

BINDING DEATH NOMINATION AND SMSF'S DRAFT DETERMINATION SMSFD 2008/D1

The Commissioner has now set out his preliminary views on whether there are any restrictions in the SIS Act or SIS Regs on a trustee of a SMSF accepting a binding death nomination from a member which nominate recipients of any benefits payable on the death of that member.

The Draft Determination provides that there are no restrictions on a trustee of an SMSF from accepting such a nomination from a member. The Commissioner explains that section 59 of the SIS Act and reg 6.17A of the SIS Regs do not apply to SMSFs.

The Commissioner further explains that the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustees, whether or not the circumstances accord with the rules in reg 6.17A. It is also made clear that a nomination is not binding on the trustee if it nominates a person who cannot receive a benefit in accordance with the operating standards in the SIS Regs.

The Draft states that a member of an SMSF is able to make a binding death benefit nomination in a different manner and form to that in reg 6.17A, provided the governing rules of the SMSF permits such a nomination.

Argyle Comment:

This draft ruling demonstrates the importance of ensuring that the rules of a self managed superannuation allow you to achieve what is intended.

MARIJANCEVIC V MANN - DEFAULT ASSESSMENTS UPHELD DESPITE INVALID GARNISHES

The Full Federal Court has unanimously dismissed a taxpayer's appeal and confirmed the validity of default assessments issued to him. The court found that the default assessments had not been issued for an improper purpose, despite the fact that a garnishee notice had been issued prior to establishing the amount of the assessments.

Facts

The taxpayer was audited for the income tax years ended 30 June 2000, 2001 and 2002. Following the audit the Commissioner issued default assessments totalling some \$1.85m for the relevant years. The taxpayer had been found in possession of a large sum of cash following his arrest and charging for drug related offences. Prior to the issue of any assessments, the Commissioner issued a garnishee notice under s 260-5 of Sch 1 of the Taxation Administration Act 1953 to prevent approximately \$592,000 that was being held by Queensland police from being returned to the Taxpayer. The taxpayer partially succeeded in objecting against the assessments and the AAT further reduced the assessments to about \$188,000.

Decision

However, the Federal Court dismissed the taxpayer's appeal that the default assessments were void on the grounds that they were issued in bad faith and for an improper purpose to support the garnish notices that had been issued beforehand.

The Court noted that the Commissioner had failed to issue the default assessment notices before he issued the garnishee notice, however it found that the invalidity of the garnishee notice did not affect the validity of the assessments. It found that the fact that the Commissioner acted too hastily in issuing the garnishee notice, or too slowly in issuing and serving the notices of the default assessments, did not mean that there was deliberate or conscious maladministration on his part and that there was no evidence of deliberate maladministration on the part of the Commissioner, and the appeal was dismissed.

Argyle Comment:

Taxpayers and advisors need to be aware of the recovery powers of the ATO

HOUSE OF REPRESENTATIVE AGREES SENATE ANENDMENTS MADE REMOVING FAMILY TRUST CHANGES

The Senate has rejected the proposed amendments to the Family Trust changes. Those specific changes as proposed by the Senate to the Tax Laws Amendment (2008 Measures No 4) Bill 2008 have now been agreed to by the House of Representatives. The amendments removed Sch 2 from the Bill which contained amendments that sought to reverse previously enacted family trust changes which dealt with changes to the definition of "family" in the trust election rules, and sought to prevent family trusts from making a one-off variation to the test individual specified in a family trust election.

The original Bill proposed to amend Sch 2F to the ITAA 1936 to change the definition of "family" in the family trust election rules to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse ie the definition of "family" that existed before the change introduced by the No 4 Act of 2007.

The Bill also sought to make amendments to prevent family trusts from making a one-off variation to the test individual specified in a family trust election (other than in relation to a marriage breakdown) from the 2008-09 income year. A variation was available where the new test individual was a member of the original test individual's family at the election commencement time. However, the variation was not available if there had been a conferral of present entitlement to, or distribution of, income or capital of the trust outside the new test individual's family group during the period in which the election had been in force.

DRAFT SMSF RULING SMSFR 2008/D4 - BORROWING EXCEPTION AND SMSF'S

The Commissioner has now set his preliminary view on the meaning of the phrases "borrow money" or "maintaining an existing borrowing of money" for the purposes of s 67 of the SIS Act in the draft ruling.

The Commissioner explains his view that the phrase "borrow money" takes on its ordinary meaning as read in the context of the SIS Act, and that the prohibition and exceptions in section 67 only apply to borrowings of money.

The draft explains that a borrowing is an arrangement exhibiting 2 necessary characteristics:

- a) a temporary transfer of money from one entity (the lender) to another (the borrower); and
- b) an obligation or an intention by the borrower to repay the money to the lender, which may be satisfied by the provision of an asset.

The Commissioner explains that whether an arrangement contravenes s 67 requires an objective analysis of all the circumstances surrounding the arrangement. He also explains that it is necessary to discover the true substance of an arrangement, having regard to its purpose and by reference to its legal nature rather than its economic effect.

The draft sets out examples of common arrangements, and explains whether they would contravene section 67. Those examples include:

- a) monies advanced by members for an SMSF to acquire assets;
- b) overdrafts maintained by an SMSF;
- c) contributions by members for an SMSF to acquire assets;
- d) margin lending account maintained by an SMSF;
- e) investing in contracts for difference by an SMSF;
- f) payments made on behalf of an SMSF;
- g) reimbursement of payments made on behalf of an SMSF;
- h) deferred repayment of amount paid on behalf of an SMSF; and
- i) instalment purchase agreement entered into by an SMSF.

The Draft explains that the phrase "maintaining an existing borrowing of money" takes on its ordinary contextual meaning and must be construed as a whole within the statutory context which it appears. It provides that an existing borrowing is maintained if a borrowing arrangement previously entered into remains in place where an SMSF trustee is obliged or intends to repay the money lent.

DRAFT SMSF RULING SMSFR 2008/D4 - BORROWING EXCEPTION AND SMSF'S

continued

Importantly, advisors and clients need to be aware of the Commissioner's view as regards an original loan being refinanced. The Commissioner explains that in such circumstances a new separate borrowing has been entered into. The Commissioner also considers that each drawdown of funds from a loan facility or similar arrangement constitutes a separate borrowing, even if the facility or arrangement makes provisions for redraws arising from earlier repayments.

Argyle Comment:

Advisors need to be aware of the importance of properly documenting borrowing arrangements for SMSF's as well as ensuring that loans are treated as such in all respects. Most important though is the issue of refinances, as advisors need to be aware of the Commissioners views as regards refinancing, particularly when clients are considering a short term loan with a view to refinancing a facility at a later stage.

**AAT DETERMINES THAT RENTAL PROPERTY NOT HELD ON TRUST
RE EAO AND FCT - AAT CASE (2008) AATA 804**

In this case the taxpayer who derived rental income from an investment property sought to argue that her mother was the true owner of the property, and that all income derived in respect of the property was actually derived by her mother.

The AAT rejected her submissions. The taxpayer purchased the property in her own name in 1996 for \$535,000. The purchase proceeds were provided by the Taxpayer's mother (*a resident of Taiwan*), and a \$96,373 loan from a bank. The property was leased to a company controlled by the taxpayer's de facto partner and another person, which company employed the taxpayer as a bookkeeper.

The Commissioner issued amended assessments for the 2000-2002 income years to include the taxpayer's assessable income rent paid by the tenant. It was argued by the Taxpayer that the property was held on trust for her mother and therefore the rent was derived by her mother.

The argument lacked documentary evidence as to the existence of the trust, other than a deed of acknowledgment executed in 2007 by the taxpayer both as trustee and as attorney for her mother.

In reaching its finding that the taxpayer had failed to establish the existence of a trust, the tribunal took a number of factors into consideration, including:

- a) the lack of documentary evidence other than the 2007 deed;
- b) the execution by the taxpayer of mortgages over the property as security for loans provided to companies in which her de facto partner had an interest;
- c) the taxpayer having informally agreed to the non-payment of rent by the tenant; and
- d) the prohibition in 1996 (under Foreign Acquisitions and Takeovers Act 1975) on the mother acquiring land in Australia.

Argyle Comment:

This case demonstrates the problems that arise when there is a lack of real evidence. Clients need to understand that when seeking to establish the existence of a bare trust or any arrangement, real evidence is needed which supports the position taken, as opposed to contemporaneously created documents.

**FOSTER V GALEA & ANOR - EX EMPLOYEE NOT FOUND TO HAVE SOLICITED CLIENTS FROM
PREVIOUS EMPLOYER ACCOUNTING FIRM**

The principal of an accounting firm has been unsuccessful in suing a former employee for breach of fiduciary duty and for breach of a restraint clause in relation to allegations that the employee had unlawfully solicited clients away from the firm to a new accounting firm he had joined.

FOSTER V GALEA & ANOR - EX EMPLOYEE NOT FOUND TO HAVE SOLICITED CLIENTS FROM PREVIOUS EMPLOYER ACCOUNTING FIRM continued

The Supreme Court of Victoria found there was no evidence to support the claims. The Court found that it had always been agreed between the parties that a large proportion of the clients that the employee had originally brought with him to the firm, which the principal had paid the employee to acquire, would eventually leave with the employee on the employee leaving the practice, given the employee had been looking after the affairs of many of them for over 20 years.

The restraint clause which prevented the employee from performing accounting work for any client of the firm for 2 years after ceasing employment with it was held to be unenforceable as it was considered to be unreasonable in the circumstances.

TAX LAWS AMENDMENT (2008 MEASURES NO.5) BILL INTRODUCED INTO HOUSE OF REPS

The Tax Laws Amendment (2008 Measures No 5) Bill 2008 was introduced in the House of Reps on 25 September 2008. Among other amendments, the bill includes changes to the GST legislation as regards the sale of real property.

The effect of the Bill, if passed will be to amend the GST Act to ensure the interaction between the margin scheme provisions and the sale of business as a going concern, the sale of farm land and the general anti-avoidance provisions does not allow property sales to be structured in a way that results in GST not applying to the value added to real property on or after 1 July 2000 by an entity registered or required to be registered for GST.

The Bill has been referred to the Senate Economics Committee for report by 13 October 2008.

KAFATARIS v DCT - EXCEPTION TO CGT EVENT E1 HELD NOT TO APPLY

The Federal Court has confirmed that CGT event E1 applied to the creation of trusts over a jointly owned property, and that the exception to the event for "a sole beneficiary of the trust who is absolutely entitled to the asset as against the trustee" did not apply to the transactions.

The husband and wife jointly purchased a property in 1987 for \$612,000. In 2002, they each executed identical trust deeds over their respective interests for the purpose of establishing superannuation funds for themselves. It is also important to note also that deeds were executed only 6 days prior to the property being sold for \$4m.

More importantly, the terms of the trust deeds provided that a "beneficiary" meant a person entitled to receive a benefit (including a member of the fund) and that the trustee had the power to pay benefits to the "dependants" and "relatives" of the members, which were defined to mean a spouse, children and grandchildren etc.

In reaching his decision, Lindgren J, first confirmed that CGT event E1 for the creation of trust applied to the transactions and determined that the exception under CGT Event E1 did not apply as under the terms of the trust deeds, the taxpayers were neither the sole beneficiaries of the trusts nor absolutely entitled to the trust assets (ie the interest in the property) as against the trustee.

The Court also noted that it was not necessary for beneficiaries of a trust to have a beneficial interest in trust property, but rather be absolutely entitled to the trust property. The Court held that the exception to CGT event E1 could only apply where the beneficiary has "a vested, indefeasible and absolute entitlement in trust property and is entitled to require the trustee to deal with the trust property as the beneficiary directs".

The Court found that the taxpayers were not entitled to their half interest in the property once it became subject to the trust. Their only entitlement was to require the trustees to pay money once the conditions for entitlement arose.

KAFATARIS v DCT - EXCEPTION TO CGT EVENT E1 HELD NOT TO APPLY

continued

Argyle Comment:

It is important for advisors to be aware of the distinction between creating a trust over real property where a person is the only beneficiary, and then also completing the next step for an exemption under E1 where the beneficiary is absolutely entitled to the asset.

CHIEF COMMISSIONER OF STATE REVENUE v SACCO (RD) - ADJOINING LAND HELD TO BE PHYSICALLY SEPARATE FROM PPR AND THEREFORE NSW LAND TAX EXEMPTION DENIED

The NSW ADT Appeals Panel has overturned the decision of the NSW ADT and affirmed the Commissioner's decision to disallow a principal place of residence (PPR) land tax exemption in respect of 2 connected properties.

The taxpayer owned 2 properties, one being his home and the other adjoining the first at its rear boundary. The taxpayer demolished a section of the boundary fence (2.4 metres wide) and installed a gate to allow family members access to the property. The Commissioner assessed the second property to land tax for the 2005 to 2007 land tax years.

At first instance, the Tribunal held that the 2 properties were to be regarded as a "parcel of land" for the purposes of the exemption, despite the presence of a boundary fence, finding that the 2 properties were undivided both in use and in physical separation.

On appeal, the Commissioner did not contest the Tribunal's finding that the 2 pieces of land were undivided in use, but rather contested that the 2 pieces of land were undivided by physical separation. It was argued by the Commissioner that this case could never be consistent with any ordinary meaning of the words *undivided by physical separation* taking into account the extent of practical separation effected by the fence, despite the presence of the 2.4 to 2.5m gate opening.

The Appeals Panel found the Tribunal's finding was not consistent with a reasonable and ordinary meaning of the phrase 'undivided by physical separation' and that the consideration by the Tribunal at first instance of use and purpose where irrelevant considerations.

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