



Pears

▶ chartered accountants ◀

ABN 38 537 994 042
Pears Pty Ltd as trustee for Pears & Co. Unit Trust

Directors

Alan Pears / FCA
Anthony Ciarroni / BBus CA
Leo Ciarroni / BCom CA

TAX REPORT BUSINESS NEWS

November 2010

IN THIS ISSUE

- Research & Development Bill
- Taxation of earnouts
- Primary production trusts
- Superannuation update
- Cash economy and benchmarking
- Compromised TFNs
- Unpaid present entitlements: final practice statement released

Research & Development Bill

What's it about?

R&D concessions were introduced to provide a tax incentive (by way of increased or accelerated deductions) for expenditure on R&D activities. These measures were introduced to encourage innovation and investment in new technology or methods.

The amending Bill proposes some changes to this existing law as outlined below.

The new R&D Bill (the Tax Laws Amendment (Research and Development) Bill 2010) is expected to become law in the new year. Once enacted, it will have effect retrospectively from 1 July 2010.

The new law will therefore affect the tax position of all entities engaged in R&D activities in the current income year.

How might it affect you?

The new Bill amends:

- which companies will be eligible for R&D concessions;
- the nature of the concession (which is being changed from a credit to a tax offset);
- the amount of the concession (businesses with a turnover of less than \$20m will have access to an increased tax offset);
- the list of exclusions (ie activities that generally cannot be R&D activities for the purposes of the concession); and
- the R&D concessions available for costs of software development activities.

As these changes are due to take effect on 1 July 2010, the eligibility for R&D concessions, as well as the amount and type of the concession (ie refundable or non-refundable offset, rather than a credit), will likely be different for your 2011 income tax return compared with your 2010 income tax return.

The type of concession will be especially relevant if you are a company with a turnover of less than \$20m in a tax loss position (so that tax deductions provide no immediate benefit). In such a situation, under the new law (once enacted), you will be entitled to a refundable tax offset so that you will receive the benefit of the

concession in the current income year.

As such, if you have in the past claimed the R&D tax credit, or suspect you may be eligible to do so in the future, you should consult with us to identify the challenges and opportunities for you arising from the new Bill.

TO DO

Taxpayers that currently claim R&D concessions, or suspect that they may be eligible to do so in the future, should consult with us to clarify their tax position under the new R&D Bill.

Taxation of earnouts

What's it about?

The government is currently looking to overhaul the taxation of earnout arrangements.

An **earnout** is broadly a right to ongoing payments from the purchaser after the sale of a business or an asset. For example, if A sells a business to B and receives, as consideration, \$100,000 and 5% of the business's turnover for the next four years, the latter part of the consideration (ie that part that is dependent on turnover) is the "earnout" component.

This earnout component is generally based on some sort of earnings or revenue measure in relation to the business or asset sold. The earnout is generally intended to spread risk between the purchaser and the vendor so



Liability limited by a
scheme approved under
Professional Standards Legislation

Suite 3 Ground Floor 24 Ross Street North Parramatta NSW 2151
PO Box 2403 North Parramatta NSW 1750

T 02 9890 3999 F 02 9890 3955 E admin@pearsca.com.au

www.pearsca.com.au

that part of the purchase price payable is dependent on the business's earnings/revenue.

Currently, under the Tax Commissioner's draft ruling, where a disposal is subject to an earnout right, the consideration on disposal constitutes the cash amount as well as the "market value" of the earnout right, and the excess of this consideration over cost base is taxed as a gain to the vendor at the time of the disposal.

The treatment set out in the ATO's draft ruling requires vendors to pay tax on an amount that they have not yet received (or may never receive) and potentially miss out on the CGT discount in relation to earnout payments.

What's changing?

The new legislation is intended to prevent this outcome so that the consideration received on disposal is equal to the initial \$100,000 (as per the example above), as well as each amount actually paid under the earnout component.

These changes will ensure that, where the vendor is entitled to CGT discounts such as the 50% discount and/or the small business CGT discounts, such discounts will apply in relation to all of the funds received as consideration for the sale (ie the initial payment plus the amounts received under the earnout component).

This legislation, once enacted, will apply from the date of Royal Assent.

Taxpayers intending to dispose of or acquire an asset or a business that is subject to an earnout arrangement should consult with us in order to identify challenges and opportunities posed by the planned reform of these rules.

NOTE

Taxpayers intending to acquire or dispose of a business or an asset subject to an earnout payment should seek advice from us as to the tax consequences of such an earnout.

Primary production trusts

What's it about?

In response to a landmark decision by the High Court in a case called *Bamford*, the ATO has withdrawn its tax ruling in relation to the averaging of income derived by primary production trusts.

Under this ruling, the income of primary production trusts was permitted to be **averaged**. This meant that beneficiaries under the trust could be taken to be carrying on a business of primary production even where the trust had nil income or a loss in a particular income year.

This ruling was withdrawn, effective from 30 June 2010. As a result, the ruling will apply to arrangements begun to be carried out on or before that date, but not afterwards.

How might it affect you?

With the withdrawal of this ruling, it is now unclear whether such beneficiaries will be taken to have carried on a business of primary production in an income year during which the trust is in a nil income or loss position.

As a result, taxpayers who conduct a primary production business through a trust should seek advice from us on how the withdrawal of this ruling may affect their tax obligations.

NOTE

Beneficiaries under a trust that carries on a business of primary production should consult with us following the Commissioner's withdrawal of his ruling on averaging of income for such trusts.

Superannuation update

ATO warns of deviant behaviour by SMSFs

The ATO is targeting the provision of financial assistance by an SMSF to its members through an unrelated trust. For example, if an SMSF invests funds in a trust and the trust then uses the funds to on-lend to a member of the SMSF.

What are the penalties?

The ATO has warned that such activity may result in the funds being non-compliant and subject to tax at the rate of 45%.

The **penalties** for such behaviour are also significant:

- trustees of super funds who provide financial assistance in this way face penalties of up to \$220,000 and/or jail terms of up to five years for individuals; and
- corporate trustees face fines of up to \$1.1m.

Superannuation Guarantee Surcharge

What is it?

The Superannuation Guarantee Surcharge is the percentage of wages paid to employees required to be withheld by employers and remitted to the ATO for the purposes of investment in each employee's super fund. This surcharge is currently 9% of wages.

Employers should consider the impact that an increase in the Superannuation Guarantee Surcharge may have on their business as the current government has made this issue one of its priorities.

NOTE

Superannuation is complex and confusing. Please contact us to obtain tax advice on dealings with your super fund if you are unsure about the consequences.

The ATO is policing the provision of financial assistance by SMSFs to members, either directly or through intermediate entities.

Compliance activities: cash economy and benchmarking

What's it about?

The ATO has renewed its focus on businesses operating in the cash economy. The ATO is targeting activities, such as income and payment of wages and other remuneration in cash, in order to avoid superannuation, PAYG

(withholding) and payroll tax obligations.

Benchmarks are used by the ATO to identify businesses that may be operating in the cash economy. The ATO benchmarks are financial indicators, such as the cost of goods sold margin, achieved by other businesses in the same industry.

How might it affect you?

Businesses that fall outside the benchmark for their industry may receive a letter asking for the relevant taxpayer to provide reasons.

While these benchmarks are drawn over a wide range, it is foreseeable that honest taxpayers who do not engage in fraudulent activities will still be sent such letters, especially where the business does not fall squarely into a specific business category, or the business operates in a geographical area which is not representative of the average population over which the benchmark is drawn.

Such letters are in some instances being sent directly to taxpayers rather than tax agents. Taxpayers who receive such a letter are encouraged to contact us.

NOTE

Businesses that receive letters in relation to falling outside the ATO's benchmarks for their industry should seek advice from us in formulating their response.

Compromised TFNs

What's it about?

The Commonwealth Ombudsman recently released his report on the ATO's treatment of taxpayers with complaints about compromised tax file numbers (TFNs).

The report considered eight case studies of situations in which the taxpayer's TFN had either been compromised or incorrectly linked by the ATO to another person's TFN.

The Ombudsman noted in his report that: "[t]he action taken by the ATO to deal with these complaints was unreasonable. Our

investigations have shown a systemic failure by the ATO to properly recognise and respond to the issues faced by taxpayers.

"When this unique identifying number is compromised, the impacts on a taxpayer can be significant. It can cause delayed refunds and payments, debts being incorrectly attributed to the taxpayer or problems with other agencies like Centrelink, where information is exchanged."

Such situations are of concern to many taxpayers, due to the potentially serious consequences. In addition, situations in which a taxpayer's TFN has been compromised as a result of ATO error are less likely to be quickly identified.

How might it affect you?

Taxpayers who are concerned that that they may have been affected should contact their tax agent or the ATO via its dedicated Call Centre, or should consult the ATO's fact sheet on this issue (available on www.ato.gov.au).

In accordance with the Ombudsman's recommendations, the ATO is currently:

- investigating measures by which to revise their systems to prevent such errors occurring in the future; and
- revising its response to taxpayers whose TFNs may have been compromised.

NOTE

If you are concerned that your TFN may have been compromised, please contact either our office or the ATO direct.

Unpaid present entitlements: final practice statement released

What's it about?

The ATO has recently released its final practice statement on the application of its ruling on unpaid present entitlements (TR 2010/3).

How might it affect you?

This practice statement may impact on your tax affairs if you or your related entities have:

- a trust under which you are able to benefit;
- income distributed by this trust to a related corporate beneficiary; and
- a shareholding in this corporate beneficiary.

Under the ATO's ruling and practice statement, where such income distributed by the trust to the corporate beneficiary remains unpaid, the amount may constitute a "loan" and therefore be seen as a dividend in the hands of the trust.

If this occurs, the trust may be required to include the deemed dividend in its net income for tax purposes in relation to the income year in which it arose.

TO DO

Family trusts with unpaid present entitlements in favour of company beneficiaries should consult with us to ensure that their tax affairs comply with the requirements of the ATO's newly released final practice statement.

Disclaimer

This newsletter provides information of general interest to our clients. The content of this newsletter does not constitute specific advice. Should you require any detailed advice on specific matters please contact our office.