

sharptax

Grant Thornton periodical
reporting on taxation issues
for business owners.

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This edition of **Sharp Tax** looks at recent news regarding agribusiness managed investment schemes as well as looking at some recent cases...

Managed investment schemes

Upfront tax deductions for non-forestry managed investment schemes (MIS) are to be removed for investments entered into after 30 June 2007. Upfront deductions are to remain for existing MIS and for all forestry MIS entered into from 1 July 2007.

This news is a combination of two separate announcements. Firstly, the Commissioner is to issue a new ruling in relation to MIS and upfront deductions, whereby he is expected to change his views from 1 July 2007 on whether participants in MIS are carrying on a business at the commencement of the scheme. Secondly, while the Government is introducing new legislation to maintain upfront deductions for forestry MIS, similar legislation will not be introduced for non-forestry MIS. We will keep you informed on this topic as news develops.

It's FBT time again

We take this opportunity to remind you that 31 March is fast approaching, meaning that its time once again to think about Fringe Benefits Tax (FBT). The due date for FBT returns and payments is 21 May 2007.

Super guarantee charge

A recent AAT case has reaffirmed that employers risk incurring a second super liability where late super contributions are made directly to a superfund instead of to the ATO. In *IWEC Pty Ltd v Commissioner of Taxation*, financial difficulties caused the taxpayer to make some late super contributions over the course of a year. The lateness of the contributions varied during the year, ranging from six months down to one day.

The AAT held that the imposition of SGC has to stand, however

inequitable it may seem. The premise for the decision is that the SGC legislation is required to be applied without exception whenever super contributions are not made by the due date. Neither the AAT nor the Commissioner have the ability to disregard the SGC legislation in this regard.

This case serves as a timely reminder that super contributions have to be made by the due date, being the 28th day after the end of each quarter. Instead of simply contributing late super contributions to a superfund, they should be made to the ATO together with additional interest and administration charges. Furthermore, late super contributions are not tax deductible.

St George Bank Sell Back Rights

The full bench of the High Court has recently overturned the Federal Court's decision in *McNeil v FCT*. By way of background, this long-running issue relates to rights (known as sell back rights) issued by St George Bank Limited to its shareholders that allow shareholders to sell their shares back to the company at a price slightly above market price.

Shareholders could then choose to exercise their sell back rights or sell the rights on the share market. For shareholders who simply chose to do nothing, the sell back rights were automatically transferred to a trustee who would sell them back to the company. The proceeds would be passed onto the shareholders.

Although the Federal Court ruled that the issue of the sell back rights to the shareholders was neither ordinary income nor a capital gain, the High Court has ruled that the Federal Court erred in its decision and that the receipt of a sell back right by a shareholder is assessable as ordinary income.

Private companies and shareholders

Anyone who owns a share in a private company needs to be aware that transactions between themselves and the company may give rise to undesired tax consequences as a result of provisions of the tax law known as Division 7A. Division 7A will be in the news this year as the law is being amended this year to relieve some of its harsh effects. We will keep you up to date on changes.

Division 7A was introduced by the Government as a measure to prevent individuals from deferring personal income tax by keeping profits within a private company. These accumulated profits could be lent to shareholders or otherwise used for the shareholders' benefit without being subject to higher personal tax rates.

Loans to shareholders

Loans by a private company to a shareholder are required to be in accordance with a number of conditions otherwise the loan balance will be deemed an unfranked dividend and assessable to the shareholder. The loan requirements are as follows:

- there must be a written loan agreement between the company and the borrower
- the term of the loan must not exceed seven years for an unsecured loan or 25 years for a secured loan
- the loan interest rate must not be any lower than a benchmark rate, which is currently 7.3% and rising to 7.55% from 1 July 2007
- prescribed minimum annual repayments must be made

A loan made between two companies is exempt from Division 7A.

Forgiveness of debts owed by shareholders

Any debt owed by a shareholder to a company that is subsequently forgiven is deemed to be a dividend under Division 7A. The only exceptions to this are:

- loans that are forgiven under the Bankruptcy Act
- loans that were previously deemed to be a dividend
- where the Commissioner is satisfied borrower could not repay the loan due to unforeseen financial hardship

Payments to shareholders

Payments (that are not loans) are potentially deemed to be dividends unless the payment is made in the course of discharging a financial liability between the shareholder and the company, or the payment is included in the assessable income of the shareholder (ie salaries or rent). A payment between two companies is also exempt from Division 7A.

Who is a shareholder?

Division 7A applies not only to shareholders but also to their associates. An associate of a shareholder not only includes relatives and spouses, but can also include any trusts with whom they are either directly or indirectly associated.

Amount of deemed dividend

The amount of any deemed (unfranked) dividend under Division 7A is essentially limited to the amount of retained earnings within a company. Therefore, transactions that fall foul of Division 7A may not give rise to a deemed dividend if the company has little or no retained earnings.

As noted above, we expect that some of the harsh effects of Division 7A will be relieved this year and we will advise you of any changes as they are legislated.

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