expenditure. The \$100 threshold rule can also be used in the sampling process.

There are some exceptions, the streamlined methods do not apply when:

- establishing a business or business venture;

- building up a significant store or stockpile of assets;
- assets held under a lease, hire purchase or similar arrangement;
- assets acquired for lease or hire;
- purchasing assets forming part of a collection of assets that is dealt with commercially as a collection, for example, for sale and lease back as a means of financing;
- acquiring trading stock or spare parts.

The streamlined methods do not apply to businesses that use the simplified tax system as they already can claim an immediate deduction for expenditure on assets costing less than \$1,000.

Deductions Relating to Personal Services Income

The Australian Taxation Office has clarified the position relating deductions against personal services income, whether personally or through another entity such as a company or trust. The other aspect is to reinforce the point that, after allowable deductions, any remaining income is attributed to the individual, ie cannot be left and taxed at the corporate rate or distributed to other family members.

The law denies a deduction for rent, mortgage interest rates or land tax relating to some or all of an individual's (or associates) residence. This, of course, does not apply in respect of business premises where such business premises do not form part of the individual's residence.

The above rules do not preclude an individual claiming a deduction for home office or study running expenses.

Payments to associates of the person providing the personal services are not deductible unless the payment is in relation to principal work, ie cannot relate to support services. Similarly, superannuation contributions are not deductible when paid on behalf of an

associate unless the work performed is principal work (and even then be mindful of the limitations!)

With regard to car expenses provided through a personal services entity, a deduction is allowable for one vehicle if there is personal use or more than one car provided there is no personal use of the cars.

Salary and wages promptly paid to the individual responsible for generating the personal services income is deductible and likewise for superannuation payments in accordance with the normal limits.

Solvency Resolutions for Companies

The traditional annual returns for companies have been abolished as from 1 July 2003. One of the remaining requirements for consideration by directors is the 'solvency resolution'. Directors are required to pass a resolution within two months of the annual return date, which is generally the date of the anniversary of incorporation of the company.

The declaration is subjective; it is the director's opinion. If the declaration is negative, ie the directors believe the company is insolvent; the ASIC (Australian Securities & Investment Commission) must be notified within seven days. If the declaration is positive, ie in the directors opinion there are reasonable grounds to believe the company is solvent, there is no need to notify the ASIC.

Directors have an obligation to reach an opinion having regard to the facts, such as:

- liquidity indicators, eg working capital, appropriateness of asset values such as debtors and stock;
- currency of statutory obligations;
- creditors demanding payment for overdue debts;
- entry into repayment arrangements;

- creditors ageing ~ beyond normal terms;
- sale or assignment of debtors;
- opening of alternative bank accounts.

Directors have a duty to ensure their company does not trade whilst insolvent. The above indicators are warning signs and the directors must determine whether there are reasonable grounds to expect that the company will be able to pay its debts as and when they fall due. There must be reasonable grounds to expect that temporary cash flow problems can be overcome, eg from capital raising, asset sales, improved trading, etc.

Pre Div 7A At-call Loans deemed to be Dividends

Private company loans that were made before 4 December 1997 are generally not subject to the deemed dividend rules in Division 7A of the Income Tax Assessment Act 1936 (ITAA 1936) provided the terms and conditions remain the same and the loan is not forgiven. However, a recent Supreme Court of Victoria case has highlighted that pre Div 7A at-call loans may be deemed to be forgiven by the operation of the various state based Statute of Limitations Acts.

In the case, *VL Finance Pty Ltd v Legudi [2003] VSC 57*, it was held that, for an at-call loan, the six year time period under the Victorian Statute of

Limitations starts when the loan was first advanced and not when a “call” is first made. In the National Tax Liaison Group (“NTLG”) minutes of 3 June 2003, the ATO stated that where an at-call loan made by a private company to a shareholder or an associate of a shareholder has become statute barred, it will be taken to be forgiven and treated as a dividend under Division 7A. The amount of the dividend will equal the amount of debt forgiven (subject to section 109Y of the ITAA 1936, which limits the dividend to the amount of the private company’s distributable surplus for that year).

The ATO’s view may allow for the possibility of pre-Division 7A loans being caught inadvertently in the Division 7A net. The precursor to Division 7A, being section 108 of the ITAA 1936 was more lenient than its successor in the circumstances when a loan could be a deemed dividend. Accordingly, many private companies quarantined their pre-4 December 1997 loans to avoid the harsher regime. Nor did they vary the terms of such loans as this would result in the loans falling under the Division 7A.

On the assumption that the ATO’s interpretation is correct, private companies with pre-4 December 1997 loans, which have remained untouched, may find that the statute of limitations operates to bring the loan under Division 7A. This is particularly relevant because the various state statutes of limitations generally provide that creditors (ie the private company) who have undocumented and unacknowledged at-call loans, generally only have six years to recover the debt

from the time the loan was made. When this time period expires, the pre-Division 7A loan may be considered to be forgiven, which means that it will fall within Division 7A. The result could be that the outstanding balance of such a pre-Division 7A loan would be deemed to be an unfranked dividend.

As a consequence it may be prudent for companies to review their pre-Division 7A loans made to shareholders and associates, and ascertain whether they need to be “acknowledged” so that they do not become statute barred and thereby treated as a deemed dividend for Division 7A purposes.

Note that each state’s statute of limitations legislation is slightly different so it is important to obtain specific advice for each situation.



Christmas Holiday Notice

We wish to advise that our office will be closed from Thursday 25th December 2003 to Friday, 2nd January 2004.

We would like to take this opportunity to wish you and your staff and families a wonderful and very safe Christmas and a prosperous New Year.



WINNER:

Congratulations to our client, Gai White, who has won the VIP package to the Australian Open Golf Tournament sponsored by Hillross. The package included airfares, accommodation and a start in the Pro-am event.

Disclaimer: The contents of this publication are general in nature and we accept no responsibility for persons acting on information contained herein without first consulting us