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The Partners and Staff at Norton & Smailes would like to wish all our clients a very Merry Christmas and a happy New Year!

## In this issue:

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### Small business CGT concessions

*Changes to the Connected Entity Rules: impact on the maximum net asset value test*

If an entity is “connected with” another entity, this has implications for the CGT small business concessions in Division 152 of the Income Tax Assessment Act 1997 (Cth) (“ITAA97”).

The meaning of “connected with” under section 328-125 of the ITAA97 relies on the concept of control. It is proposed that the direct control rule in section 328-125(2) will be amended. The

proposed amendments are currently contained in an Exposure Draft (the Tax Laws Amendment (2011 Measures No. 7) Bill 2011).

Prior to the proposed amendments, an entity controls another entity (other than a discretionary trust) if the entity and/or its affiliates “beneficially own, or have the right to acquire the beneficial ownership of” relevant interests in the other entity.

For CGT events that occur on or after 10 May 2011, an entity controls another entity (other than a discretionary trust) if the entity and/or its affiliates “own, or have the right to acquire ownership of” relevant interests in the other entity. In other words the definition of control now looks at legal ownership rather than beneficial ownership.

Below is an example of the effect of this change.

### Example

The net value of the CGT assets of Company X are \$7,000,000.

The shares in Company X are held 40% by the Larry Family Trust, 35% by the Jeff Family Trust No. 1 and 25% by the Jeff Family Trust No. 2. Larry is the trustee and appointor of the Larry Family Trust. Jeff is the trustee and appointor of both of the Jeff trusts. The Jeff Trust No. 2 was formed only a few years ago to buy out the 25% interest in Company X formerly held by the Funkhouser Trust.

Under the current definition (i.e. prior to the proposed amendments), there is/was a sound technical argument that a discretionary trust does not satisfy the requirements of section 328-125(2) because it does not, and cannot, “beneficially own” interests carrying the relevant rights in another entity. Therefore, Company X could not be said to be connected with the Larry Family

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Trust or the Jeff trusts. A consequence of this result is that if, for example, the Larry Family Trust was selling its shares in Company X, the net value of the CGT assets of Company X (i.e. \$7,000,000) would not be counted in the maximum net asset value test calculation (in section 152-15) of the Larry Family Trust. Rather, only the value of the Larry Family Trust's shares in Company X would be counted (i.e. \$2,800,000). This means that the Larry Family Trust could potentially satisfy the \$6 million maximum net asset value test.

Under the proposed new definition, the focus is on legal ownership rather than beneficial ownership. A discretionary trust will legally (via its trustee) own interests in the company carrying the relevant rights. Therefore, because the Larry Family Trust legally owns 40% of the shares in Company X, Company X will be connected with the Larry Family Trust. The result is that under the proposed new definition, the Larry Family Trust fails the maximum net asset value test.

An interesting observation is under both the current and the proposed new definition of control in section 328-125(2), Company X will not be connected with the Jeff Family Trust No. 1 or the Jeff Family Trust No. 2. This is because neither trust, and/or its affiliates own interests in Company X which carry at least 40% of the relevant rights as the Jeff Family Trust No. 1 only owns 35% of the shares in Company X, and the Jeff Family Trust No. 2 only owns 25% of the shares in Company X. The Jeff Family Trust No. 1 and the Jeff Family Trust No. 2 will not be affiliates of each other because a

trust cannot be an affiliate of another entity. For the purposes of determining whether Company X is connected with each of the Jeff trusts, it is irrelevant under the company control tests in section 328-125(2) that the Jeff trusts are connected with each other (the Jeff trusts will be connected with each other because they are both controlled by Jeff: section 328-125(1)(b)).

This means that if the shareholders of Company X are selling their shares, the Jeff trusts can both potentially satisfy the maximum net asset value test, but the Larry Family Trust cannot.

In this case, the Larry Family Trust could ask the Commissioner (under section 328-125(6)) to determine that it does not control Company X on the basis that Company X is, in essence, "controlled" (in a general sense) by the Jeff trusts who together hold 60% of the shares in Company X. This argument has problems since "controlled" ought to be construed within its meaning in section 325-125 and hence Company X would not be seen to be "controlled" by the Jeff Trusts – bad luck Larry.

Perhaps what this article illustrates best is that the definitions that apply to the CGT small business concessions are highly technical and do not necessarily produce equitable results. If you need assistance understanding the definitions used in Division 152, please contact us.

Contact: Alan Krawitz or Chris Smiles.

### Super guarantee charge

The superannuation guarantee charge ("SGC") is imposed upon those employers who fail to pay prescribed superannuation contributions for the benefit of their employees. The charge is equal to the amount of superannuation that should have been paid for that employee (currently 9%).

The ATO requires employers who have not paid the prescribed superannuation contributions for their employees by the quarterly cut-off date for payment to lodge an SGC statement. If the employer has paid a superannuation contribution for an employee after the quarterly cut-off date, the employer may be able to use this late payment as an offset to reduce the amount of super guarantee charge payable.

### *Do you know who is an employee and who is a contractor?*

The ATO may issue an SGC assessment to an employer who it determines has failed to meet its superannuation obligations. Of particular significance is the distinction between an "employee" and an "independent contractor" when determining if an employer has failed to pay the prescribed superannuation contribution for a person.

Some recent Federal Court decisions have outlined the difference between an "employee" and an "independent contractor", and the factors to take into account when making the distinction.

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Consequences of an SGC statement or an SGC assessment for the **employer**:

- (a) no deduction is allowable for the SGC (whereas the 9% contributions would have been deductible);
- (b) risk of penalties applying;
- (c) risk of general interest and administration charges applying on top of the SGC;
- (d) risk of sick leave, annual leave, and long service leave having to be back-paid for the employee;
- (e) no cut-off date for the liability to pay SGC. ie the ATO can review an employer's records beyond 5 years;
- (f) SGC is calculated by reference to a broader earnings base of "salary or wages", as opposed to the narrow earnings base of ordinary times earnings ("OTE").

Consequences of an SGC assessment for the **employee**:

- (a) No ability for the SGC to be remitted to take account of the fact that the relevant individual may already have paid superannuation on their own behalf, leading to a risk of excess contributions tax;
- (b) the employee would have incorrectly claimed deductions for superannuation contributions, and should not have been charging GST.

*What you should do?*

If you:

- are required to lodge an SGC statement;
- have been issued an SGC assessment; or

- are currently employing independent contractors, please contact us for advice.

Contact: Daniel Fry or Chris Smailes.

#### **Directors liability for unpaid tax debts**

New legislation is proposed to extend the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts.

If you require assistance with understanding when a Director may be liable for PAYG withholding liability or for superannuation guarantee amounts, please contact us.

Contact: Daniel Fry or Chris Smailes.

#### **Excess contributions tax**

Recent statistics released from the ATO show that approximately 20% of applications to the ATO to disregard or reallocate contributions are successful.

For the 2009-2010 year, approximately 2,580 excess contribution tax ("ECT") assessments have been issued, with more expected in the coming months.

If you require assistance with an application to the ATO to disregard or reallocate a contribution, or to object to an ECT assessment, please contact us.

Contact: Daniel Fry.

#### **Disclaimer**

This publication is intended to provide general commentary and information. It is not intended to

be a complete or definitive statement of the current law or proposed law. This publication should not be relied upon as legal advice. Professional legal advice should be sought before any action is taken in relation to the matters described in this publication.

Should you have any questions please contact Richard Norton, Chris Smailes or Daniel Fry.

#### **Norton & Smailes**

We advise on:

- income tax, GST, capital gains tax, FBT
- superannuation and superannuation deeds
- stamp duties, payroll tax and other State taxes
- wills, estate planning and business succession planning
- trusts and trust deeds
- objections and appeals
- tax and commercial litigation
- commercial law

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