

### EXCESS CONTRIBUTIONS - UP TO 7,588 POTENTIAL BREACHES

The ATO has identified 7,588 potential cases of individuals exceeding the \$1 million cap on non-concessional superannuation contributions made during the transitional period from 12 May 2006 to 30 June 2007.

It has reported that the potential breaches were identified by analysing member contribution statement (MCS) data and tax return data.

The ATO has indicated that the number of actual excess contribution tax assessments raised will be less than the figure set out above as the Commissioner will need to examine the following factors:

- a) misreporting by funds and individuals;
- b) exclusion of CGT and personal injury exemptions;
- c) pre-10 May 2006 contributions;
- d) employer contributions from multiple employers (noting that concessional contributions in excess of age based limits also counted towards the \$1 million cap); and
- e) the potential application of the Commissioner's discretion under PS LA 2008/1, and the potential availability of transitional release authorities.

The ATO has indicated that it will be conducting a trial investigation of 200 cases to assess the situation in identifying actual excess contribution tax cases.

**Argyle Comment:**

***Taxpayers and advisors should ensure that clients have reviewed their affairs to ensure that any breaches are identified prior to the commencement of an audit.***

### SAME BUSINESS TEST FAILED AND PRIOR YEAR LOSSES DENIED: LILYVALE HOTEL PTY LIMITED v FCT

The Federal Court has affirmed the Commissioner's decision that a taxpayer was not entitled to a deduction for prior year losses because it did not satisfy the requirements of the same business test for the relevant test period.

Facts

The Taxpayer Company built a hotel and contracted for the provision of the day-to-day operations and management to another entity (The Manager). It did this through a management agreement signed between the Taxpayer and the Manager.

In 2002, the shares in the Taxpayer were sold to an unrelated third party. In the 2003 ITR, the taxpayer claimed a deduction for carried forward losses in the amount of \$10,579,458.

The Taxpayer considered that it failed the continuity of ownership test and sought to rely on the same business test to deduct the prior year losses.

The Commissioner issued a notice of assessment in November 2005 disallowing the deduction, the Taxpayer objected, the Commissioner disallowed the objection and the matter ended up before the Federal Court.

Held

It was accepted by the Court that the taxpayer carried on the business of managing the hotel after the share sale.

## SAME BUSINESS TEST FAILED AND PRIOR YEAR LOSSES DENIED: LILYVALE HOTEL PTY LIMITED v FCT continued

However the Court noted that the critical question was whether the taxpayer carried on a similar business after the change as it did, before the change, and it noted that it was a question of fact to be determined by the activities of the Taxpayer.

One argument put forward was that the Taxpayer used the Manager as an Agent to run its business. The Court held that notwithstanding an "agency" relationship existed, the Taxpayer's business activities could not be concluded from its legal relationship with the managing entity. The Court also held that the business activities of the Manager did not necessarily need to be attributed to the taxpayer.

However, the Court found that the Taxpayer did not have an active role in the daily operations of the hotel prior to the change in shareholdings. It was found that the Taxpayer merely provided and maintained the premises, funded the operations of the hotel and paid the agreed fees to the Manager.

On this basis, the Court found that the taxpayer did not carry on the same business for the relevant period and the deduction was disallowed.

### **Argyle Comment:**

***Take care when making changes to the way an entity operates its business after acquiring an entity carried forward with tax losses. The Loss deduction provisions are quite complicated. This case has a broad application and great care is needed.***

## AAT UNABLE TO DETERMINE VALIDITY OF ASSESSMENT - TAXPAYER'S APPEAL DISMISSED: KENNEDY v ADMINISTRATIVE APPEALS TRIBUNAL

The Full Federal Court has dismissed an appeal by a taxpayer who argued the AAT had erred in not considering the "validity" of amended assessments issued.

### Facts

In response to being issued assessments for \$7million, the Taxpayer argued that the assessments had been issued in bad faith.

The Taxpayers arguments included, among other things that the assessments were issued for the collateral purpose of assisting other government agencies.

### Held

The Full Federal Court unanimously dismissed the taxpayer's appeal.

The Court noted that the applicant Taxpayer, having chosen to go down the AAT path to dispute the assessments was bound by the AAT not legally having the jurisdiction to determine the validity of assessments in dispute before it.

It noted that an application to the AAT under Pt IVC of the *Taxation Administration Act 1953* was limited to the issue of whether an assessment was "excessive", and not whether the assessment was valid.

The taxpayer's claim that the AAT had incorrectly refused to exercise its powers under s 37(2) of the *Administrative Appeals Tribunal Act 1975* to require the Commissioner to produce the additional documents upon which he based the assessments was also dismissed. In dismissing this claim, the Full Court noted that the Commissioner was only required to produce documents he considers necessary to a review before the AAT, and that he had otherwise produced all of the documents relevant to the taxable facts in this case.

## AAT UNABLE TO DETERMINE VALIDITY OF ASSESSMENT - TAXPAYER'S APPEAL DISMISSED: KENNEDY v ADMINISTRATIVE APPEALS TRIBUNAL

continued

### **Argyle Comment:**

*It is extremely important that Taxpayers carefully consider the approach taken in disputing assessments and administrative decisions. The forum chosen, the legal issues presented for consideration, the issues disputed, and the presentation of relevant facts and material. Properly understanding the importance of each element is critical to achieving the right outcome.*

## NSW STATE TAX LEGISLATIVE AMENDMENTS

The NSW Treasurer, The Hon. Michael Costa MLC, announced changes to State taxes and duties as part of the 2008 Budget, and they have now been introduced as part of the State Revenue and Other Legislation Amendment (Budget) Bill 2008. The changes deal with Payroll Tax and Stamp Duties.

### Amendments to Payroll Tax Act 2007

At present the tax free threshold for the 2008-09 year is \$623,000. This amount is to be indexed annually in line with the percentage increase in the Sydney CPI All Groups Index, as determined by the ABS, for the 12 months ending on 31 March prior to each financial year.

The more exciting news is that the payroll tax rate of 6 per cent is to be reduced as follows:

- a) to 5.75% from 1 January 2009
- b) to 5.65% from 1 January 2010
- c) to 5.5% from 1 January 2011.

### Amendments to Duties Act 1997

- a) Duty on the transfer of business assets other than land has been brought forward from 1 July 2012 to 1 January 2011.
- b) Duty on the transfer of shares in share management fisheries will be abolished on 1 January 2009.
- c) Effective 1 July 2008, no duty will be chargeable on a transfer, or an agreement for the sale or transfer, of marketable securities or a land rich acquisition, if the Chief Commissioner is satisfied that the transaction is made to give effect to a scheme that would qualify as a roll-over under subdivision 124-Q of the ITAA 1997 (CTH).

**State Revenue Legislation Amendment Bill 2008 (NSW) was assented to on 2 July 2008. Some of the amendments made by the Bill include:**

### Partitions of land

At present the Duties Act 1997 provides for a duty concession on a transfer of land that is jointly owned where the land is transferred to one or more of the joint owners (referred to as a partition).

The amendment provides that the concession does not apply in cases where the Chief Commissioner of State Revenue is satisfied that the partition is part of a scheme to avoid duty on an exchange of land between parties who are not joint owners.

### Concessions for deceased estates

At present, the Duties Act 1997 provides for a duty concession on a transfer of dutiable property by the legal personal representative of a deceased person if the transfer is made under and in conformity with the trusts contained in the will of the deceased person or arising on intestacy. Duty on such a transfer is charged at a flat rate of \$10, rather than ad valorem. The amendment extends this concession to the following cases:

**NSW STATE TAX LEGISLATIVE AMENDMENTS**

continued

- a) an appropriation of the property of the deceased person in or towards satisfaction of a beneficiary's entitlement under the trusts contained in the will of the deceased person or arising on intestacy,
- b) a transfer of dutiable property of a deceased person to a beneficiary of the estate by agreement between 2 or more beneficiaries to vary the trusts contained in the will or arising on intestacy. In the second case, the concession will only apply to that part of the dutiable value of the property transferred which is dutiable property to which the beneficiary was entitled under the will or on intestacy. Ad valorem duty will remain chargeable on the transfer to the extent that it varies the trusts contained in the will or arising on intestacy.

Incorporation of pharmacists

Under the Pharmacy Practice Act 2006 it is permissible for a pharmacy business to be carried on by a pharmacist's body corporate. Previously, a corporation was prohibited from having a pecuniary interest in the business of a pharmacist (under section 25 of the Pharmacy Act 1964).

The amendment provides for a duty exemption for any pharmacist, or partnership of pharmacists, that becomes a body corporate. A transfer of dutiable property of the pharmacist or partnership to the incorporated body will be exempt from duty. This is similar to the exemption that applies to lawyers who incorporate.

First Home Plus

The First Home Plus scheme under the Duties Act 1997 allows first home owners to obtain a duty exemption or concession when they build or purchase their first home. At present, the scheme requires that an application for a concession under the Act relate to the whole property.

The amendment will allow an application to be made under the scheme where the property concerned is a land on which 2 or more homes are built or are to be built, if the Chief Commissioner of State Revenue is satisfied that the first home owner will be entitled to occupy the home that the first home owner is acquiring to the exclusion of the persons who occupy other homes on the land.

**OUTSOURCING OF TAX AGENT SERVICES COULD LEAD TO PROSECUTIONS: TAX AGENTS BOARD**

At the conference of the Chairs of each of the six Tax Agents Boards on 6 March 2008, the issue of outsourcing of tax agent work was considered.

The conference considered that at each board should, in considering cases dealing with this issue, a number of particular factors should be considered in each case.

The factors identified include whether:

- a) the person providing the outsourcing services is a registered tax agent
- b) there is an employment relationship in place between the person providing the outsourcing services and the persons undertaking the work
- c) there is a sufficient degree of supervision and control over the work being outsourced
- d) there was any breach by the agent engaging the outsourcing service of the agent's privacy and secrecy obligations
- e) the outsourcing arrangements properly maintained the confidentiality of the client information and prevented any dissemination of information without the ultimate client's authority
- f) the outsourcing arrangements comply with the Tax File Number disclosure
- g) there had been any misrepresentation by the tax agent engaging the outsourcing services as to who would undertake the client's work and where that work would be performed.

**OUTSOURCING OF TAX AGENT SERVICES COULD LEAD TO PROSECUTIONS: TAX AGENTS BOARD**

continued

The issues the board identified include whether an agent:

- a) was engaged in misleading and deceptive conduct
- b) had neglected the business of a principal s251K(2)(b)(i) of the 1936 Act
- c) is guilty of misconduct as a tax agent s251K(2)(b)(ii) of the 1936 Act
- d) is a fit and proper person to prepare income tax returns and transact business on behalf of taxpayers in income tax matters s251BC of the 1936 Act, and
- e) was in breach of section 251N of the 1936 Act.

It was considered that where a view was formed that some or all of the above elements were present, boards would need to consider whether they should refer cases to the Commissioner for possible prosecution.

**Argyle Comment:**

***Principals outsourcing work should ensure appropriate measures are put in place to ensure they can demonstrate all reasonably possible measures are in place to prevent the above issues arising.***

**ATO DATA MATCHING EXERCISE - MARINE VESSELS**

The ATO recently announced that it will be conducting a data matching exercise for Marine Vessel owners. The ATO will be collecting details of taxpayers that have registered a marine vessel with the any of the following State bodies:

- a) NSW Maritime Authority;
- b) Maritime Safety Queensland;
- c) Marine Safety Victoria;
- d) Marine and Safety Tasmania;
- e) Department for Transport, Energy and Infrastructure (Safety and Regulation Division) (SA);
- f) Department for Planning and Infrastructure (Marine Safety) (WA).

The ATO has indicated that the state bodies do not have details as to the value of registered vessels, but all registered vessels. The ATO is going to be obtaining information on all registered Vessel Owners in order to match information relating to small, but expensive vessels.

It has also indicated, where a marine vessel is operated by an agent, the ATO will be pursuing both the agent and the Owner, as both may be deriving benefits from the Vessel.

The ATO has estimated that it will be matching approximately 160,000 persons or entities records.

The Tax Office says the intention of the Project is to identify taxpayers who have purchased a high-value vessel and who have not lodged tax returns or who may not have declared all of their income.

The ATO has indicated that when the last data matching exercise took place with vessels, nearly 25% of identified taxpayers had at least one outstanding tax return.

**SMSF PROHIBITION ON GIVING FINANCIAL ASSISTANCE TO MEMBERS: SELF MANAGED SUPERANNUATION FUNDS RULING SMSFR 2008/1**

SMSF Ruling 2008/1, released on 16 July 2008, explains the prohibition on trustees of SMSF's giving financial assistance using the resources of the fund to a member or relative under s 65(1)(b) of the SIS Act.

## SMSF PROHIBITION ON GIVING FINANCIAL ASSISTANCE TO MEMBERS: SELF MANAGED SUPERANNUATION FUNDS RULING SMSFR 2008/1

continued

### Financial assistance prohibition

The Commissioner explains that financial assistance is given to a member of an SMSF or a relative of a member in contravention of s 65(1)(b) if some aid, help or a benefit is given to that person, regardless of whether or not such assistance was requested. It can include the provision of a guarantee, indemnity, security or charge or the taking on of an obligation, or any other arrangement that, on an objective assessment is in substance to provide financial assistance to a member or relative of a member using the resources of the SMSF, including indirect financial assistance.

### Resources

The assistance must be given using the resources of the fund. It is the Commissioner's view that the resources of an SMSF are used if an arrangement or transaction relies on the assets of the SMSF, whether or not there is a positive, negative or nil effect on the net assets as a result of that arrangement or transaction.

### Assistance

The ATO states that s 65(1)(b) can apply if financial assistance is given *directly* or *indirectly* to a member or relative through a third party.

### Examples

The following arrangements involving a member or relative of an SMSF contravene the section:

- a) giving a gift of an SMSF asset to a member/relative;
- b) selling an SMSF asset for less than its market value;
- c) purchasing an asset for greater than its market value;
- d) acquiring services in excess of what the SMSF requires;
- e) paying an inflated price for services acquired;
- f) forgiving a debt owed to the SMSF by a member/relative;
- g) releasing a member/relative from a financial obligation owed to the SMSF, including where the amount is not yet due and payable;
- h) delaying recovery action for a debt owed to the SMSF by a member/relative;
- i) satisfying, or taking on, a financial obligation of a member/relative;
- j) giving a guarantee or an indemnity for the benefit of a member/relative;
- k) giving a security or charge over SMSF assets for the benefit of a member/relative.

Whether the arrangement or transaction contravenes s 65(1)(b) depends on the commercial reality of an arrangement having regard to the facts of the particular case.

### Factors indicating a financing arrangement include:

- a) the arrangement exposes the SMSF to a credit risk, or a financial risk, of a member/relative;
- b) the arrangement is on non-arm's length terms that are favourable to a member/relative;
- c) the arrangement not a usual or normal commercial arrangement;
- d) the arrangement is not consistent with the investment strategy of the SMSF;
- e) under the arrangement an amount is paid by the SMSF, and later repaid to the SMSF, in amounts or in a manner that may be equated with the repayment of a loan;
- f) the arrangement results in a diminution of the assets of the SMSF whether immediately or over a period of time.

## SMSF PROHIBITION ON GIVING FINANCIAL ASSISTANCE TO MEMBERS: SELF MANAGED SUPERANNUATION FUNDS RULING SMSFR 2008/1

continued

### Unrelated entities

The Rulings explains that the section is not contravened if an SMSF invests on commercial terms in an unrelated entity and that unrelated entity, independently of the SMSF and in its own right and from its own resources, gives financial assistance to a member or relative.

### Financing and leasing

In some cases, a financing arrangement, although not the lending of money as prohibited by s 65(1)(a), is prohibited by s 65(1)(b). The type of financing arrangement would generally be in the nature of a sale and lease back arrangement. However, the Commissioner does not consider that all leasing arrangements would contravene s 65(1)(b).

### Business real property

An SMSF may acquire business real property from a member or relative and lease it to a member or relative, however the Commissioner explains that such arrangement must not contravene s 65(1)(b).

### **Argyle Comment:**

***Care must be taken with arrangements involving Members of SMSF's. All dealings with SMSF's must be treated as though the parties are at arms length. This would include such things as regular and on time payment of rent for use of Business Real Property by a member of a Fund or a related party as well as careful consideration of all dealings with financiers.***

## SOLE PURPOSE TEST AND INCIDENTAL BENEFITS: SELF MANAGED SUPERANNUATION FUNDS RULING SMSFR 2008/2

SMSF Ruling 2008/2 released on 16 July 2008 sets out the Commissioner's views on the application of the sole purpose test under section 62 of the SIS Act.

It sets out the factors the ATO will consider in determining whether the provision of an incidental, remote or insignificant benefit by a self-managed superannuation fund (SMSF) amounts to a breach of the sole purpose test.

### Sole purpose test

The sole purpose test is a fundamental aspect of the regulation of superannuation which prohibits trustees from maintaining an SMSF for purposes other than the providing for retirement or death benefits for or in relation to fund members.

The ATO warns that a strict standard of compliance is required under the sole purpose test, requiring exclusivity of purpose.

### Incidental benefits

The Ruling acknowledges that incidental benefits outside the scope s 62 (eg retirement, employment termination or death benefits) may occur in certain circumstances. But it also explains that provision of benefits other than those specified in s 62 that are incidental, remote or insignificant do not automatically fall outside section 62. It explains the circumstances surrounding the SMSF's maintenance must be viewed holistically and objectively.

### Relevant Factors

The Commissioner explains that the sole purpose test is particularly concerned with *how* a trustee of an SMSF came to make an investment or undertake an activity, which is likely to vary from trustee to trustee.

## SOLE PURPOSE TEST AND INCIDENTAL BENEFITS: SELF MANAGED SUPERANNUATION FUNDS RULING SMSFR 2008/2 continued

The ATO explains that factors which commonly arise in considering whether the provision of benefits not specified in s 62 contravene the sole purpose test include:

- a) the trustee negotiated for, or sought out, the benefit (even if the additional benefit is negotiated for or sought out in the course of undertaking other activities that are consistent with s 62);
- b) the benefit has influenced the decision-making of the trustee to favour one course of action over another;
- c) the benefit is provided by the SMSF to a member or another party at a cost or financial detriment to the SMSF;
- d) there is a pattern or preponderance of events that, when viewed in their entirety, amount to a material benefit being provided that is not specified under s 62.

The ATO also explains the following factors may suggest that no contravention of section 62 has occurred:

- a) the benefit is an inherent or unavoidable part of other activities that are consistent with the provision of benefits under s 62;
- b) the benefit is remote or isolated, or is insignificant (whether it is provided once only or considered cumulatively with other like benefits) when assessed in light of other activities undertaken by the trustee that are consistent with s 62;
- c) the benefit is provided by the SMSF on arm's length commercial terms (eg if the benefit is provided at market value), consistent with the financial interests of the SMSF and at no cost or financial detriment to the SMSF;
- d) all of the activities of the trustee are in accordance with the covenants set out in s 52 (eg in the best interest of the beneficiaries and exercised with the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally obliged to provide);
- e) all of the SMSF's investments and activities are undertaken as part of or are consistent with a properly considered and formulated investment strategy.

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### Penalties

The Commissioner explains that contravention may attract civil and criminal consequences and place at risk the SMSF's status as a complying superannuation fund.

### **Argyle Comment:**

***Trustees and Advisors should ensure that investments undertaken by Trustees of SMSF's are done in accordance with a properly formulated investment strategy. In addition, Trustees need to ensure that they can provide proper evidence that they are not deriving any personal benefit from investments in such things as jewellery and works of art or other types of investments such as holiday style homes.***

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