



DISCRETIONARY TRUST TRAPS

Prior to the recent attention drawn to trust accounting and taxation by the advent of Bamford's case not much focus was placed on ensuring that trust accounts complied with the requirements of trust law and the complex taxing of trust income and loss provisions.

THIS ISSUE

PREPARING PAST TRUST TAX RETURNS	...1
NEWS IN BRIEF	...2
KEY DATES	...3
ABOUT CGD	...4

COMMON ERRORS: *Preparing past trust tax returns:*

1. Distributions of the wrong kind of income

In the past many tax professionals have found it too onerous to refer to trust deeds due to budget constraints. As a result the calculations of trust income have been by default based on accounting standards and trust distributions have been resolved around the accounting income of the discretionary trusts. This presents a serious problem where the trust deed defined the trust income to be income pursuant to section 95 of the Tax Act (i.e. generally taxable income).

2. Distributions to ineligible persons

Similarly, in the rush to prepare tax distributions that provide the best outcomes for clients, distributions may have inadvertently been made to entities that were not eligible trust beneficiaries, such as the Settlor of the trust. This can result in unintended tax consequences including the taxation of income at the highest marginal rates in the hands of trustees.

3. Errors in distribution resolutions

In most discretionary trust deeds the Trustee is required to determine which beneficiaries will receive income of the trust. The Trustee also has the important obligation (although often ignored) of determining how the income of the trust will be determined (i.e. as taxable income or income based on accounting concepts). Many tax advisors fail to outline the trustee's determination as to the kind of income noting only which beneficiaries will receive income. This may arguably result in an invalid income distribution minute or the wrong kind of income being distributed.

4. Unpaid distributions to corporate beneficiaries

Where distributions have been made to corporate beneficiaries but remain unpaid Division 7A issues may inadvertently have arisen resulting in deemed unfranked dividends for shareholders of the corporate beneficiaries that are also beneficiaries of the trust.

[Continued >](#)

5. Unpaid present entitlements and income attribution

Furthermore, where unpaid distributions remain outstanding they may give rise to income entitlements for beneficiaries that must be allocated prior to distributions to other beneficiaries. Please contact us to discuss the appropriate ATO treatment.

6. Sub trusts

Many trust deeds (particularly unit trust deeds) provide that any distribution of income of the trust that is not paid (in cash) is deemed to be set aside in a separate sub trust. This treatment of trust income has many complex incidental consequences that should be examined going forward.

7. Trust loss rules and income injections

Where discretionary trusts carry on businesses that incur losses in the start-up years tax advisors may be tempted to advise that income be distributed to such trusts to absorb losses. Attention must be placed on the complex trust loss provisions set out in Schedule 2F of the Income Tax Assessment Act 1936. These tests include the control test, pattern of distribution test, stake holder test (where applicable) and the income injection test. These tests are complex to apply and may be affected by Family Trust Elections.

8. Fixed and Non-Fixed trusts

Following from the point above, many tax advisors may assume that they are dealing with fixed trusts, but on close inspection of the trust deed a fixed trust may actually fail the onerous fixed trust test set out in ITAA36. This means that previous tax assumptions may have been incorrectly made and losses incorrectly claimed as deductions.

Furthermore, there remains a great deal of uncertainty regarding the question of whether beneficiaries can ever be entitled to unpaid income that is notional tax income only and is never received as actual income by the Trustee.

If you consider that you may have encountered any of the issues listed above or would like to discuss the implications these issues may have on your group, please contact us for further advice.

NEWS in Brief

It is now possible for Australian Companies to pay Dividends from Capital

Under the new Section 254T of the Corporations Act 2001 a company will not be able to declare a dividend unless:

- its assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the dividend payment;
- the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and
- the payment of the dividend does not materially prejudice the company's ability to pay its creditors

This means, like trusts, a company will also be able to return capital to investors.

Directors minutes must still be prepared to document the determination to pay the dividend. Dividend statements must also be issued to all shareholders in receipt of the dividend.

Please contact us if you require assistance with this documentation.

SMSF Borrowing Rules updated

Rules for SMSF to borrow have been further expanded with three major enhancements.

SMSF can now:

1. Refinance an existing loan;
2. Borrow for purchase costs such as stamp duty etc; and
3. Can borrow only for a single asset in a single arrangements, e.g. if a SMSF wants to purchase BHP shares & ANZ shares at the same time – two arrangements must be put in place.

The new sections of the SIS Act are 67A and 67B and the borrowing is now called "Non-recourse Loan Arrangement" and not "Instalment Warrant".

Continued >

ATO lifting the lid for cash economy

The ATO has decided to contact approximately 110,000 taxpayers via mail who may be participating in the cash economy. The letters support the ATO's strategy to deal with under-reported or omitted income and cash transactions used to hide or evade tax obligations.

The ATO will identify business taxpayers who may be involved in the cash economy based on indicators such as:

- small business benchmarks;
- data matching; and
- allegations of tax evasion reported to the ATO by the community.

Letters will be sent to businesses that are identified as reporting outside the small business benchmarks for their industry. If you receive this letter, please contact us to discuss your obligations and respond to the ATO.

Loans by private companies to Shareholders: Rules have changed

From 1 July 2009, non-commercial loan rules under Division 7A were tightened. This means that the value of benefits private companies provide to shareholders or associates through the use of company assets, for example houses and cars, may now be taxable as a deemed dividend if they provide them for:

- free, or
- less than their market value.

Under Division 7A, the term 'payment' now includes providing an asset for use by an entity. Before these changes, only transfers of property were caught under the provisions. A transfer of property occurs if ownership of the asset is transferred or there is a lease of real property (for example a holiday house owned by a private company and used by the shareholder).

We strongly **recommend that this is the time** to review the use of all your company assets to determine whether Division 7A applies to your company. If a Division 7A payment arose in the 2010 income year, it may be converted to a loan before the earlier of the company's lodgement day for the 2010 income tax return or the actual date that the return is lodged. Please contact our office immediately if you require further clarification.

Are you hiring staff on ABN's?

The ATO has found that many employers are incorrectly treating employees as contractors and pressuring them to get an Australian Business Number (ABN) in order to reduce their labour costs (such as workers compensation, payroll tax and compulsory superannuation etc). Employees also prefer to be paid as contractors in order to avoid PAYG withholding tax being deducted from their payment.

Having an ABN does not automatically make a person a contractor – you must consider the specific conditions under which you engage your workers. There are a number of factors you need to consider when deciding whether a worker is an employee or a contractor.

These factors include:

- Degree of control that can be exercised over the worker. If an employer has the right to direct how, when, where and by whom the work is to be performed the worker is likely to be an employee
- Whether the worker is paid for the time worked or the result produced. Workers being paid by the hour are more likely to be employees. Workers being paid for a result are more likely to be independent contractors.

If you have employees who are insisting that you pay them as contractors, and you are unsure about whether they are classified as employees or independent contractors, contact us to discuss.

KEY DATES

OCTOBER

Sun	Mon	Tue	Wed	Thu	Fri	Sat
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

28th October 2010

- September 2010 quarterly activity statement due (if lodging on paper form)
- Payment required of September quarterly superannuation employer contributions

NOVEMBER

Sun	Mon	Tue	Wed	Thu	Fri	Sat
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

1st November 2010

- Tax returns due (all individual income tax returns not lodging via tax agent)
- Tax returns due for prior year late lodgers.

7th November 2010

- October payroll tax return due for payment & lodgement

21st November 2010

- October 2010 monthly activity statement

25th November 2010

- September 2010 quarterly activity statement due (if lodging via tax agent)

DECEMBER

Sun	Mon	Tue	Wed	Thu	Fri	Sat
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

1st December 2010

- Large company tax payments due

21st December 2010

- November 2010 monthly activity statement due (if lodging via tax agent)

ABOUT CGD

CGD Business Solutions is a progressive accounting practice CGD is founded on the basis of working closely with clients; delivering quality services to help clients establish and grow their businesses. Our key staff members have achieved senior positions with a Big 4 Melbourne accounting firm, and have developed strong tax technical skills and business know how.

Services provided include:

- Accounting, including preparation of special purpose financial reports;
- Taxation, including preparation of income tax and fringe benefits returns, activity statements, tax risk and review analysis, assistance with ATO audits;
- Outsourced back office functions including virtual CFO's and management consulting;
- Self managed superannuation fund administration and advice;
- Specialist taxation advice, including tax structuring;
- Tax effect accounting / financial accounting disclosures.



ACCOUNTING,
TAXATION &
ADVISORY SERVICES

P 03 9769 3700
F 03 9769 3799

E office@cgdpartners.com.au
A Level 10, 50 Market St.
Melbourne, VIC 3000

For a complementary business & taxation health check, please do not hesitate to contact our office to organise a meeting.