

Fiscal Watch

Is Your Will Tax Effective?

It is possible to structure your estate so that minor children receive income for their welfare, maintenance and advancement in life without penal rates of tax that apply to income distributed to them from family trusts in their lifetime.

Income which is derived by the trustee of the trust estate from the investment of any property that devolved for the benefit of the beneficiary from the estate of a deceased person is "excepted trust income", ie, income that is excepted from the general rule that applies to income of minors which means that it is taxed at normal marginal tax rates eg, there is a tax free threshold of \$6,000 per minor beneficiary.

There is an anti-avoidance rule but this only applies where the income derived by a trustee arises directly or indirectly under or as a result of an agreement that was entered into or carried out by any person for the purpose, or for purposes that included the purpose, of securing that that assessable income would be excepted trust income. This was designed to catch arrangements whereby a person would enter into an arrangement with an

elderly relative so that income could be diverted through their estate upon death.

You can structure your estate to protect your children and grandchildren in this way.

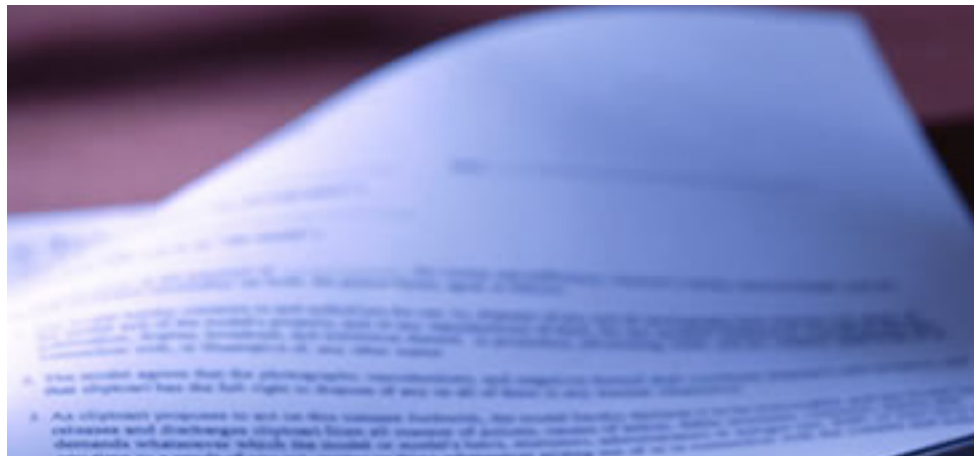
Public Trading Trusts – Will you be caught?

Certain types of trusts can be caught by the public trading trust rules which means they are taxed as corporations without flow through other than by way of frankable distributions.

Often people get caught unintentionally. It is important if you are operating in the trust area raising funds from the public that you are aware of how these rules operate.

For example, certain types of property trusts can be caught. An example would be a property trust which invests in retirement villages. If the investment by the property trust is not carefully structured, the property trust will be caught by the public trading trust rules.

Another example is a trust which only invests for an income return but the assets in which it invests are not within the eligible investment business categories such as a trust which invests in artworks.



A trading business is one that does not wholly consist of an eligible investment business so it only requires an activity outside this area and you will be caught.

It is important to seek advice when establishing a trust to ensure you are not caught by these rules. It is possible to structure the proposed business without being caught by these rules such as stapled security arrangements.

Self Managed Superannuation Funds – Gearing of Investments

There is now an exception to the general prohibition on an SMSF borrowing monies.

An SMSF is permitted to borrow provided the loan is what is called a “Complying Loan”. Although this was designed to permit the SMSF to invest in instalment warrants, the amendments to the law are capable of a wider application.

There are some limitations such as the loan having to be limited to the asset purchased and the asset must be one in which the fund may invest eg, it must not offend the in-house asset rules.

However, there are now additional options open to trustees of superannuation funds.



Personal Services Business (PSB) – Operation or Results Test - Not determined by whether independent contractor or employee – separate test

In a test case before the Federal Court, an objection against the decision of the Deputy Commissioner to refuse to grant a PSB determination with respect to two entities that were personal services entities whose ordinary income or statutory income included the personal services income of a particular individual. Without a PSB determination, the income of the entities would be treated as income of the individuals employed by those respective entities and assessed in those respective individuals’ hands accordingly.

The issue was whether the entities satisfied the results test in order to be entitled to a PSB determination.

In order to satisfy the results test a personal services entity in relation to 75% of the personal services income of one or more individuals that is included in the personal services entity’s income must satisfy each of the following criteria:

- > the income is for producing a result
- > the personal services entity is required to supply the plant and equipment or tools of trade needed to perform the work from which the personal services entity produces the result
- > the personal services entity is or would be liable for the cost of rectifying any defect in the work performed.

It was argued by the taxpayers that the reference to “independent contractor” in the legislation and the public taxation ruling meant that there was no room for any penumbra of circumstances in which the results test might not apply, but the individual may still be seen as an independent contractor. Effectively the taxpayer was arguing that if the taxpayer concerned satisfied the indicia of an independent contractor then it must satisfy the results test and therefore be entitled to a PSB determination.

However, the Court held that just because the personal services income provisions of the ITAA 97 apply to an individual and the individual’s circumstances do not satisfy the results test does not mean that the individual is an employee for the purposes of any Australian law or any instrument made under an Australian law. Therefore an entity could be an independent contractor at law without satisfying the results test.

The Court agreed with the submission by the Deputy Commissioner that while the results test is based on the common law criteria for characterising an independent contractor from an employee/employer relationship, the results test is satisfied by meeting the three specified criteria. Therefore for the purposes of the results test it is not necessary that all the recognised indicia of an independent contract are present and therefore even though there may be many of the indicia of an independent contractor present in particular circumstances if the three results test criteria are absent the interposed entity or personal services entity is not entitled to a PSB determination.

The Court held that the whole purpose of the results test is to bring an eye guided by substance, not form, to the circumstances of the provision of the

personal services to the party who acquires or receives them. The central relationship for examination (irrespective of the nature and number of interposed entities) is between the individual whose exertions produce the personal service income and the requirer or acquirer of those exertions or services. Thus, in assessing what the income is “for” and whether the income is “for producing a result”, one directs attention to all the circumstances of the individual and, in particular, what the individual does at, and with, the ultimate acquirer or requirer of the services.

In this case it was held that the taxpayers were not engaged to produce a result. They were simply employed through the interposed entities to do the skilled and specialised work of an instrument engineer which was coordinated with the work of other engineers within the business of the acquirer to produce a result within the acquirer’s business which could not be said to be the result of the individual taxpayer.

Section 255 Notice Effective to Intercept Dividend Payments to Non-resident

The High Court has recently considered the application of section 255 of the ITAA 36. This section effectively allows the Commissioner to issue a notice to intercept payments to a non-resident to recover tax due and payable by the non-resident. Prior to this case the Commissioner took the view that the section could apply before any assessment of tax due by the non-resident had issued and that it could apply to whatever taxation liabilities the non-resident then had or would have in the future.

The High Court rejected the wide interpretation sought to be given to that

section by the Commissioner. The Court held that the section could not apply where there was no assessment issued. The reference to the tax "which is or will become due by the non-resident" only applied where there was an assessment but the time for payment of that tax had not arrived. The section did not refer to the possibility of tax becoming payable in the future.

In this particular case, the company on which the 255 notice was issued by the Commissioner had declared but not paid a dividend. Prior to payment of the dividend and after the issue of the first set of section 255 notices, the non-resident shareholder assigned the right to receive the dividend to another non-resident and gave an irrevocable direction to the company to pay the dividend to the assignee.

After the above had occurred, the Commissioner issued an assessment to each of the non-resident shareholders and issued further section 255 notices to the company in respect of the dividends payable but not paid.

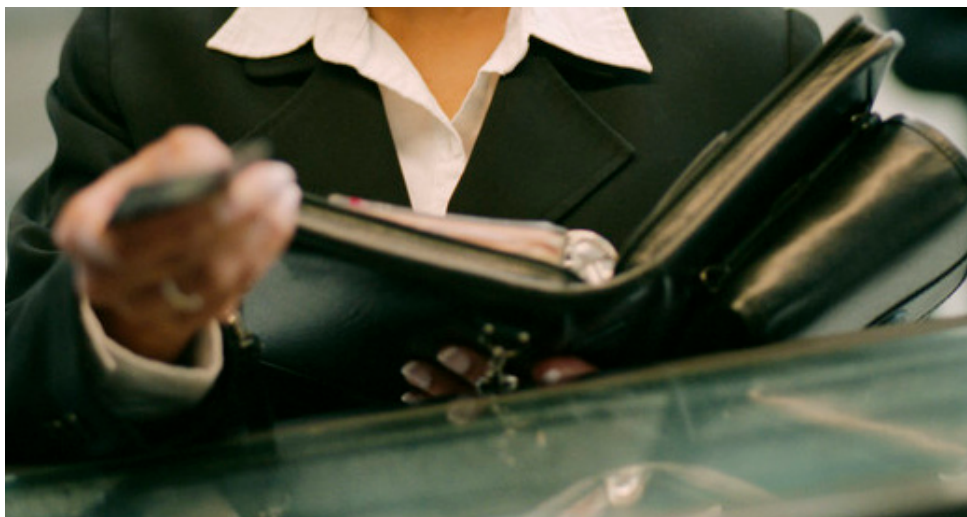
The first notices were held to be invalid because there was no tax assessment determining the liability of the non-resident at the time of issue of those

notices in accordance with the High Court's above interpretation of the section.

It was argued that the dividends were not a debt until the time fixed for payment which was after the dividends had been assigned and therefore at the time fixed for payment the company was not in control of money belonging to the non-resident shareholders which meant the second notices had no effect.

However, the Court held that the company was contractually bound to deal with the dividend it had declared only with those who were its members on the record date. The company therefore was and remained liable to pay the dividend to those who were its members on the record date notwithstanding the assignment of the same.

Therefore, even though the dividends had been assigned at the date of the service of the second notices, the company remained contractually bound to the non-resident shareholders for payment of the dividend. The second notices were therefore effective to require the company to retain the monies out of the dividends payable to those non-resident shareholders.



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Piper Alderman Lawyers

Sydney

Level 23
Governor Macquarie Tower
1 Farrer Place
Sydney NSW 2000
DX 10216,
Sydney Stock Exchange
Phone: + 612 9253 9999
Facsimile: + 612 9253 9900

Melbourne

Level 9
60 Collins Street
Melbourne VIC 3000
DX 30829, Collins Street
Phone: + 613 8665 5555
Facsimile: + 613 8665 5500

Brisbane

Level 9
239 George Street
Brisbane QLD 4000
GPO Box 3134
Brisbane QLD 4001
DX 105, Brisbane
Phone: + 617 3220 7777
Facsimile: + 617 3220 7700

Adelaide

167 Flinders Street
Adelaide SA 5000
GPO Box 65
Adelaide SA 5000
DX 102, Adelaide
Phone: + 618 8205 3333
Facsimile: + 618 8205 3300

Email: enquiries@piper-alderman.com.au

www.piper-alderman.com.au

For further information contact:

Alan Jessup

+61 2 9253 9911
ajessup@piper-alderman.com.au

Adam Stoker

+61 2 9253 9926
astoker@piper-alderman.com.au

Dahniah Mithiran

+61 2 9253 9986
dmithiran@piper-alderman.com.au

Judy Choate

+61 8 8205 3426
jchoate@piper-alderman.com.au