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TAX matters

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Tax – Division 7A – more details on the Budget Announcements

As highlighted in our May 2009 Special Budget Edition of Tax Matters, in the 12 May 2009 Federal Budget the Government announced that it would introduce legislation to tighten the rules that prevent shareholders and their associates avoiding tax on distributions and benefits they receive from private companies. The intention was that the measure would extend the Division 7A deemed dividend rules to cover payments constituted by benefits provided by way of a licence or right to use real property and

chattels provided at less than market value.

In our Special Budget Edition of Tax Matters we foreshadowed that it may be the case that the new measures could also apply to benefits provided by trusts where those trusts have made distributions to private companies for tax purposes which remain unpaid. However, on 5 June 2009 a Treasury Consultation Paper (“TCP”) was released regarding the proposed changes and how they might be implemented. It makes no mention of whether the measures will extend to such benefits provided by trusts. It remains to be seen whether the consultation process will result in the draft legislation addressing this issue.

The TCP also outlines other technical amendments that are proposed to strengthen Division 7A, including amendments to ensure that corporate limited partnerships cannot be used to circumvent the operation of Division 7A. Further, it identifies a number of issues in relation to the way in which Division 7A deals with trusts, unpaid present entitlements to income and payments or loans to shareholders or their associates. The Government is seeking to address various issues in this regard, including the following:

1. Situations where Division 7A may be circumvented by interposing an entity, for example a second trust,

between a trust and the private company with the unpaid present entitlement to income;

2. Circumstances in which Division 7A may be ineffective as the result of a private company with no distributable surplus being interposed between a trust and a shareholder (or associate) of another private company which has an unpaid present entitlement owing to it by the trust;
3. Revaluation scheme arrangements where an unrealised gain is distributed to a shareholder (or associate) of a company with an unpaid present entitlement to income where the shareholder in turn loans the amount back to the trust. As Division 7A currently stands, the deemed dividend in these types of arrangements may be limited to the amount of the unpaid present entitlement owed to the private company with repayments of the loan to the shareholder (or associate) by the trust not caught by Division 7A. The Government proposes to tighten the operation of Division 7A to address these types of arrangements;

4. Amendments to clarify the operation of Division 7A in relation to “re-borrowings” of amounts before a loan is repaid, to address the strategy of deferring the repayment of loans year by year.

The TCP also states that it is proposed that the definition of “distributable surplus” will be amended to take into account Division 7A payments made by a company during an income year, for example by way of a transfer of property to a shareholder for less than market value. Where assets are transferred to shareholders during an income year the value of those assets is not currently taken into account in calculating the company’s distributable surplus at the end of the income year – which may reduce the amount of a Division 7A deemed dividend.

Contact: Rachael Munro and Chris Smailes.

Transfer Duty - exemption for farming property – a hard road to hoe

Do you know that the transfer of farming property from one generation to the next is, by way of policy, meant to be exempt from stamp duty (now transfer duty) but often is not? Do you know that many taxpayers fail in their attempt to have the exemptions apply?

From 1 July 2008 the Stamp Act 1921 (WA) (“Stamp Act”) which governed the laws regarding stamp duty in Western Australia was replaced with the Duties Act 2008 (WA) (“Duties Act”). Although the Duties Act changed many aspects in regard to stamp duty in Western Australia it did keep some remnants of the old legislation. This includes the exemption from transfer duty where farming

property is transferred from an individual to a discretionary trust of which only the individual’s family are beneficiaries and which the individual does not control.

The exemption is only obtained where the property has been used in a business of primary production by the owner or a related entity immediately before the transfer and the property will continue to be used by the new owners or by a related entity in a business of primary production, after the transfer.

The requirements to obtain the farming exemption from transfer duty generally are technically complex and usually require extensive submissions to be made to the Office of State Revenue. In turn the Office of State Revenue will look at the transaction closely and apply the concessions in the law strictly.

Upon closer review of the relevant sections of the Duties Act, there are many restrictions and peculiarities to the exemptions which become evident. One such restriction in the case of a transfer to a trust is that the transferee entity has to be a special type of trust, far more limited in its width of the class of beneficiaries than a standard family discretionary trust. This would exclude say other companies or trusts in which family members have an interest from being beneficiaries.

There is also a risk that the Office of State Revenue may refuse to grant an exemption, or revoke an exemption previously given, through the application of the anti-avoidance provisions in the Duties Act. However, a person may request the Commissioner of State Revenue to determine if a proposed transaction would be exempted, by providing the Commissioner with all relevant information regarding the proposed transaction. The Commissioner is bound by this pre-transaction decision

in relation to the proposed transaction, provided full and true disclosure was made to the Commissioner, and providing the transaction actually entered into does not differ materially from the transaction to which the pre-transaction decision request related.

Given the concerns outlined and the ability of the Office of State Revenue to deny the use of an exemption, it may often be the case that a pre-transaction decision request should be made prior to any transaction in which the parties intend to utilise the farming exemption in the Duties Act.

Contact: Chris Smailes or Ryan Gruenthal

Superannuation - Ordinary time earnings redefined, are you complying?

On 13 May 2009 the ATO released SGR 2009/2 titled “Superannuation guarantee, meaning of the terms ‘ordinary time earnings’ and ‘salary or wages’”, which applies from 1 July 2009. SGR 2009/2 finalises draft ruling SGR 2008/D2, and replaces SGR 94/4.

SGR 2009/2 provides the ATO’s views on the meaning of ‘ordinary time earnings’, which is relevant to employers for the purposes of calculating the minimum level of superannuation support required for individual employees under the Superannuation Guarantee (Administration) Act 1992 (Cth). The ruling also explains the meaning of ‘salary or wages’.

The ATO’s views outlined in SGR 2009/2 differ in several important respects to those which were contained in the draft ruling, SGR 2008/D2. All employers need to be

aware of the ATO’s views in SGR 2009/2, as they are relevant for the purposes of calculating superannuation contributions. Critically, employers will need to consider whether changes need to be made to their systems in light of the views expressed in SGR 2009/2, and if so, whether those changes need to be implemented for 1 July 2009 (being the ruling’s commencement date).

One of the key changes in SGR 2009/2 from the position in SGR 2008/D2 is the ATO’s interpretation of the meaning of “ordinary hours of work”. Under SGR 2009/2, “ordinary time earnings” is interpreted to mean all earnings resulting from “ordinary hours of work”. An employee’s ordinary hours of work are the hours specified as his or her ordinary hours of work under the relevant document(s) that governs the employee’s conditions of employment. Any hours worked in excess of, or outside the span of, those specified ordinary hours of work are not part of the employee’s ordinary hours of work. According to SGR 2009/2, this is so regardless of whether the hours that the employee normally, usually or regularly works are in excess of, or outside the span of, the specified ordinary hours of work; such as, for example, where an employee regularly works overtime. Only the ordinary hours specified in an award or agreement are included in ordinary time earnings. This interpretation contrasts with SGR 2008/D2, where the ATO expressed the view that ordinary hours of work would include, for example, overtime if regularly worked.

The ATO’s changed views in SGR 2009/2 need to be carefully considered by employers pre 1 July 2009 in regard to:

1. calculating the mandatory superannuation guarantee contributions they must make to their employees post 30 June 2009; and
2. when negotiating and drafting employment agreements. The terms of the employment agreement become critical in this regard.

Contact: Chris Smailes or Alan Krawitz

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