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SEEKING MERCY FROM THE ATO ON PRIVATE COMPANY LOANS

The ATO is becoming less liberal in its application of the Commissioner's Discretion under 109RB where a taxpayer breaches Division 7A with respect to loans made from Private Companies. Namely, that the ATO have been tightening up their legislative interpretation of what constitutes an 'honest mistake' or an 'inadvertent omission'.

As background, the discretion was brought in to provide relief to taxpayers due to Division 7A's complex nature, the widespread misunderstanding of the Division and frequent, perhaps inadvertent breaches. Where a Division 7A breach has occurred, a deemed unfranked dividend is taken to be paid by the company to the shareholder (or associate, if the borrower is not the shareholder). If the Commissioner were to grant the discretion, the operation of Division 7A is nullified by either franking the deemed dividend, or disregarding the deemed dividend entirely, subject to some agreed corrective action.

As per the legislation, the discretion can only be exercised by the Commissioner if it is determined that the underlying error arose from an 'honest mistake' or 'inadvertent omission'. Practice Statement 2011/29 outlines the common circumstances and decision-making process the ATO would follow in granting the discretion. There is now confusion and uncertainty as to what extent that Practice Statement 2011/29 can now be relied upon.

Since the inception of the discretion, the ATO has been generous in granting it favourably for taxpayers. Taxpayers that act in good faith and come forward with their mistake had a level of comfort that their honesty would be rewarded. However, the direction that appears to now be taken would be one that actively discourages healthy, active and honest communication between the taxpayer, tax agent and the ATO.

The ATO Assistant Commissioner of private wealth, Kasey Macfarlane, was recently asked about whether there has been a crackdown on the discretion. In response she stated that "*It is not a crackdown on the exercise of discretion. The discretion has always been there and continues to*

be there for honest mistakes or inadvertent omission but it has to meet the threshold for it to be exercised favourably".

In practice, taxpayers generally rely on their tax agents to manage Division 7A issues and risks due to the complex nature of the rules. However, the onus and responsibility to manage the risks ultimately fall on the taxpayer. And unfortunately, breaches of Division 7A will generally arise from a lack of understanding from the taxpayer. Particularly around the concept that companies are 'separate legal entities' and their funds are not the clients' funds!

In our opinion, it is difficult to see what scenario could now qualify as an 'honest mistake' or 'inadvertent omission' given we are 27 years into the operation of Division 7A, especially when the breach has occurred in a year where an accountant has reviewed and prepared the necessary financials and tax returns.

The proposed self-corrective mechanism to be legislated as part of the Division 7A reforms is now long overdue and the ATO's tightening of their discretionary powers is not good news for taxpayers (or their tax agents) that identify a Division 7A breach, after the time in which it can be rectified.

If you need assistance on identifying or managing your Division 7A risks, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

Employee Vs Independent Contractor

The ATO's recent Decision Impact Statements (DIS) on two Court cases provides some guidance on the term 'employee' for the purposes of the Superannuation Guarantee (Administration) Act 1992 (Cth) (SGAA). This in turn provides some key takeaways to the on-going saga of determining whether workers are employees or independent contractors.

In the Full Court's decision in *JMC Pty Ltd v FCT [2023] FCAFC 76* (JMC) and the High Court's decision in *Jamsek v ZG Operations Australia Pty Ltd (No 3) [2023] FCAFC 48* (Jamsek), both Courts held that the individual contractors were not "employees" for the purposes of either s12(1) or s12(3) of the SGAA.

Relevantly, s 12(1) of the SGAA states that "employee" and "employer" have their ordinary, common law meanings, while s 12(3) extends the requirement of an employer (or principal) to pay superannuation to **a person** who works under **a contract** that is **wholly or principally for their labour**.

Importantly, in their DISs, the ATO outlines their current approach to assessing whether a contract is *wholly or principally for labour* and in turn whether a worker is an employee requiring the principal to pay superannuation guarantee (SG).

The following are some key takeaways from the comments made by the ATO in their DISs, particularly on the extended meaning of the term "employee" under s 12(3). For the worker to be deemed an employee under this provision the following will be considered:

1. **There should be a contract** – The contract will be used to identify if there is natural person, i.e. an individual – who is a party to the contract in their personal capacity. Importantly, only a natural person can 'work under a contract'. In Jamsek, the Drivers were not parties to the contracts, rather it was their partnerships that were the relevant parties to the contract.

2. **Wholly or principally 'for' the labour of a person** - The contract must be 'for' labour with this element being assessed from the perspective of the person engaging the service provider (i.e. the principal). Essentially, if there is a power of delegation, even if the consent of the 'employer' is required, then the contractor is free to do the work themselves or substitute another person to do the work (as was the case in JMC), the contract is not 'for' the labour of the contractor.

3. **That the person must 'work' under that contract** - A contract to produce a result is also not a contract for labour. However, to the extent that the contract involves a mix of labour and the provision of goods/equipment, a quantitative assessment to assess whether the contract is principally for labour needs to be made on the relative contributions of the labour component and the equipment component.

The ATO accepts the Court's view that a quantitative analysis of the components of the service was the most appropriate valuation methodology for those cases. However, in assessing whether a contract is principally for labour under s 12(3), the ATO have stated that in some instances, a qualitative analysis is required on the components of a supply of services.

The essential message to businesses and their advisors in considering whether the worker is an employee or independent contractor, is in assessing whether the contract between the parties is for contracting services **or** wholly or principally for the labour of an individual(s). Both a qualitative and quantitative analysis of the labour component may be necessary.

If you would like to discuss the above in further details, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

CAUTION BEFORE ADDING YOUR SPOUSE TO YOUR HOME'S TITLE

Subject to certain conditions, it is possible in Western Australia for someone who is married or has been in a de facto relationship for 2 years or more to transfer part of the family home to their partner, and for that transfer to be exempt from transfer duty.

The desire to affect this transfer can arise for many reasons, be it asset protection, estate planning, at the behest of a bank or mortgage broker when applying for a loan, the belief there are tax benefits, or of course, for natural love and affection.

While actioning the transfer may be the result of well-intentioned reasoning, such a transfer may have some unintended tax consequences.

While the transfer may be exempt from transfer duty, there is no such exemption for capital gains tax purposes (with the exception being a transfer arising from a relationship breakdown).

The transfer results in the prevailing market value for the part interest being treated as the transferor's proceeds for the sale, and the transferee's cost base or their interest. This may not cause any issue if the property has always qualified for the main residence exemption. But what if it hadn't always been so?

What if the property was a rental property when it was acquired, and subsequently became the transferor's main residence? In this case only a partial main residence exemption may apply to the property. The transfer of the part interest in the property is a CGT event for which market value proceeds have been received. A capital gain or loss may arise depending on the cost base of the property.

Consideration of the main residence status of the property is essential as it may lead to a real cash outflow as a result of a realised capital gain.

There can be flow on consequences should the property's use change after the transfer. Let's say the property starts being rented out, and the couple are now earning rental income. If the transferor had initially taken out a mortgage buy the property, however now continues to have the mortgage but only owns half of the property, can 100% of the interest expense be claimed? It should not be assumed that this is the case.

For any pre-CGT properties, such a transfer will mean the transferee's interest in the property is now a post-CGT asset.

The above is not an exhaustive list of the potential tax impacts. The transfer cannot be undone, so it is important that the potential tax impacts are understood before any contracts are signed to affect the transfer.

If you have any questions on the property transfers, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

Is it time to consider or revisit your Estate Plan?

According to the most recent Intergenerational Report released by the Federal Government in August 2023, the next 15 to 20 years will see the greatest transfer of intergenerational wealth ever, with the number of Australians aged over 65 doubling from now until 2055 (and those over 85 will more than triple). Some estimates state the wealth transferred could be in excess of **$5 Trillion**!

Many clients will need assistance to effectively transfer the control and wealth of their Family Group to the next generation. To do so tax effectively requires pre planning and as your accountant, and your trusted advisor, we are well placed to facilitate that process.

The process of transferring wealth to the next generation can be termed many things, but for the purpose of putting a label on it and perhaps some consistency of message going forward, we will call it preparing an Estate Plan.

For many clients it is time to start the conversation on considering your Estate Plan and what you would like to see happen to your assets, entities including businesses and your super before (up to and in retirement) and after you die.

Whilst it is not an easy discussion and can take some time to gain traction it is a discussion we need to have at some point, even if it is in bite size pieces.

Where a client's wealth is held within trusts or companies, the control and operation of those entities after they pass is the key Estate Planning consideration. The assets themselves are not disposed of just because the trustee, director or shareholder dies.

Assets held in your Superannuation Fund will require their own Estate Plan to ensure that when the member's benefit is paid out, the tax effectiveness the Fund has enjoyed is not undone by taxes on exit.

Personally held assets also have their own considerations when they pass to or through the Estate to ensure the right amount of capital gains tax (CGT) is eventually paid when a beneficiary sells that asset.

CGT Implications for the Trustee and Beneficiaries of Deceased Estate

From the perspective of the trustee and beneficiaries of the estate, where assets pass to the trustee on death, any capital gain or loss that arises in the hands of the trustee when those assets subsequently pass to one or more beneficiaries is disregarded.

Upon the transfer of the deceased's assets to either the trustee of the deceased estate or one or more beneficiaries, the acquisition date and cost base of the assets are taken to be:

Assets	**Acquisition Date**	**Cost Base**
Pre-CGT	Date of death	Market Value as at date of death
Post-CGT	Date of death	Cost base or reduced cost base of the deceased
Main Residence	Date of death	Market Value as at date of death

For the purpose of applying the 50% general discount on a capital gain, for post CGT assets only, the trustee or beneficiary is taken to have acquired an asset when the deceased acquired the asset.

This means that the discount is available even when the trustee or beneficiary disposes of the asset within 12 months of acquiring it, as long as the deceased acquired it at least 12 months before the trustee or beneficiary disposes of the asset.

There are many tax issues that can arise when asset pass through an estate and these will need to be considered as part of an overall Estate Plan. Whilst the Will may deal with what happens to those personal assets, an Estate Plan should consider the tax implications of these bequests, the ongoing control of trusts and companies, ensuring necessary directions are in place for the Superannuation Fund and any other specific business, investment, health and family directions the client desires.

Estate Planning is more than just preparing the Will and requires input from your accountant, financial advisor and other professionals to ensure the Estate lawyer can properly document the Plan to ensure the best outcome for the client.

If you would like to discuss the steps in developing or revising your Estate Plan, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.