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# Death benefits: Tax exemption win for super funds

The government has shone some light on SMSF death benefits after a long period of uncertainty with the recent release of its “Mid-Year Economic and Fiscal Outlook” paper for 2012-13.

The welcome news for the many retirees who are taking pensions from their SMSF is that super death benefits will be spared the prospect of being doubly taxed where a benefit must be paid from a fund on the death of a member.

This means that the tax exemption on investment earnings that support a pension can continue to apply following the death of a member until the member’s benefits have been paid out, even if there is no reversionary pension recipient nominated. The pension of a fund member who dies will continue to be viewed as a pension for tax purposes until the death benefits are paid to beneficiaries. This will need to be achieved however as soon as practicable.

The previous situation threatened an SMSF with double taxation in the form of a 10% or 15% capital gains tax (CGT) being levied on any investment assets sold by the fund to pay out death benefits, plus a 16.5% tax on certain benefits if they were destined to go to a beneficiary who was not a dependent of the late member, such as an adult child (which is frequently the case with superannuation death benefits).

The mid-year review paper revealed that the government will eliminate — effective from July 1, 2012 — any obligation on superannuation funds to pay CGT where a super pension is cashed out to pay a death benefit.

The previous view, hanging over the heads of SMSF trustees since being published by the Tax Office as draft ruling TR 2001/D3, was that when a fund member dies and there is no reversionary beneficiary arranged, a pension account reverts to accumulation phase. This exposes the pension-supporting assets to CGT when sold to pay out benefits.

One as-yet-unresolved issue is that the previous draft ruling was seeking to have that particular interpretation of the rules retrospectively applied to July 2007. The latest announcement only states that a pension retains pension status until benefits are paid with effect from July 2012.

The intervening five years, if not addressed by the government, may remain an area of uncertainty until this is clarified — however experts expect that the final ruling will incorporate the mid-year review announcement in some way when it is finally handed down. Whether this will address beneficiaries who have already paid taxes on benefits being eligible for refunds is yet to be seen, however we will inform clients as the facts are made known. ■

## About this newsletter

Welcome to MC & Co’s client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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# Boost retirement savings with tactical superannuation planning

There are tax tweaks built in to the super system that canny retirees can work to their advantage.

While providing income for retirement is the obvious purpose of a pension paid from a self-managed superannuation fund (SMSF), a little strategic application when managing a super pension can also make use of certain wealth-building attributes that have evolved out of the changing superannuation landscape.

The first issue to consider when starting a pension with all or part of your super savings is that returns from your investments will move to a zero tax status in respect of income derived from assets supporting the pension.

The fund's investment earnings such as interest, dividends or rental income (if it owns a direct property) are taxed at 15% in the accumulation phase, and any realised capital gains will most likely be taxed at 10% (under the super rules, capital gains on investments held for at least 12 months are entitled to a one-third discount, which reduces the effective tax to 10%).

But once in pension phase – as long as the investments backing the pension stream are clearly identified and segregated, or an appropriate actuarial certificate is obtained – the super rules allow these investments to be exempt from any tax. So there is neither 15% levied on investment returns, nor 10% on net capital gains.

For example, the pension-paying SMSF has share holdings that are fully entitled to dividend imputation credits (and this will be a common scenario). In these circumstances, franked income such as imputation credits and in some cases trust distributions, can be valuable for an SMSF because of the 30% tax credit attached to most franked dividends.

These tax credits are used in an investor's hands, in this instance an SMSF, to reduce the amount of income tax payable, and if the credits exceed the investor's tax bill the amount will be refunded by the Tax Office once the fund's tax return is lodged. The extra benefit for an SMSF results from its low (15%) or zero tax rate (depending if it is in accumulation or pension phase). When a fund receives a fully franked dividend, the franking credit will not only offset tax payable on the dividend itself, it will either offset tax payable on the SMSF's other income (including concessional contributions) or be refunded.

One thing to remember in this scenario however is that an SMSF investor will be required to have held the dividend-paying shares at risk for more than 45 days (or 90 days for preference shares) in order to be eligible to claim the credit. The fund's investment strategy document should record that it will invest in franked dividend paying equities.

But the tactical thinking doesn't stop here. Say the fund member was born before July 1960, and has therefore attained preservation age. Being able to start a pension from age 55, combined with the transition to retirement income stream rules, means the member can receive a transition to retirement pension (ask this office if you need more information on transition to retirement pensions). This will give the fund member a valuable tax advantage (as spelled out above) with the potential to tactically enhance their pre-retirement earnings through a more tax-efficient treatment of investment returns.

Extra earnings may be able to be put back into super by way of concessional contributions that could be especially valuable as an added boost for retirement savings — keeping in mind the relevant contribution caps. ■

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# Should you transfer your business premises into your SMSF?

There can be some solid reasons to consider having the ownership of your business premises in the name of your self-managed superannuation fund (SMSF). To start with, if your business is travelling along steadily, it will provide a steady source of rental income for the SMSF and capital growth. It may also provide a level of stability for you as a business owner by not having a third-party landlord. There are additional advantages that, depending on a business owner's circumstances, may make transferring commercial property into an SMSF a tempting option.

One of the primary reasons for making such a change is tax. As the asset, which is the business premises, will be held by a superannuation fund, tax on income and capital gains will generally be less than the business would have been liable for. For an SMSF, earnings (which includes rental income) are taxed at 15%. For the business, rent or lease expenses are deductible for the business taxpayer, which pays tax at a rate of 30% (if a corporate). The end result is that the people behind these two entities — the SMSF and the business — finish up overall saving 15 cents in the dollar of tax paid.

There are two other positives that can come out of the business making lease payments to the SMSF. These payments are a monetary contribution to the fund that is not counted towards the members' contribution caps for the year, as they are "investment earnings". It should be noted that rent must be charged at market rates. The situation can also be further improved once fund members commence pension phase, as tax on earnings then reduces to nil where the asset is supporting the pension.

A second reason to consider having the SMSF buy one's commercial premises is the resulting transaction will be a monetary fillip for business, and can either refresh its capital situation or perhaps pay down debt.

A third reason, depending on which state the business premise is in, can be stamp duty exemptions or concessions. Many states have legislated to provide stamp duty concessions when a commercial property is transferred into a super fund. However these concessions can vary depending on the state, so advice from this office may be needed.

A fourth potential attraction, which may depend on circumstances, is that assets can be rendered less accessible to creditors once they are held by superannuation funds. There are various allowances made within the bankruptcy laws, for example, that can open these transactions up to being unwound in some circumstances — so the fact that assets are held in an SMSF may not be an iron-clad strategy on the off-chance that creditors could come knocking.

One inflexible requirement, in order to comply with the regulations, is that the property in question must be "business real property" that is used wholly and exclusively for the business. And although the regulations permit purchasing from a related party, the acquisition must be made at fair market value, therefore an independent valuation must be carried out and recorded.

Buying the property must be consistent with the written investment strategy of the SMSF, and the asset must be acquired with the "sole purpose" of providing for the retirement savings of the fund's members.

An important consideration is the capital gains tax (CGT) implications that will be triggered by moving the property asset from one owner to another, which is the liability of the "seller" of the business premises to the SMSF. In many cases, the business owner may be eligible for the small business CGT concessions, which can significantly reduce or even remove altogether CGT payable on the sale of the property asset. Ask this office for more details.

Another potential benefit that should be mentioned at this point is that once the premises are owned by the SMSF, and over the course of time the members of the fund commence to take a pension, the subsequent sale of the (hopefully increased in value) property will not be subject to CGT if the property supports the pension liability. And even if the property is sold before any pension is commenced, as long as it has been held for at least 12 months the tax on any capital gain is still taxed on a concessional basis in the SMSF at 10%.

It is possible to complete the transfer of property into the hands of an SMSF for "nil consideration" — that is, no money changes hands but the property is transferred as an "in-specie" contribution to the fund. Its value however will then be considered a contribution, and will therefore be included in the annual contribution cap limits. A combination of an exchange of cash plus proportional in-specie transfer is possible. It should also be mentioned that CGT can still apply to in-specie transfers.

*Continued* ➔

## Should you transfer your business premises into your SMSF? (cont)

If circumstances make it a better option for the SMSF to buy the business premises, but the fund has limited cash resources, it is possible for the SMSF to take out a loan for the property purchase via a limited recourse borrowing arrangement. One essential requirement is that the property must be unencumbered — that is, any existing mortgage must be discharged. Such a loan has the benefit (due to its being of "limited recourse") of isolating the other assets of the SMSF from the lender should the borrower default.

One option here is that the business is at liberty to provide this loan. One feature of gearing in a super fund is that anyone can lend the money, so many small business property owners are using these provisions to allow their SMSF to borrow money from the business under a limited recourse borrowing arrangement to enable it to buy their commercial property. If you are considering entering into an SMSF borrowing, it is imperative that appropriate advice be obtained at an early stage. ■

# FBT and your Christmas party planning

End of year Christmas celebrations are a chance to get everyone together for some fun as well as thanking the team for a job well done. Business owners may have the option to unlock the bar fridge for employees, but should make sure they are not the ones stuck with the tax hangover.

As with any benefit that a business provides to staff that is outside the safe definition of "salary", the question of whether it is a (taxable) fringe benefit or not will need to be addressed.

But it's not like the taxman doesn't know how to have fun — the Tax Office may be prudent, but there's still some wriggle room in the tax rules to let your hair down. Christmas-time entertainment up to the value of $300 for each employee may be exempt from FBT. This may also be the case where an employee's spouse attends.

The Tax Office states that there are no different FBT rules that apply to Christmas entertainment, and that these social functions come under the "minor benefits" umbrella. A minor benefit will be FBT-exempt where, broadly, the benefit is less than $300 and provided on an infrequent and irregular basis. And herein lies a possibly Santa-inspired tweak to how the rule is applied, as the minor benefits threshold applies to each benefit provided, not to a total value of "associated benefits". So if, as a generous employer, you also give a gift to everyone, the party and the gift are considered separately for FBT purposes. If each is less than $300, they are both generally FBT free.

Note that there are different ways in which entertainment may be treated for FBT purposes, such as the "50/50 split method" or the "12 week register method", and where these are adopted the treatment of Christmas party expenditure will be different to what is described above (consult with this office about the alternatives).

### Exemption negates deduction

But remember that if a benefit is exempt from FBT, you cannot claim it as an income tax deduction, nor can you claim any GST credits arising from these "supplies".

The safest option FBT-wise would be to hold the Christmas party on the business premises on a working day, as providing the food and drinks will be FBT free, if it's only employees who attend. If spouses or partners are invited (the law refers to them as "associates") the cost will still be FBT free if less than $300 (if the minor benefit rule applies), and if bona fide clients attend there is no FBT in respect of them. If the party is held off-premises, at say a restaurant or pub, the $300 limit applies to both employees and associates, subject to the application of the 50/50 split or 12 week register methods referred to above.

### Where do taxis stand?

For an employer thinking of paying for this travel option for staff, the important consideration in regard to this will be venue. If the taxi travel is from home to an entertainment venue (that is not the workplace) and home again, the Tax Office will include the cost of the ride as part of the entertainment and deem that it is to be included in the cost-per-head total (that is, it counts towards the $300 minor benefit limit).

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# Selling up? Don't forget this GST exemption

The concept of a "going concern" exemption for the purposes of the goods and services tax (GST) can still cause confusion when businesses are sold, despite the fact the tax has been in place for more than a decade.

A "going concern" refers to an enterprise's ability to continue trading. The sale of a business may be GST exempt if the enterprise is deemed to be a going concern. The Tax Office says a supply of a going concern occurs when:

- "a business is sold, and that sale includes all of the things that are necessary for the business to continue operating", and
- the business is carried on, "up until the day of sale".

The GST exemption has its advantages — a buyer of a business does not have to find extra funds to cover an additional amount for the GST which is added to the purchase price.

A buyer facing the payment of GST in a transaction is entitled to get the tax back via the input tax credit system. This cannot happen until some time after the completion of the transaction. It should also be remembered that while the GST will eventually be refunded, any stamp duty that is payable on the sale of a business will include the amount for GST.

## What are the requirements for the exemption?

Business owners may be aware of the existence of a GST exemption but not completely understand the way it operates. The GST legislation says that the sale of a going concern will be GST-free if:

- the sale is "for consideration"
- the purchaser "is registered, or required to be registered" for GST, and
- "the supplier and the recipient have agreed, in writing, that the supply is of a going concern".

The sale of business contract will usually specify that the business (that is, the "supply") is a going concern when the contracts are exchanged. This is critical, because it shows that all parties to the sale acknowledge that the business is a going concern.

A vendor is required to supply "all of the things that are necessary" for the continued operation of the enterprise. This does not mean everything that is owned by the business. It does, however, mean those things without which the enterprise could not function. Generally, this includes the necessary assets such as premises, plant and equipment and customer contracts. It can also include arrangements such as ongoing advertising.

The legislation requires the vendor to carry on the business "up until the day of sale", with the business deemed to be transferred on the date on which "effective control and possession" of the business is handed over to the buyer. While this date generally refers to the settlement date, "the day of sale" may occur before or after the settlement date.

The tax liability risk (in case the Tax Office does not view the sale as a supply of a "going concern") ultimately lies with the seller, as it is the "supplier" in any transaction that is required to remit GST to the Tax Office.

Some vendors seek to avoid the tax liability risk related to the business by including a clause in the sale contract requiring the buyer to indemnify the vendor for any GST that may be payable in the event that the Tax Office does not view the transaction as one of a going concern. ■

# FBT and your Christmas party planning (cont)

But if the cab drives from home to a function held at the workplace, and/or from the workplace back to home after the festivities, the taxi fare is exempt from FBT.

## Spreading the joy

Some canny business operators have taken the convivial, and tax effective, approach of holding more than one social event over the year. Rather than have just one large bash at Christmas, a business may decide to spread the entertainment budget out to, say, an end-of-financial-year function in winter.

Dividing the party purse into two events can reduce the value of the entertainment each employee enjoys below the minor benefits limit of $300, and keeps the FBT liability of an employer to a happy minimum. It should be remembered however that to be a minor benefit it is necessary that the particular benefit (or similar benefits) be provided irregularly and infrequently. ■

# Company directors face new liabilities

If you are a company director or an associate of a director, you are likely to be affected by changes to the *Personal Liability for Corporate Fault Reform Bill 2012* which reduced the scope for companies to engage in fraudulent activity or evade their employees' entitlements.

The changes not only render company directors personally liable for outstanding superannuation guarantee (SG) charges and pay-as-you-go (PAYG) withholding if the company fails to make these payments within the stipulated time; it places the burden of proof on company directors to prove they are innocent.

Directors will only face personal criminal liability for the misconduct of a company in specific circumstances – such as when there is potential for significant public harm that may be caused by the particular offence or the director has the capacity to influence the conduct of the company. However, prosecution is not the first and foremost punishment if a director is found to be personally liable for a company's offence; administrative penalties and the initiation of civil recovery processes are each an alternative to prosecution.

Key elements of the changes that came into effect on June 30, 2012 are outlined below. ■

## New law

- In addition to liability for PAYG withholding amounts, directors are personally liable for their company's unpaid SG charge.
- In addition to estimating unpaid PAYG withholding liabilities, the Commissioner can estimate unpaid superannuation guarantee charge.
- A new director does not become liable for a director penalty until 30 days after they become a director.
- In order to recover a director penalty from a director, the Commissioner must issue a director penalty notice and wait until the end of 21 days after issuing that notice before commencing proceedings. However, the Commissioner may also serve a copy of a director penalty notice on the director at his or her tax agent's address. Giving a copy of the notice to the tax agent does not affect when the Commissioner may commence proceedings to recover the penalty.
- A director can achieve remission of their personal liability by causing one of three things to happen before a director penalty notice is issued or within 21-days after the issue of the notice:
  - the company pays the liability
  - an administrator of the company is appointed, or
  - the company begins to be wound up.
- However, where three months has lapsed after the due day for the company liability and the liability remains unpaid and unreported the director can no longer achieve remission of the penalty. For new directors, the three month period counts from when they become a director of a company, rather than three months after a debt arose.
- It counts as a defence if a director had an illness that prevented them from participating in the management of the company, or if they took all reasonable steps to ensure compliance. In addition to these defences, a director is not liable to a director penalty if the company treated the *Superannuation Guarantee (Administration) Act 1992* (SGA Act 1992) as applying to a matter in a way that was reasonably arguable and the company took reasonable care in applying the SGA Act 1992 to the matter.
- In some instances, directors and their associates are liable to PAYG withholding non-compliance tax, a tax equivalent to reducing PAYG credit entitlements where the company has failed to pay amounts withheld to the Commissioner.

# The mechanics, and tax consequences, of insolvency

It is unlikely to be an aspiration for any individual or business owner, but the words "going broke" can still have unfortunate resonance — even though there are many instances where "fault" lies with circumstance rather than personal or even a business's shortfall. But hitting the wall does not necessarily mean there can be no come-back — even Donald Trump was bankrupt in the early '90s.

One central difference between bankruptcy and liquidation is that the former will apply for individuals going broke in their personal capacities, such as sole traders, but companies will look at either going into administration or liquidation.

It is generally less complicated to wind up the business of a sole trader who has declared bankruptcy than to wind up a business run through a corporate structure, a trust or partnership. The sole trader is also less complicated to wind up because the principal of the business is also personally responsible for all debts and liabilities accrued by the business. To wind up business as a bankrupt, a trustee is appointed (either by yourself or by your creditors) to conclude all current contracts, sell remaining stock and other assets, pay outstanding debts and creditors, and notify all concerned (the bank, customers, suppliers).

For any business with an ABN, the Tax Office says you need to notify it that you have ceased trading within 28 days of doing so, and to cancel registration for GST, if applicable, within 21 days of cessation of trading. You can keep and re-activate the ABN if things pick up for you in the future, but if it is kept active you will still have to lodge activity statements.

## Voluntary administration

If your company can't pay its debts and is insolvent, voluntary administration and liquidation are two of the key options. Voluntary administration is where a company's directors hand over the business to a professional administrator to decide on the best plan of action.

The definition of insolvent is when liabilities total more than the value of assets, and debts cannot be paid. Insolvent trading is where a business continues to incur debts even though the owner or directors are aware, or should be, that the business cannot pay them. A business's principals in these cases can be held personally liable, and even face jail time in the most extreme cases.

Voluntary administration can be a way for businesses in financial distress to get some wriggle room from creditors. Going into administration could stave off having to go into liquidation if the business is administered in such a way to maximise the chances of it continuing in business (or if that's impossible, then to at least get a better result for creditors and shareholders upon the inevitable liquidation). The first step is a meeting of directors and appointment of an administrator, who will try to salvage the business's financial standing.

Apart from a voluntary administration, an administration can also be initiated by a secured creditor or the company's shareholders. The company may also be put into receivership, which is where an external receiver takes over the company's assets and sells them to pay off secured debt.

## The liquidator

If going into administration or receivership does not lead to a viable arrangement, then liquidation is the alternative. Liquidation is the formal process for winding up a company's financial affairs to settle debts with the proceeds of the sales of its assets.

A vote of creditors or a court order can put a business into liquidation, or the business can do so voluntarily. The appointed liquidator will prioritise creditors into certain classes, with secured creditors first (those whose claims against the company are protected by a charge over a specific asset or group of assets – like a bank that issues a mortgage), then unsecured creditors (with contractual rights to receive a set amount of money but not backed by a charge over a specific asset) and lastly shareholders.

Generally, the claims of one priority class must be fully satisfied before those of the next priority

## The mechanics, and tax consequences, of insolvency (cont)

level down get to see a cent. There may be pro-rata payments among claimants at the same priority level if not enough funds can be cobbled together. (The liquidator's costs are always met however.)

The liquidator's job is to get the best result for creditors and shareholders, and part of this can be collecting, valuing and selling all assets. If any insolvent trading is uncovered, company directors can also be sued by creditors to recoup funds.

If continuing trading is in everyone's best interests, then the liquidator can go down that path. Another outcome of this can be to be able to sell the business as a going concern, as well as perhaps to finish and sell work in progress — the aim is to wind up the company, but to do it in a commercially practical way.

### Disposal of assets

Of course, as with every other stage of the business life cycle, you will have to factor in the tax consequences of dealing with the business's financial woes. If assets are sold to pay debts, the proceeds would still be subject to tax as ordinary income or as capital gains in the usual way. But be aware that if the business has to sell its trading stock or other assets at bargain prices (below market value), in some instances tax law may nevertheless treat the sale as having been made at market value anyway, regardless of how much was actually received.

If you are a sole trader winding up your business or if you own shares in a company being wound up, and you sell the assets of the business or the shares in the company, you will still be subject to tax on the sales. But where the sale is taxed under the CGT rules, you could be entitled to various tax exemptions and concessions under the small business CGT concession rules (see separate story on page 5). In the best-case scenario, 100% of a capital gain could be tax-free.

If a creditor or a lender decides to forgive part or all of a debt or a loan (that is, releases the business from the obligation of paying the amount back), the amount may fall under the "commercial debt forgiveness" rules. In essence, the business may have to reduce the value of its tax losses (and there may be some if the business has been in strife for a few years) by the amount forgiven. However the forgiven amount would not be assessable income, and sometimes there may be no tax consequences at all.

On a couple of related notes, if you (or your company) cancel contracts in the course of winding up, there may be capital gains or losses as a result – intangibles such as contractual rights come within the CGT regime. And if you are a shareholder of a company being liquidated, any distribution you receive from the liquidator should be tax-free to the extent that it is a return of your original investment amount; anything above that amount is likely to be taxed as a dividend. ■

## ATO says the cost of managing tax affairs has increased

Every year, the Tax Office issues a comprehensive statistical report based on the most complete set of data at its disposal. Its most recent *Taxation Statistics* is compiled from tax return information from 2009-10 as well as FBT, GST and activity statement data from the 2010-11 year. One item of data listed in *Taxation Statistics*, the cost of managing tax affairs, is taken directly from the label on the individual tax return form. This label records expenses relating to preparing and lodging tax returns for taxpayers, and includes expenses such as tax agent fees and interest charges imposed by the Tax Office. The Tax Office's statistical report shows that the cost of managing tax affairs increased by 11.3% from 2008-09 to 2009-10. ■

| | | | 2008-09[1] | | | 2009-10[1] |
|---|---|---|---|---|---|---|
| | Number of taxpayers | Total cost $m | Average cost per taxpayer $ | Number of taxpayers | Total cost $m | Average cost per taxpayer $ |
| Individuals[2] | 5,734,042 | 1,838 | 320 | 5,671,852 | 2,017 | 356 |

1: Data for the 2008-09 and 2009-10 income years includes data processed up to 31 October 2012 and 31 October 2011 respectively.

2: This will not include data from the tax return where the taxpayer has claimed the cost of managing tax affairs under a different label.