

**LEGISLATION BY PRESS RELEASE - TRUST
CLONING CGT EXCEPTION TO BE ABOLISHED**

On 31 October 2008, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP, announced that the Government will abolish the trust cloning exception to CGT events E1 and E2.

Generally, a capital gains tax event happens when an asset is transferred to a new or existing trust. However, under the trust cloning exception no event happens if the asset is transferred to the trust from another trust and the beneficiaries and terms of both trusts are the same.

However the other exceptions will remain and a mere change of trustee of a single trust will continue not to trigger a CGT taxing point.

The Assistant Treasurer indicated that the amendment is aimed at resolving uncertainty surrounding the application of the exception, as well as removing the possibility of using the trust cloning exception to eliminate tax liabilities on accrued capital gains.

The amendments will apply to CGT events happening after 31 October 2008, and legislation is expected to be released shortly.

ATO GUIDANCE ON SMSFS AND IN-HOUSE ASSETS: SMSFR 2008/D5

The ATO has released a draft SMSF Ruling which explains the main issues with respect to the definition of in-house asset as set out in section 71 of the Superannuation Industry (Supervision) Act 1993, as they apply to self-managed superannuation funds.

The draft considers the meaning of a number of key phrases including asset, loan, investment in, lease, and lease arrangement.

Section 71 of the SIS Act provides that an in-house asset is an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund.

Subject to a number of exclusions which may, superannuation funds are prohibited from acquiring in-house assets where the value of those assets exceed 5% of the total value of the fund's assets.

Section 10(1) of the SIS Act provides that an asset means any form of property and includes money whether Australian currency or foreign currency. The draft explains that the phrase has a very wide meaning and includes every type of right, interest or thing of value that is legally capable of ownership including real property and personal property including any right or interest that is of value and legally capable of ownership.

Section 10(1) of the SIS Act provides that a loan includes the provision of credit or any other form of financial accommodation, whether or not enforceable, or intended to be enforceable, by legal proceedings. The draft explains that it extends to include arrangements that are in substance financing arrangements deferring the payment of an amount, including a loan of money, sale of

ATO GUIDANCE ON SMSFS AND IN-HOUSE ASSETS: SMSFR 2008/D5**continued**

goods or land on credit, instalment payment arrangements and arrangements for the deferral of payment of debts or entitlements. However, the draft also provides that not every payment deferral is necessarily a loan.

The draft explains that the meaning of the term investment is the asset resulting from applying the assets of the SMSF or entering into a contract for the purpose of gaining interest, income, profit or gain. It explains that where money or assets are provided for the benefit of a related party or related trust for the purpose of receiving income, interest, profit or gain, a sufficiently close connection will be established between the investment and that entity to enable it to be described as an investment "in" that entity.

Argyle Comment:

This draft follows a string of ATO opinion on the application of the SIS Act in connection with SMSF's. It is increasingly important for advisors to be aware of the application of these provisions, particularly given the onerous obligations imposed on advisors and fund auditors.

AAT SETS ASIDE NON-COMPLIANCE NOTICE FOR SMSF -RE XPMX AND FCT

In a recent decision the AAT has set aside a notice of non-compliance issued to a self-managed superannuation fund after finding that the Commissioner's notice was invalid and ineffective.

Facts - The Fund was a single member fund established in 1998 with contributions of \$12,000, made only on or about the first year. No regulatory return or approved auditor had been lodged or appointed since the fund was established, and no income tax returns for the Fund had been lodged for the 2001 to 2003 income years. In addition, none of the Funds records were in order or even in existence. The trustees argued that meeting the regulatory requirements were too onerous and costly.

In May 2007, trustee was issued with a notice of non-compliance for contravening the SIS Act. The Commissioner concluded that the SMSF had failed the culpability test in s 42(1A) of the SIS Act, in that all members of the fund were directly or indirectly knowingly concerned in, or party to, the contraventions.

Decision - The notice of non-compliance was set aside after the tribunal found that the notice was invalid and ineffective as the Commissioner had incorrectly made its decision under ss 42(1) and s 42(1A) of the SIS Act, instead of the relevant provisions for SMSFs in ss 42A(1) and 42A(5).

More importantly, the Tribunal declined to disregard the Commissioner's technical error and it explained that the Commissioner's intention was based upon what he perceived as serious contraventions of the SIS Act and the failure of the culpability test. It further explained that as the culpability test in s 42(1A) does not apply to SMSFs, the Tribunal considered that the Commissioner may have otherwise refrained from issuing the notice of non-compliance.

The Tribunal ordered that, pursuant to s 262A of the SIS Act, the trustees be provided with an opportunity to furnish a written enforceable undertaking to transfer or roll-over the Fund into a nominated industry, retail or public offer complying superannuation fund, as opposed to being issued with a non-compliance notice. In doing so, it noted that the acceptance of an enforceable undertaking from a trustee is an option available to the Commissioner to deal with a contravention by an SMSF trustee as set out in PS LA 2006/19.

Argyle Comment:

Section 295-325 of the Income Tax Assessment Act 1997 provides that a super fund which

AAT SETS ASIDE NON-COMPLIANCE NOTICE FOR SMSF -RE XPMX AND FCT continued

loses its complying status is assessed for tax at the rate of 45% of the value of its assets (less any undeducted contributions). It is important to note that until a superannuation fund's complying fund notice is formally revoked under section 40 of the SIS Act, a fund continues to be a complying fund and assessed as such.

**TRUST REIMBURSEMENT AGREEMENTS
ATO DECISION IMPACT STATEMENT - RAFTLAND CASE**

In a High Court decision recently, Raftland Pty Ltd as trustee of the Raftland Trust v FCT, the High Court unanimously confirmed that the "trust reimbursement agreement" provisions in s 100A of the ITAA 1936 applied to distributions of some \$4m made to a beneficiary of the trust under an arrangement whereby the income was applied for the benefit of other beneficiaries. As a result, it found that the trustee was assessable on the income under s 99A of the ITAA 1936.

The decision arose in the context of a trust purchased from a third party for a fee and used for the trafficking of losses. The ATO has now released a decision impact statement outlining its views with respect to the impact of the decision on its administrative practices and treatment of taxpayers in similar circumstances.

The ATO explains that the decision confirms and reinforces the Commissioner's ability to challenge trust loss trafficking arrangements by ascertaining the true intentions of the parties. It also explains that it will not always be necessary to look to complex anti-avoidance rules to defeat tax avoidance arrangements. The ATO explains that it will continue to challenge trust loss trafficking arrangements by seeking to ascertain the true intentions of the parties, by applying section 100A and/or by applying other general anti-avoidance and integrity provisions of the taxation law.

Argyle Comment:

Whilst this case represents the striking down of arrangements using third party trusts for trafficking losses, the decision as well as the decision impact statement represents the possibility that the trust reimbursement provisions could be applied in a broader context. Advisors need to properly review client circumstances as well as trust deeds to ensure the reimbursement provisions don't have application to their circumstances.

ADDRESS BY ATO CHIEF TAX COUNSEL – ATO APPROACH TO TAX LITIGATION

In a recent address in Melbourne on 24 July 2008, Mr Kevin Fitzpatrick, Chief Tax Counsel, gave an insight into the ATO's approach to tax litigation.

Test case program – he explained that there are currently 23 test cases in progress which are funded under the Tax Office's test case program. He explained that in 2007-08, 13 cases were agreed to be funded out of 31 applications. He explained that the eligibility criteria can be explained broadly as follows:

- (a) the issue deals with an area of law which is uncertain and/or contentious;
- (b) the issue is of significance to a substantial segment of the public or has significant commercial implications for an industry segment; and
- (c) it is in the public interest for the issue to be litigated.

Use of external solicitors and counsel

He also explained that a number of changes to the ATO practices have been implemented including:

- (a) a focus on improved case management;
- (b) ongoing training & development in the analysis of facts and evidence at an early stage; and
- (c) implementation of a process for identification of matters likely to proceed to litigation to ensure early attention to case preparation.

ADDRESS BY ATO CHIEF TAX COUNSEL – ATO APPROACH TO TAX LITIGATION continued

He outlined the importance of being able to narrow down the issues in dispute at an early stage. In terms of being able to settle a matter, it is not just about trying to narrow down the legal issues, but also the facts in dispute. Mr Fitzpatrick advised that the settlement of cases prior to a case getting to the litigation stage requires the ATO to be made aware of all the relevant facts as early as possible. Thus, it becomes extremely important for advisors to understand the issues and be able to establish the facts as early as possible.

Argyle Comment:

Test case fund is often overlooked as an option to many unresolved issues which may in fact fit within the general criteria set by the ATO in considering such cases. It is important for advisors to keep this in mind, no matter how small an amount in dispute may be as it is generally the issue that is of importance in these matters and not the amount.

SPECIAL DISABILITY TRUSTS – SENATE COMMITTEE RECOMMENDS CHANGES

The Senate Standing Committee on Community Affairs tabled its report with recommendations in the Senate on 16 October 2008.

In relation to Special Disability Trusts, the report recommended that:

- (a) the sale of a property that is owned by a SDT and used by the beneficiary as their principal place of residence be treated the same as any other person's principle place of residence, that is, exempt from CGT;
- (b) the transfer of property and other assets to a SDT be exempt from CGT and stamp duty;
- (c) unexpended special disability trust income be taxed at the beneficiary's personal income tax rate.

The Committee noted that the tax arrangements which currently apply to SDTs diminish their value for carers and people with disabilities.

Other recommendations included:

- (a) that the asset value limit for SDTs in s 1209Y of the Social Security Act 1991 be increased to \$1m and annually indexed according to a rate which reflects ordinary investment returns or the CPI, whichever is greater;
- (b) that the provisions relating to the SDT gifting concession be amended to annually index the gifting concession limit to the rate applied to the special disability trust asset value limit;
- (c) that the allowable uses of SDTs be expanded to include all day-to-day living expenses that are met to maximise the beneficiary's health, wellbeing, recreation and independence;
- (d) that unexpended income from a SDT be able to be contributed, on a pre-tax basis, to a superannuation fund for the trust beneficiary;
- (e) that when a SDT is used to purchase a first home for the trust beneficiary, the First Home Owner Grant should apply and be payable to the trust;
- (f) that the single trust rule in s 1209M(6) of the Social Security Act 1991 be amended to allow 2 trusts for each beneficiary.

SDTs were introduced in September 2006 to help parents and immediate family members make private financial provision for the current or future accommodation and care of a family member with a severe disability. They were designed to enable families to make these provisions without reducing the disabled persons entitlement to disability support pensions, age pensions, veteran pensions or related benefits.

Argyle Comment:

The uptake on these types of trusts has been quite slow due to the prohibitive nature of them from a tax perspective. It would appear that on the passing of the recommendations, these types of trusts will become more popular.

**AAT DECISION - RE BOTTAZZI AND FCT
CAPITAL GAIN ON PROPERTY SALE UPHELD – PENALTIES REDUCED**

In a recent AAT Decision, a taxpayer has succeeded in having penalties reduced from 75% to 25% of the relevant tax shortfall.

In this case, the taxpayer sought to challenge penalties and a tax shortfall of \$178,867, derived from a capital gain on the sale of a property.

The taxpayer argued that the property was at all times held in trust for a Mr Scharkosi who was the beneficial owner and occupied the property, made all loan repayments, paid all expenditure relating to the property and according to the taxpayers submissions was entitled to proceeds of any sale of the property.

It was found that there was no documentary evidence of any express or implied trust supporting the taxpayer's primary contention. The taxpayer had included rental income from the property and had claimed deductions relating to the property for the 1996 and 1997 income years.

The Tribunal found that there was no evidence of either the cost of any improvements or the date on which they were made and there was no supporting evidence the transfer of the property was made on a non-arm's length basis.

The Tribunal acknowledged that the amended assessment was issued more than 4 years after the original assessment, it noted that the Commissioner may amend an assessment at any time if there had been an avoidance of tax due to fraud or evasion and it held that on balance, there was an avoidance of tax due to evasion and therefore the amended assessment was valid.

The Tribunal confirmed the Commissioner's decision, but decided to reduce the penalty from 75% to 25% of the tax shortfall.

Argyle Comment:

This case highlights two points. The first is that any legal argument requires firstly substance, and then form. But most importantly any argument that cannot be supported without facts will face difficulty. Secondly, in all cases advisors need to consider whether the application of penalties at the level applied are appropriate.

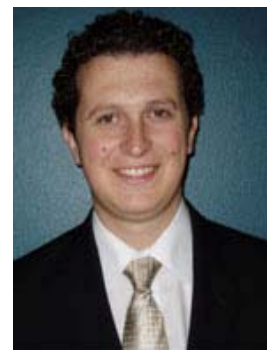
For further information or enquiries please contact any member of the Argyle Lawyers Pty Limited Taxation & Superannuation Team.

Contact Details

Phone + 61 2 8263 6622 (direct)
Fax + 61 2 8263 6633
Email pbobbin@argylelawyers.com.au
Mobile 0408 111 831
1983 Bachelor of Commerce (Accounting & Finance Systems)
 Bachelor of Laws University of New South Wales
1998 Master of Taxation (distinction) University Western Sydney
 Fellow of the Taxation Institute of Australia

**GEORGE SAMARAS - SOLICITOR****Contact Details**

Phone + 61 2 8263 6628 (direct)
Fax + 61 2 8263 6633
Email gsamaras@argylelawyers.com.au
Mobile 0407-003-010
2003 Bachelor of Laws /Bachelor of Commerce (Acc)
 Studying Master of Laws
 Member Young Lawyers Business Law Committee
 Fellow of the Taxation Institute of Australia
 Member of TIA Membership Committee
 Regular chair and presenter in professional forums

**DANIEL HAWRYLUK - SOLICITOR****Contact Details**

Phone + 61 2 8263 6637 (direct)
Fax + 61 2 8263 6633
Email dhawryluk@argylelawyers.com.au
Mobile 0413 555 222
2002 Bachelor of Social Science / Bachelor of Laws University of Western Sydney
2006 Masters of Taxation University of New South Wales

**MARY FERIZIS - SOLICITOR****Contact Details**

Phone + 61 2 8263 6646 (direct)
Fax + 61 2 8263 6633
Email mferizis@argylelawyers.com.au
Mobile 0416 025 019
1999 Bachelor of Arts Sydney University
2003 Bachelor of Law University of Technology, Sydney
2004 Admitted to the Supreme Court of New South Wales
2008 Diploma in Financial Planning - Kaplan

