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MKT TAXATION ADVISORS

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SMALL BUSINESS RESTRUCTURE ROLLOVER RELIEF

As part of the 2015 Federal Budget announcement, the Government announced that it would introduce a rollover relief for small businesses wanting to change their business structure. The measure passed the House of Representatives late last month and now awaits the Senate.

The proposed legislation will provide much more flexibility for small businesses to change their business structure, such as from individuals or companies to family trusts, trusts to trusts, without being subjected to adverse income tax outcomes. It is proposed that the draft legislation will apply from 1 July 2016.

Requirements for the Rollover Relief

To be eligible for the rollover, the following requirements must be satisfied:

- the proposed restructure must be a genuine restructure;
- the entities must be either a Small Business Entity ("SBE"), an affiliate or connected entity of an SBE or a partner in a partnership that is an SBE;
- the restructure must not result in a change of the 'ultimate economic ownership' of the transferred assets;
- the transferred assets must be CGT assets that are active assets; and
- both the transferor and transferee must be Australian residents for tax purposes.

Genuine restructure

The first criterion for eligibility for the rollover is that the transfer of the asset must be a genuine restructure. A 'genuine' restructure is determined having regard to all of the facts and circumstances surrounding the restructure. Examples of factors that would indicate a genuine restructure include:

- it is a bona fide commercial arrangement undertaken to enhance business efficiency,
- the business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership,
- the transferred assets continue to be used in the business,
- the restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business,
- the restructure is not artificial or unduly tax driven, and
- it is not a divestment or preliminary step to facilitate the economic realisation of assets.

Safe harbour

A safe harbour rule is available to provide certainty to small businesses where, for three years following the rollover:

- there is no change in the ultimate economic ownership of any of the significant assets of the business (other than trading stock) transferred under the restructure,
- those significant assets continue to be active assets, and
- there is no significant or material use of those significant assets for private purposes.

Ultimate economic ownership

The restructure must not have the effect of changing the ultimate economic ownership of transferred assets in a material way. The ultimate economic ownership refers to natural persons. As such, where the assets are held by a company, trust or partnership, the ownership must be traced to the natural person owners of the interests in these interposed entities that will ultimately benefit economically from the assets. Where there are more than one individual involved, their shares must have the same proportionate ownership after the restructure.

Discretionary trusts

Discretionary trusts may be able to meet the requirements for ultimate economic ownership on their facts. For example, a trust may be non-fixed for the purposes of the income tax law but, because there is no practical change in which individuals economically benefit from the assets before and after the roll-over, there will not have been a change in ultimate economic ownership on the facts.

However, given the nature of a discretionary trust, it may mean that it is not possible to determine proportionate ultimate economic ownership of the assets of the trust. Therefore if a discretionary trust seeking to use the roll-over (either as transferor or transferee) is a family trust, they may instead meet an alternative ultimate economic ownership test.

In the case of discretionary trusts, the alternative test states that a transaction will be taken as not having the effect of changing the ultimate economic ownership of assets where

- immediately before or after the transaction took effect, the asset was included in the property of a discretionary trust that was a family trust; and
- every individual who, just before or just after the transfer took effect, had ultimate economic ownership of the asset was a member of the family group of that family trust.

To be treated as a family trust, a trust must make a Family Trust election.

Issues arising

Genuine restructure?

Whilst the legislation provides various factors to consider in determining whether a transaction constitutes a genuine restructure for the purposes of the rollover there are still subjective elements where it is inevitable that the taxpayer and the ATO may be at odds.

Is the restructure objectively seen as a "bona fide commercial arrangement" undertaken to "enhance business efficiency"?

If the restructure is to allow key employees (or indeed other family members) to obtain an interest in the business, so as to "enhance business efficiency" how does that sit with the next factor of the business having to operate under the same "ultimate economic ownership"?

We presume that if there is a more than a nominal tax benefit resulting from the transfer it will be difficult to argue that the restructure qualifies as a genuine restructure. Or is it Part IVA that will reverse the effects of the rollover?

Without further guidance from the ATO and ultimately the Courts as to the meaning of the term "genuine restructure" there will remain significant risk in applying the rollover, certainly without either a Reasonably Arguable Position prepared by a tax advisor, or even a PBR obtained from the ATO.

Finally, the introduction of a Safe Harbour Rule is a welcome move that should provide a degree of certainty to SBE's that seek to use the rollover, provided they can meet the three year restriction period. The EM provides no details on whether the ATO has discretion to overlook the three year period in the case of death, a third party sale or other unforeseen event.

Ultimate Economic Ownership

The transfer of assets from Individuals to Companies or Fixed Trusts and vice versa appears quite straight forward enabling the unwinding of formal legal structures, such as companies and fixed trusts where the business perhaps no longer requires that formality.

However, moving eligible assets out of a company and back into either a Family Trust or individual shareholder's hands and thereby enabling the CGT discount to be applied upon a future sale would carefully need to consider the "genuine restructure" requirement.

The transfer to a discretionary trust that has elected to be a Family Trust will no doubt give rise to the most discussion and consideration. It appears that the only requirement is that the transferee must be a member of the Family Group of the Family Trust in order for this requirement to be met.

Therefore the ability to move eligible assets including shares from an individual or a company to a Family Trust can be extremely attractive from a tax perspective, however it will still need to meet the requirements of being a "genuine restructure". This will be a crucial determination.

If you have any queries on the proposed rollover, please call Sean Pearce or Peter Hong.

Tax Planning in March?

The Federal Government previously announced that all tax policy will be reviewed to rein in the budget deficit. Items such as superannuation, taxation of multinationals and changes to negative gearing and even a potential lift in the GST rate were all touted as potential reforms. As the process has unfolded the Government has appeared to back away from many of the proposed reforms.

With the public mood and that of the cross benches firmly opposed to any upward or outward changes to the GST, the Government may be forced to compromise to achieve some savings, and this may see changes to the Superannuation regime once again.

Areas that may be targeted include:

- Caps or increased taxes on Concessional Contributions (though Non Concessional Contributions may also be targeted);
- Taxation of Assets supporting pensions when the level of member benefits, or the income derived on these benefits, exceeded a concessional threshold;
- Taxation of Pensions for those over the age of 60;
- A Restructure of the Lump Sum Tax regime, which may affect the taxes on Lump Sums for retirees aged 60 and above;
- Changes to the rules around Limited Recourse Borrowing Arrangements; and,
- Further changes to the Centrelink and Veterans Affairs assessment of Pensions paid by Superannuation Funds.

All of the above changes are likely as they can be said to target mainly the "rich" and those well off enough to be able to afford to go without these concessions. If these changes are to be made they will most likely be announced on budget night with the changes coming into place on that night. All current arrangements should remain untouched.

As tax planning is an activity usually carried out in May or early June each year, if these changes are passed on budget night many taxpayers will have already lost access to these concessions rendering many tax planning strategies useless.

It may therefore be wise to start contacting clients now to start the tax planning process especially where a strategy has been determined with action planned for later this financial year. Planning for some of these changes includes:

- Making Concessional Contributions and Non Concessional Contributions (including drawdowns and re-contributions);
- Payment annual pension entitlements;
- Planned Lump Sum drawdowns;

- Realisation of significant capital gains on Superannuation assets;
- Limited Recourse Borrowing Arrangements for the acquisition of new assets, including assets in unit trusts or companies;
- Centrelink and Veterans affairs planning where Superannuation pensions are concerned.

By taking these steps prior to the May Budget you will reduce the risk that your clients will lose the benefits of these concessions should touted changes be announced on budget night.

If you have any queries in relation to this, please contact Chris Schoeman.

GST Audit Alert: Selling Residential Property that has been rented

If your client has claimed input tax credits (ITCs) on construction costs and then rented out this residential property, they will be on the ATO's audit target list. This is especially the case where the property has now been sold.

Tough economic times have meant that for many property developers, the apartments or properties they had built for sale have been held onto and rented, awaiting a change in the property market conditions.

From a GST perspective, the fundamentals are – if you build a residential apartment and rent it out you can't claim ITCs on the costs of construction. If you build and sell a residential apartment you can claim ITCs, and you also will have to pay GST on the sale. Where a developer has developed an apartment intending to sell it and then decides to rent it, the GST treatment is a whole lot more complicated.

The Commissioner issued GST Ruling GSTR 2009/4 Goods and services tax: New Residential Premises and Adjustments for Changes in Extent of Creditable Purpose setting out his view of how GST applies in these circumstances. Essentially, it focuses on intention – if you intend to make a taxable supply (ie. the sale of new residential apartments) then you can claim full ITCs. If that intention changes to residential renting (which is an input taxed supply), the law requires you to make an adjustment to the amount of ITCs (on construction costs, for example) that you previously claimed.

Importantly, if you cannot show that you ever had a sale intention, or the ATO thinks that any expected sale was so far in the future that you were just running a rental enterprise, you would generally have to pay back all the ITCs originally claimed.

The rules about how much you may be required to pay back to the Commissioner are different if you change your intended use of a residential apartment (from sale to rental), and different again if you had two intentions at the same time (sale and rental) after you correctly claimed input tax credits on construction costs. The challenge for accountants and their developer clients will be to work through the very complicated adjustments to determine the extent of creditable purpose rules contained in Division 129 and identify if they have to pay back any ITCs. The difficulty is to prove to the Commissioner in an audit, which of the rules will apply to your client.
To make life even more difficult, the actual adjustment steps that need to be worked through can be extremely complex, and the Commissioner has been successful in audit and in court when

he has disputed the calculations developers have used to work out how much ITCs they needed to pay back.

As always, it is better to be prepared than wait for the ATO to call for an audit. The ATO are allowing "voluntary disclosures" in regard to this matter, however it is important to be aware of the GST consequences before you get caught within the ATO's audit radar.

As a first step, you should consider the ITCs that were claimed during the construction phase of residential developments. This is the starting figure that the Tax Office will be looking at. If there has been a chance of intention, there is a high probability that the Commissioner may want to charge penalties and interest as well as request a repayment of the ITCs that were claimed.

The actual adjustments to calculate this are complex and time consuming. We can assist in this process having attended to many GST audits in this area recently.

If you would like to discuss these matters further, please contact Mimi Ngo.

PROPOSED CHANGES TO DIVISION 7A - PRIVATE COMPANY LOANS

Although this may be seen by some as old news, the Board of Taxation's review of Division 7A was released by the Government in June 2015 and then promptly included in the current Tax Reform-process.

With that process likely to result in its first announcements either late this month or as a part of the May Federal Budget, we thought we should remind you of the Board's recommended changes.

The Board has developed a reform model called the '**Amortisation Model**', which has the following characteristics:

- The maximum loan term would be 10 years, not 7 years or 25 years secured.
- The prescribed maximum loan balances during the term of the loan (including any accumulated interest) would be as follows:
    - 75 per cent of the original loan by the end of year three;
    - 55 per cent of the original loan by the end of year five;
    - 25 per cent of the original loan by the end of year eight; and
    - 0 per cent of the original loan (that is, fully repaid) by the end of year 10.
- Similarly, interest would be able to be accrued annually but would have to be paid by the end of years three, five, eight and 10. This changes the requirements for annual minimum repayments or principal and interest.
- There should be no requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist by lodgement day for the income year in which the loan was made. Accounting entries should suffice here.
- **All of the pre-existing loans and UPEs** are proposed to be treated as follows:

Pre-1997 loans **Pre-2009 UPEs** **Post-2009 UPEs**	Repayable with interest over 10 years from the date of enactment in accordance with new complying loan rules.
Complying 7-year loans	Term extended to 10 years, repayable with interest, in accordance with new complying loan rules.
Complying 25-year loans	Repayable in accordance with existing terms (that is, grandfathered).

If the Government is of the mind to accept the Board's recommendations, significant changes will occur to previously quarantined loans and UPE's that will require immediate action by your clients. Furthermore, the potential abolition of the 25 year secured loan means that clients who may be in a position to convert an unsecured 7 year loan to a 25 year secured loan may want to make arrangements for that to happen now, before that option is removed.

We have been working with a number of firms to better prepare their clients for potential changes to Division 7A and would welcome your call to discuss the options.

MKT Accountants Network 2016 Footy Tipping

We would like to invite you to join our AFL Footy Tipping competition for the 2016 season. The competition is free to enter and available to yourself and any member of your firm. Prizes are available for weekly winners as well as those who finish in the final top 3. Please visit the news page on our website www.mkttax.com.au/tax-news for details on how to join.

The season starts on Thursday 24th March 2016 so register ASAP in order to get those first round tips in!