

CLIENT ALERT

August 2005

Tax News, Views and Clues

Transfer of Assets between Trusts

The Tax Office has recently released an interpretative decision (ID) concerning the transfer of an asset between two discretionary trusts for capital gains tax (CGT) purposes.

CGT event E2 typically occurs when a CGT asset is transferred to a trust. This causes the taxpayer who disposed of the asset to be assessed on any capital gain.

However, where the asset is transferred from one trust to another, CGT event E2 may not apply, provided the beneficiaries and terms of both trusts are the same at the time the asset is transferred.

The ID considers a case where the two trusts have the same beneficiaries and trust deed, but a different trustee, appointors and establishment date. The Tax Office considers that the establishment date and the trustee of the two trusts do not have to be the same. However, the ID outlines the Tax Office's view that the two trusts must have the same appointor. The Tax Office also indicates that the vesting dates must be the same.

As the appointor has the power to appoint and remove a trustee, it is considered that the identity of the appointor is a term of the trust. Consequently, as the terms of both trusts must be identical, both trusts must have the same appointor in order for the exemption to apply.

- **TIP:** The ability to transfer assets between identical trusts can provide useful planning opportunities for asset protection, estate planning and business structuring generally. Professional advice should be sought on this complex matter.

Service Trusts

The Tax Office has released a guide regarding its approach towards service entities set up by professional firms such as accountants, lawyers, doctors and engineers. The guide will also apply to other organisations that charge related entities for staff and services.

A professional services firm may set up another entity known as a 'service entity', which is contracted to provide certain services to the professional firm. The services provided may include short-term or long-term staff, the lease of plant and equipment and the premises in which the firm operates.

The fees charged by the service entity are typically based on costs plus a mark-up.

The guide provides a set of criteria that the Tax Office considers, if adopted by taxpayers, will demonstrate that the fees charged by the service entity are commercially realistic. The Tax Office requires taxpayers to show that the operations of the service entity are a genuine business that is separate from that of the professional services firm.

The Tax Office recommends that all professional services firms review their service agreement arrangements in light of the guide's recommendations. It will allow taxpayers twelve months to ensure that their own circumstances reflect the recommended mark-ups and other criteria outlined in the guide.

- **TIP:** Taxpayers who operate service entities should carefully review the Tax Office guide and address any issues over the next 12 months. This should reduce any risk of future adjustments should a Tax Office audit occur.

Family Trust Elections

It is often necessary to make a family trust election in relation to a trust to ensure that deductions are more readily available for trust tax losses. An election may also be necessary to ensure that franking credits (tax offsets) can be utilised.

The trust can only make the election where it passes strict ownership and control tests. In making the election, the trust must nominate an individual known as the 'test individual'. Thereafter, the trustee will be restricted to making distributions to members of that individual's family, plus certain wholly owned entities and charitable organisations. Other trusts or companies may make similar elections so that the trust can distribute to them.

Distributions outside of this group result in penalty tax at the top marginal rate (family trust distribution tax).

The Tax Office has recently released two interpretative decisions (IDs) concerning family trusts that clarify which family members may be included in the family group.

The first ID considers the inclusion of stepchildren in the test individual's family. It states that if the spouse of the test individual dies, any stepchildren are no longer included in the defined family group.

The second ID looks at two different trusts with different test individuals who are brothers.

The Tax Office has declared that since the brothers are members of each others' families, their own trusts will be able to distribute to each other, provided additional elections are made, called interposed entity elections.

These elections in turn have a further impact on distribution flexibility and should be very carefully considered.

- **TIP:** Taxpayers should regularly review their trusts and consider whether elections are required to make use of tax losses or franking credits. The potential impact on distribution flexibility should also be considered.

2005/06 Financial Year Updates

The Tax Office has recently released the following statutory amounts/rates for the 2005/06 financial year:

- The car limit is \$57,009 — this is used to calculate depreciation deductions and is unchanged from the previous year.
- The luxury car tax threshold also remains equal to the car limit of \$57,009.
- The benchmark interest rate for shareholder loans is 7.30% per annum.
- The improvement threshold for CGT separate asset purposes is \$109,447.
- The age-based deduction limits for superannuation contributions by employers and eligible persons are:
 - under 35 years of age: \$14,603;
 - 35 to 49 years: \$40,560; and
 - 50 years and over: \$100,587.

CGT — Cost Base

The Tax Office has recently released an interpretative decision stating that, following a demerger, an averaging method of calculation must be used to determine the cost base of shares held in each company.

Please contact us for further information.

GST on Property

The Tax Office has recently released a number of interpretative decisions (IDs) in relation to GST on commercial and residential property.

The Tax Office has considered whether GST must be charged where an option is granted for the purchase of property for a specified amount up until a specified date. In exchange for the option, the buyer pays a percentage of the purchase price.

Whether GST is charged depends on the type of property supplied. The Tax Office has declared that if the option entitles the buyer to purchase a commercial property then the supplier must charge GST on the option fee. However, if the option relates to an existing residential premises which is itself input taxed, then no GST is charged on the option fee.

In another ID, the Tax Office has considered whether GST must be charged or claimed in relation to a credit arrangement entered into for the purchase of residential premises.

Broadly, a credit arrangement is where the purchaser of the property agrees to pay monthly instalments and interest for an extended period of time. The purchaser is entitled to occupy the residential property from the contract date until final payment. On final payment the title passes to the purchaser.

The credit arrangement is considered to be a financial supply and is input taxed. Consequently, no GST is charged on the interest component.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.