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Private Use of Company Assets

The Federal Government announced in the 2009 Budget that it intended to amend Division 7A to tax shareholders who use assets owned by private companies. For example, company owned boats and holiday houses that are used by shareholders and their associates for private use. Treasury has released exposure draft legislation, to have effect from 1 July 2009.

Details of Proposed New Law

A deemed dividend will arise where a private company grants a lease or licence to use company property or assets to a shareholder or shareholder's associate (unless they pay market value rent for the use of the assets).

The draft legislation treats these arrangements as a payment under Division 7A. As the shareholder or shareholder's associate are deemed to receive a payment from the company, they will be treated as having received a deemed dividend, illustrated in these examples from the draft explanatory memorandum:

Use of a yacht

Ben is a shareholder of a company that manufactures yachts. The company owns a yacht used for demonstration purposes. Every second weekend the company allows Ben to use the yacht for free. Ben is not an employee of the company so his use of the yacht is not subject to fringe benefits tax.

Ben's use of the yacht is a payment for Division 7A. Ben is required to pay for his use of the yacht (at market value rates) or the use will result in the company being treated as paying a deemed dividend (subject to having a distributable surplus). He will be liable to pay tax on the deemed dividend if the payment is not converted to a loan and repaid before the lodgement day or a loan agreement is made.

Use of a car

Peter is a shareholder of a company. Every second weekend Peter takes a company car home for private use and returns it on Monday. Peter is not an employee of the company so his use of the car is not subject to fringe benefits tax.

Peter's use of the car is a payment for Division 7A even when he does not drive the car. The fact the car is available means he has a licence to use it. Peter is required to pay for the car (at market value rates) or his use will result in the company being treated as paying a deemed dividend (subject to having a distributable surplus). He will be liable to pay tax on the deemed dividend if the payment is not converted to a loan and repaid before the lodgement day or a loan agreement is made.

Exceptions

Minor benefits

This exception covers the minor use of company assets. It applies where the use of the asset would amount to a minor benefit under the fringe benefits tax regime. Under the FBT legislation, the use of an asset will be minor where the notional value of the benefit is less than \$300.

Otherwise deductible payments

This exception covers the use of benefits where the otherwise deductible rule applies in a similar manner to the FBT legislation. That means the deemed dividend is reduced to the extent the shareholder or shareholder's associate would have been entitled to claim a tax deduction if they had personally incurred expenditure on the lease or licence.

Dwellings used by a shareholder

There is also an exception for the use of dwellings where the shareholder or shareholder's associate who is granted the lease or licence to use the dwelling:

- is carrying on a business;



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- was granted a lease, licence or right to use the land or water on which:
 - the dwelling is situated or adjacent to, or
 - the building in which a dwelling is situated, for the primary purpose of carrying on that business;
- was granted the licence or right to use the dwelling for the purpose of enabling the shareholder or shareholder's associate to carry on that business; and
- the dwelling is less than 10% of the area of the land, water or building used to carry on that business.

This provides a carve-out for many farmers, primarily those who have a farmhouse on land owned by a company or trust.

Practical Issues Still Outstanding

It is unfortunate the draft legislation leaves a number of issues outstanding, making it difficult to advise how they apply.

Availability or usage

One of the main outstanding issues is whether the deemed dividend would be based on the market value of:

- the actual use of the asset by the shareholder or shareholder's associate; or
- the availability to use the asset by the shareholder or shareholder's associate.

This is highlighted when comparing the two examples above. In the case of Ben and his yacht, Ben is taxed on the actual use of the yacht; whereas, in the second example Peter is taxed on the availability of the car (notwithstanding his actual use of the car).

The draft explanatory memorandum does not make it clear what happens in the conventional situation of a holiday home which a family may only use it for a

number of weeks (rather than a full year). Should the family be taxed on the actual use of the property, or the fact the property is available to them for the full year?

Options for Affected Taxpayers

The reaction to this proposal may be to transfer the asset to the shareholders, which may be appropriate for low value assets. However, careful thought will need to be given to assets with a significant value or significant unrealised profit.

For lower value assets, it may make sense to transfer the asset out of the company, perhaps financed by way of a dividend. For example, an asset valued at \$20,000 which does not have any unrealised CGT gain could be distributed by way of a fully franked dividend, this would require a small payment of tax in addition to the franking credits.

However, transferring assets with a greater value may result in a much larger tax bill and may not be feasible, particularly those that have a large unrealised CGT gain in the company. If the transfer was to be funded by a franked dividend, the top-up tax and CGT could be as much as half the value of the asset. There may also be stamp duty payable on the transfer.

In these circumstances, it may be better for the company to simply charge market value rent (or for the shareholders to be assessed on the deemed dividend).

Notwithstanding, until the final legislation is released, it would be prudent to wait for the final law prior to acting.



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Economic Focus

PIGS aren't flying, but China is

Amongst the many who thought 2010 would be the year where modest economic growth would be disrupted by an occasional after-shock of the GFC, few would be disappointed so far.

Three key themes appeared in January and are expected to dominate the global economic outlook for the remainder of this year.

1. Fears of a looming sovereign debt crisis.

The dire position of numerous developed economies has investors nervous as government debt levels have spiralled due to stimulus spending, tax cuts and generally poor fiscal management.

Greece, Portugal, Spain and Ireland (better known as PIGS) all have debt levels that exceed their Gross Domestic Product (GDP) and may all need some assistance from the European Union.

2. Fears that the Chinese will tighten monetary policy.

China's economic growth is surging, ably assisted by the aggressive lending programmes of the Chinese banks. The fear of the creation of an asset bubble, which would eventually burst, has led the Chinese government to reign in the lending practices of the banks in an attempt to control growth.

While that appears to be an intelligent policy decision, there is an unhealthy reliance on China's strong growth to drive the global economic recovery.

3. President Obama and the 'Volcker Rule'.

This proposal is aimed at curbing proprietary trading by US banks so that

the risk of a repeat of the near collapse of the US financial system in 2008 is reduced.

Unfortunately, the banks' profits will also be reduced. While this is unlikely to have an adverse impact on the US economy, the fear that President Obama is starting to get tough with economic policy has created negative sentiment.

Are these really after-shocks? It can be argued that the so-called PIGS are too small to hurt the global economy. Also, even with a slow down, China will still be growing at 7% per annum.

And there are doubts whether the Obama proposals will get past the Senate anyway. Meanwhile, US economic data has been uninspiring at best. Housing activity is flat, jobless claims unexpectedly increased and consumer confidence took a surprising dive last week.

While the situation is looking much better than this time last year, growth in most of the developed economies is still stagnant.

In comparison, the Australia economy is shining with strong labour force data and resilient retail sales following three 0.25% rate increases late in 2009. The cautious approach by the Reserve Bank should continue until the impact of these rises is apparent.

Superannuation Focus

The Minimum Pension Payment

Once you commence a superannuation pension, the law requires that pension account holders receive their minimum payment each financial year. The minimum payment is calculated by multiplying the member's pension account balance on 1 July of the year the pension is being paid by a percentage factor. If a pension is commenced on another date, the minimum payment is calculated proportionately to the number of days left



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in the financial year. The amount is rounded to the nearest ten dollars.

The following table shows the age-based percentage factor:

Age	% of pension balance
Under 65	4%
65 - 74	5%
75 - 79	6%
80 - 84	7%
85 -89	9%
90 - 94	11%
95+	14%

This financial year (and the last), the minimum annual pension payment has been reduced by 50% e.g. a 66 year old member's percentage factor is 2.5% of the account balance.

Not withdrawing the minimum can have far reaching implications and lead to harsh penalties. If the minimum pension is not paid, the superannuation fund will lose its tax-free status for the year.

Therefore, earnings on the member's investments are taxed as if in accumulation phase (15%) rather than pension phase (tax-free). Capital Gains Tax (CGT) also applies to any asset sales in that particular financial year.

For example, the sale of a large property could incur significant CGT that would have been exempt if the pension standards were met.

The withdrawals may also constitute a lump sum benefit and would be subject to normal taxes applicable to the withdrawal of a benefit in the accumulation phase.

To be on the safe side, always withdraw a little bit more than the minimum - it could prevent a major tax headache.

New Tax Rulings

Division 7A loans and trust entitlements

Draft Taxation Ruling TR 2009/D8 – Income tax: Division 7A loans: trust entitlements

This draft Ruling expresses the Commissioner's opinion on the circumstances in which a private company with an unpaid present entitlement (UPE) to an amount from an associated trust estate, in circumstances where funds representing that present entitlement remain intermingled with funds of the trust, may be taken to have made a loan to that trust within the meaning of Division 7A of ITAA 1936. The draft ruling indicates that unless the funds representing the UPE are kept in a sub-trust separate from the funds of the main trust and used for the specific benefit of the corporate beneficiary, the UPE would be converted into a loan to the trust and deemed to be a dividend. This is unless the loan is governed by a complying Division 7A loan agreement or repaid before the corporate beneficiary's income tax return lodgement day for the year the loan was made.

Deductible even when it's over

The debate regarding how long a taxpayer can claim expenses in relation to a business or enterprise, after it has concluded has occupied many a tax journal. The AAT has recently allowed interest on a loan used to satisfy a guarantee even though the loan was taken out after the income producing activities had ceased.

The taxpayer found an individual willing to invest in a venture through an investment company on the basis that repayment was secured by a mortgage over property. The taxpayer agreed to offer his house as security (guarantee). The taxpayer, as promoter, was to receive a commission from the investment, so the nexus between income and the offered guarantee was established.



CRM Business Advisors Pty Ltd

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Nevertheless, the investment failed and the taxpayer subsequently had to mortgage his property in accordance with the guarantee, requiring him to take out a loan against his property and he claimed interest and bank fees associated with the loan.

This is an area where one is often concerned about the expenses of liabilities arising after the earning of income. The tribunal would appear to have used good business logic which is no doubt able to be extrapolated to other similar circumstances.

ASIC Compliance – Don't get caught

ASIC receives nearly 400,000 incorrect forms every year, even more which are lodged late and incur late penalties. ASIC is now getting tougher on corrections of lodged forms. They now require statutory declarations and evidence of all amendments, including dates which would not impact on the late penalties.

What can you do to avoid delays and late fees?

- Double check the dates provided on the documents. Make sure that the consents, resignations or applications match the actual ASIC Form 484.
- Religiously lodge the Form 484 - change to addresses, officeholders or share structure, within 28 days of the actual changes.
- Lodge Form 205, usually used to change company names, within 14 days of the actual resolution date.
- Prepare and retain in the company records a director's solvency resolution and have it signed within two months of the annual review date for small proprietary companies.

ASIC is becoming far more active and will charge late penalties for late form lodgements and can also charge late penalties for not being advised of changes at the time of the annual review.

To avoid this exposure contact our office.

Tax Talk Now Monthly

As we approach the end of the financial year, there are more tax-related matters that we wish to bring to your attention.

To address this issue we will now be publishing Tax Talk monthly instead of bi-monthly until we are well into the winter months.

If you have any questions about anything you have read in Tax Talk, please don't hesitate to contact us.