



LEGAL NEWS for accountants

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Legal News for Accountants: It's Back!

After broadening the original Legal News for Accountants into Legal News for Business, we decided to revert to our roots. The focus of Legal News for Accountants is to provide you with relevant and material updates on key issues affecting your practice and clients.

You will still receive Legal News for Business, which will contain some of the articles from this newsletter.

STOP PRESS: Stamp duty exemptions to be abolished

The exemptions from duty on the transfer of real property and other dutiable property from a company to its shareholders on a capital reduction or winding-up will be abolished in Victoria under the *State Taxation Acts (General Amendment) Bill 2005*.

The abolition of the exemptions will, if the Bill is passed, apply from the day after the Bill receives Royal Assent. Clients wishing to distribute property to shareholders and rely on these exemptions should consider acting now.

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Combined debit/credit loan agreement available now

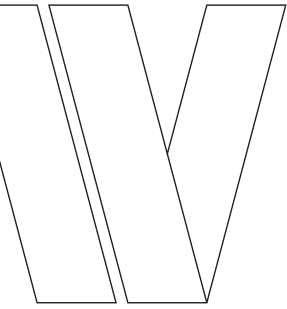
Hall & Wilcox has available a single convenient agreement that can be used to ensure both that:

- ♦ *debit loans* from a private company (and a trust that owes an outstanding present entitlement to a private company) do not give rise to deemed dividends under Division 7A; and
- ♦ *credit loans* to a company on which interest is charged are "debt interests" under Division 974 so that the company is not prevented from claiming interest deductions and is not required to the interest payment as a dividend.

The agreement is simple to implement and manage, even for a large group of related entities, as any number of related companies, trusts and their associates can sign and become parties to the single agreement. As further related entities come into existence, the agreement allows for them to accede to and become parties to the original agreement.

Importantly, the agreement does not just cover loans between a company and its shareholders. The ability for any related or associated entity to become a party to the agreement enables all affected loans to and from those associates to be covered.

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Capital Gains Tax & Family Law

The Forgotten Cost of a Family Law Settlement

Tax issues are not always associated with family law dealings. However, capital gains tax ("CGT") can represent a significant cost in a family law settlement. When a marriage ends, prudent tax planning can make a considerable difference to the parties' post-divorce financial positions. This means there is an order in which things must be done; do the property settlement before the divorce goes through.

When does the Family Court take CGT into account?

In dividing the property of a husband and wife, the Family Court must first determine the value of the pool of property. The Court deducts liabilities from the gross value of the assets to arrive at the net value of the property available for division. The Court takes liabilities such as loans, and in certain circumstances the cost of realising an asset, into account.

The Court considers the following factors in deciding whether or not CGT should be taken into account:

- ◆ Is the likelihood of the asset being realised in the foreseeable future high or inevitable?
- ◆ Was the asset acquired solely as an investment with a view to its ultimate sale for profit?

If the Court considers there is a real possibility that the asset will be sold, then it will take into account the costs associated with the disposal of the asset. These costs would include CGT that is imposed on any increase in the asset's value.

Ways to Minimise CGT

Transfer of ownership of the family home, investment properties, shares and equities attract CGT rollover relief if the transfer is pursuant to a Family Court order.

Any capital gain or loss that would otherwise arise is disregarded at the time of the transfer. The existing cost base passes to the transferee and CGT is not payable until another transfer of the asset occurs which attracts CGT.

A binding financial agreement, as defined by the *Family Law Act 1975*, made by the parties dealing with the financial matters before, during or after the marriage, is not an "order" of the Court for CGT roll-over relief purposes. Such financial agreements, therefore, do not currently

attract CGT roll-over relief. However, this is about to change (see below in this publication).

It should be remembered, though, that CGT roll-over relief is not always desired, for example, in a situation where a realised capital gain could be used to offset existing losses.

Limitations

Three major limitations with the roll-over spring to mind. Firstly, because the asset transfer must occur "because of" the relevant court order, the roll-over is not available in the many cases where a transfer of assets is done prior to reaching court and is later ratified by the relevant court. As such, where possible, the parties to a marriage breakdown should await a court order directing the division of property before they actually transfer the property between them.

The second limitation concerns the transfer of assets by a company to a spouse. While the company gets CGT roll-over relief, the transfer of the assets will be a dividend within its ordinary meaning, in which case the spouse is assessable on the value of the asset. It seems ridiculous that the law provides relief from CGT but no relief from assessment of the transfer as a dividend.

Finally, there is a shortcoming in cases where a company or trust, which has made an interposed entity or family trust election, transfers assets to a former spouse of the test individual. As the former spouse will no longer be a member of the family group, the trustee or company will be liable for Family Trust Distribution Tax at the rate of 48.5%. Importantly, this liability can extend to the directors of the company.

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News Alert

It's now easier to get 'divorce' CGT Roll-Over Relief

Marriage breakdown capital gains tax (CGT) roll-over relief is to be extended under the Budget announcements.

Currently, the roll-over relief applies only if a court order is obtained in relation to the transfer of assets.

The proposed changes will extend the relief to the transfer of assets agreed upon by parties under a binding financial agreement or awarded in arbitration to which both parties have consented.

The primary operation of the CGT relief will be for property settlements between divorcing people in Australia, under the *Family Law Act 1975*. Roll-over relief will also apply to settlements in similar written agreements made under State, Territory or foreign laws relating to de-facto relationship breakdowns. It also applies to settlements ordered by arbitration, corresponding to those made under the *Family Law Act 1975*.

The Government also intends to make two related amendments. The first of these amendments will ensure that the CGT main residence exemption interacts more appropriately with the marriage breakdown rollover relief. The second will ensure that marriage breakdown cash settlements do not give rise to CGT liabilities.

The commencement date of the changes is not yet known, but we understand that the roll-over relief will apply to roll-overs occurring after the date of Royal Assent; hopefully this year.

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More time to rethink your consolidation elections

The following elections may now be made, revoked or changed up until 31 December 2005.

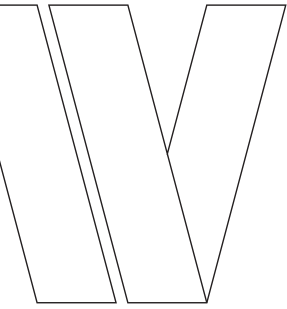
- ◆ The election to retain an entity's existing tax cost bases (i.e. to "stick"). This may reduce the administrative burden on your clients and could also produce a more tax effective result.
- ◆ The election to utilise certain continuity of ownership losses incurred in an income year that ended before 21 September 1999 over three years. This could potentially increase the rate that carried forward losses can be used in a consolidated environment.
- ◆ The election to use "loss donor" and "value donor" provisions to increase an entity's available fraction. This again may provide a faster rate of loss utilisation for a consolidated group.

- ◆ The election to waive capital injection rules. This will affect how an entity's available fraction is calculated and could potentially increase the rate of loss utilisation also.
- ◆ The election to cancel a loss on transfer to the head company. Where certain losses have a low available fraction, or won't be used in a reasonable time, their cancellation may have a positive impact on the cost setting rules.

Importantly, the election to enter into consolidation cannot be revoked if it has already been lodged with the Australian Taxation Office.

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Reducing the margin for error on property transactions

Significant GST amendments

Anyone that deals with real property should be aware of the important changes that the *Tax Laws Amendment (2005 Measures No. 2) Bill 2005* proposes to make to the *GST Act*. The main changes relate to the use of the margin scheme and supplies of “new” residential property.

Agreement in writing

Suppliers will no longer be able to simply choose to apply the margin scheme when they make a taxable supply of real property. If the margin scheme can be applied to a transaction, the supplier and the purchaser (or other recipient) must agree in writing at, or before, the time of the supply (usually settlement) that the margin scheme will be applied to the transaction. The Commissioner has the discretion to allow an extension of the time, within which parties are able to agree to apply the margin scheme.

This change will be effective from the date of assent. The other changes will have effect from the date on which the Bill was introduced in parliament, which was 17 March 2005.

GST-free acquisitions

Where a supplier originally acquired real property as GST-free farm land or using the going concern exemption, the margin on the supply will now be calculated with reference to the GST-inclusive market value of the property on 1 July 2000, rather than the value at the time when the supplier had acquired the property. This will be a very important consideration for some parties that wish to acquire real property GST-free. They will need to keep in mind the fact that, if they subsequently make a taxable supply of the property, either the total consideration for that supply, or the difference between the consideration they receive and the value as at 1 July 2000, will be subject to GST. This may make the margin scheme less lucrative.

Consider the following situation:

- ◆ a taxable supply of real property is made in 2004 (and the margin scheme is not applied);
- ◆ that real property is sold GST-free in 2005 (applying the

going concern exemption); and

- ◆ a taxable supply of the property is then made in 2006 and the margin scheme is applied.

GST would be paid on the taxable supply in 2004; but no GST would be paid on the supply in 2005. Prior to 17 March, the GST on the supply in 2006 would be calculated on the increase in the value of the land between the supply in 2005 and the supply in 2006. Under the proposed changes, the GST in 2006 would be calculated on the increase in the value of the land between 2000 and 2006.

The ATO will be receiving GST twice on the increase in the value of the property between 2000 and 2004; once when GST is paid in 2004 and again in 2006 when GST under the margin scheme is calculated back to the value of the property in 2000!

GST groups, joint ventures and the margin scheme

The changes will also prevent a member of a GST group that is not eligible to apply the margin scheme from making an intra-group supply to enable another group member to apply the margin scheme when they make a further supply to a third party. A GST group member will now only be able to apply the margin scheme to a supply of real property outside the group if the group member that initially acquired the property would have been eligible to apply the margin scheme.

The basic rules apply to supplies of real property by a GST joint venture operator to a joint venture participant. If the joint venture operator is eligible to apply the margin scheme to a taxable supply it makes to a third party, the joint venture operator is also entitled to apply the margin scheme to a taxable supply of the property to a joint venture participant.

GST groups, joint ventures and new residential property

Where a taxable supply is made from one GST group member to another, the *GST Act* ordinarily treats it as if it were not a taxable supply. Some GST groups were utilising this GST treatment to their advantage. One group member would make a taxable supply of “new residential premises” to another group member and not pay GST, because it was treated as if it were not a taxable supply under the grouping rules. The second group member would then supply the residential premises to a third party as an input taxed supply, on the basis that it had already been sold as a taxable supply and was no longer “new residential” premises.

The proposed amendments provide that the first sale of new residential premises outside the GST group will be taxable, as new residential premises will retain their character as new residential premises, despite intra-group supplies.

The basic rules will still apply to joint ventures, because GST is payable on a supply of new residential premises from a joint venture operator to a joint venture participant.

Supplies to and from associates

To ensure that supplies to and from associates are not misused to reduce GST, the changes to the legislation clarify that the margin scheme is calculated using the GST-inclusive market value of the property, where real property is acquired from, or supplied to, an associate.

Inherited real property and the margin scheme

Where a beneficiary inherits real property, the beneficiary and the deceased person will now effectively be treated as one entity, for the purposes of determining whether the margin scheme can be applied to the sale of the property by the beneficiary. The calculation of the margin will depend on factors, such as, when the property was acquired, when it was inherited, or when the relevant entity (the deceased in some circumstances, the beneficiary in other circumstances) registered for GST.

Development costs, legal fees and other costs relating to the property

Costs incurred to acquire, develop or improve real property

are not included in determining the value of the land for the purpose of calculating the margin scheme. For the purpose of calculating the margin, consideration only includes the price paid for the property, not the other expenses such as development or renovation costs, legal fees, stamp duty, etc.

Amalgamated property

When an entity supplies amalgamated property it can still apply the margin scheme if part of the property was acquired using the margin scheme or as a GST-free, input taxed or non-taxable acquisition, even though the other part of the property was acquired as a taxable supply without applying the margin scheme. However, an increasing adjustment is required for the part of the property that was acquired under the basic rules (ie. the taxable supply for which the margin scheme was not applied).

Full contract price not paid

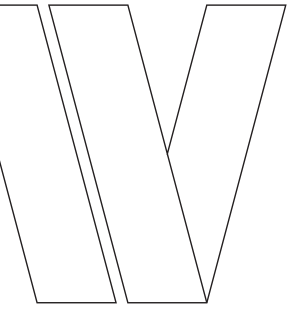
Where a supplier of real property applies the margin scheme to a property for which it never paid the full purchase price stated in the contract, the margin is calculated based on the actual consideration paid, rather than the purchase price stated in the contract. This may be relevant where the first purchase is under a terms contract between related parties.

Action

Property developers will need to be conscious of the impact that the decisions they make when they acquire properties will have on the GST treatment of supplies they make when they subsequently dispose of those properties.

If clients save GST by acquiring real property as part of a GST-free going concern today, will they suffer the consequences of having to charge their customers more GST on a higher margin when they sell? The GST treatment of property transactions, including elections to use the going concern exemption or the margin scheme, cannot be considered in isolation!

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The recent raft of superannuation changes

How do your clients' trust deeds stack-up?

Many superannuation fund trust deeds will need updating to take advantage of, and comply with, the raft of recent changes to superannuation law, including:

- ◆ Choice of fund;
- ◆ Interdependency relationship;
- ◆ Contribution rules;
- ◆ Compulsory cashing rules;
- ◆ Market-linked pensions;
- ◆ Government co-contributions; and
- ◆ Non-commutable pensions on transition to retirement.

We have just updated our deed to deal with these changes.

Choice of Fund

Choice of Fund legislation has been passed, effective from 1 July 2005. It is important that a fund's trust deed does not require the contributing employer to be a participating employer.

Interdependency Relationship

From 30 June 2004, subject to the fund's trust deed, superannuation death benefits can be paid to a person with whom the deceased member had an interdependency relationship. This is a person:

- ◆ with whom the deceased member lived or had a close personal relationship; or
- ◆ who provided to or received from the deceased member financial support or domestic and personal care.

This allows death benefits to be paid tax free (up to the deceased's pension RBL) to a person with whom the deceased lives and has a close personal relationship, where they provide each other with domestic and financial support.

To take advantage of this, the fund's trust deed must be flexible enough to allow death benefits to be paid out to this additional class of beneficiaries.

Contribution Rules

The work test to accept contributions in respect of a person under 65 was removed from 1 July 2004.

The work test for contributions, made in respect of members aged from 65 to 74, has been changed from a weekly test to an annual test. The requirement to be "gainfully employed on a part-time or full-time basis", where the contributions are not mandated employer contributions, was replaced.

The new requirement is that the member must have been gainfully employed during the financial year of the contribution for at least 40 hours, in a period of no more than 30 consecutive days, in that financial year.

Once this annual requirement has been satisfied, contributions can be made in respect of that member for the rest of the financial year, regardless of their employment status.

Your client's trust deeds should be reviewed to ensure the contribution rules in the trust deed are not more restrictive than the new rules described above. If they are, the more restrictive rules in the trust deed would prevail.

Compulsory Cashing Rules

From 1 July 2004, the compulsory cashing rules were also amended to contain an annual test rather than weekly test. This should address some anomalies created by the weekly test.

Where a member is aged between 65 and 74, they must take their benefits if they are not gainfully employed for at least 240 hours during the preceding financial year. Further, a person who was not aged 75 on 1 July 2004 must cash their benefits from their superannuation fund (as soon as practicable) after the member has turned 75.

Despite this change, if your client's trust deed has the old weekly test, then that is what would apply.

Market-linked pension

From 20 September 2004, a new type of income stream was introduced called the market linked income stream (MLIS). The MLIS is an account-based pension that is not readily commutable and restricts payments to a proportion of a member's account balance per year.

IMPORTANT: This is not advice. Readers should not act solely on the basis of the material contained in this newsletter. Items herein are general comments only and do not constitute or convey advice as per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas covered in this newsletter. © Copyright 2005.

Your client's superannuation fund trust deed should be flexible enough to allow the payment of such a pension before it is commenced. If not, a market-linked pension cannot be paid without upgrading the trust deed.

Government Co-contributions

The Federal Government will make a \$1.50 co-contribution for every \$1 of personal contributions made in a financial year, up to \$1,500 for low income earners that are eligible for the superannuation government co-contribution, with total income below \$28,000 and phasing out up to \$58,000.

It is important that the relevant trust deed allows the Government to make a contribution. Some trust deeds restrict contributions to participating employers, members and members' spouses.

Transition to retirement – non-commutable pensions

From 1 July 2005, a member of a self-managed superannuation fund who has reached preservation age (eg. 55 years of age) will be able to access their superannuation benefits by way of a non-commutable allocated pension/annuity or a non-commutable market-linked pension/annuity, without needing to retire.

In this case, non-commutable simply means that the allocated pension or market-linked pension cannot be taken as a lump sum except in a limited number of circumstances, such as, to pay superannuation contributions surcharge, to

give effect to a payment split, or if another condition of release with a 'nil' cashing restriction, such as retirement, has been reached.

A non-commutable allocated pension can be commuted at any time to roll it back within the superannuation system and restart the accumulation phase.

For a non-commutable market-linked pension, the restriction on commutation would only affect the first six months where the pension would otherwise be commutable under the normal rules of a market-linked pension. As mentioned above, during that period, the pension could still be commuted within the superannuation system, but could just not be taken as a lump sum.

To take advantage of this new condition of release, the trust deed must allow benefits to be accessed when a member reaches preservation age, without needing to retire, and must allow the payment of a non-commutable market-linked pension and allocated pension.

Action

If you would like us to review your clients' trust deeds, please contact us.

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News Alerts

It's my name and I'll use it if I want to: Company or Business Names

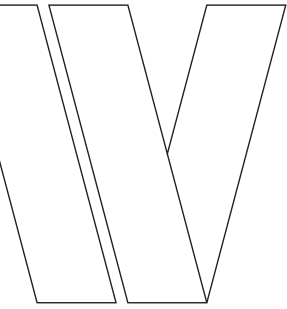
Trade mark registration gives exclusive rights to use a name (subject to a number of exceptions). Company and business name registrations do not.

Your clients may be forced to abandon use of a trading name, even after many years of trading under the name, if another business has registered a similar name as a trade mark. The mere fact that the name has been registered as a company or business name will provide no protection at all. Whilst it is possible to generate rights through use, this involves substantial risk and uncertainty.

It is therefore extremely important when you establish a new business for a client that trade mark searches are conducted (both of registered and unregistered marks) and trade mark registration is sought.

This should help protect your clients from being forced to abandon use of a name in the future.

To find out more about trademark registration see the April 2004 IP/IT newsletter available on our website at www.hallandwilcox.com.au



Land Tax & The Primary Production Business Exemption

A Recent Decision Highlights The Requirements

Many primary producers claim land tax exemption. An incorrect claim may result in having to pay the land tax assessed, plus penalty and interest on the land tax. The cessation of the exemption may also give rise to a liability for special land tax.

In the recent case of Harper, the Victorian Civil and Administrative Tribunal (“VCAT”) held that the exemption was not available because no primary production business was being conducted.

Although this case was decided on quite specific facts, it is relevant and should be considered by anyone that wishes to claim the exemption. It highlights the specific requirements set out in the *Land Tax Act 1958*.

Betty Harper (“Harper”) inherited the land. Harper’s land was “wholly or partly within the metropolitan area” and “wholly or partly within an urban zone” under a planning scheme. Accordingly, the land must be used “solely or primarily for the business of primary production” and either:

- ◆ Harper must be “normally engaged in a substantially full-time capacity in the business of primary production” of the type carried on on the land, or
- ◆ a relative of Harper’s must be “normally engaged in a substantially full-time capacity” in the business that is carried on on the land (whether or not Harper is also normally so engaged) and no other person can be so engaged on the land.

Harper claimed that during the relevant period, the land was used either to graze cattle, owned by Harper’s brother (“Alan”), or to grow lucerne and either sold it or fed it to his cattle. Harper and Alan did not negotiate the price of the lucerne, but paid what Harper’s accountants deemed to be appropriate “for the value of the lucerne” he sold.

The lucerne could not be described as a “commercial enterprise”. VCAT held that Harper:

- ◆ was not running a commercial enterprise;
- ◆ could not be said to be “carrying on the business of primary production”; and, accordingly,

- ◆ the land was not used “solely or primarily for the business of primary production”, in relation to the growing and harvesting of lucerne.

Additionally, Harper was held not to be “normally engaged in a substantially full-time capacity in the business of primary production” in relation to the growing and selling of lucerne. She worked as a nurse three days a week and spent three days a week at the farm. However, Harper only spent a very small part (if any) of her time at the farm in the production of lucerne.

The question then arose as to whether the business of grazing cattle was carried on on the land and whether Alan was “normally engaged in a substantially full-time capacity” in the business of grazing cattle. In two years, Alan used the land for a couple of months.

VCAT said that “there needs to be some use or control over the land during the relevant period by the relative who is alleged to be using the land substantially full-time in the capacity of a business of primary production”. Alan had no control over the land and there was no evidence that he was using the land for primary production.

Action for landowners

Landowners need to ensure that they (or a relative of theirs) are normally (actually) engaged in substantially full-time farming. They need to negotiate prices for their produce.

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Long-term non-reviewable contracts

On 1 July 2005, the GST grace period granted to contracting parties who have entered into long-term contracts (including leases) will end. The transitional provisions have allowed for parties in long-term contracts (contracts that had not made provision for GST at the time they were entered into) to avoid paying GST. A “long-term contract” is a contract that was entered into before 8 July 1999 (or 2 December 1998, if the recipient is not entitled to a full input tax credit) and is still on foot.

The transitional provisions allow the contract to be GST-free until the earlier of a “review opportunity” and 1 July 2005. Where a review opportunity has not arisen, the new *Tax Laws Amendment (Long-Term Non-Reviewable Contracts) Act 2005* (“the Act”), which became law on 22 February 2005, will apply.

The concern for partners that supply goods or services under long-term contracts, is that they may become liable to remit one eleventh of the current price for such supply to the ATO. If, by 1 July 2005, no agreement concerning the treatment of GST is reached between the parties and the arbitration process is not undertaken, the cost of the supply will be considered GST-inclusive. This will result in one eleventh of the price being remitted to the ATO, but not being recoverable from the recipient of the supply.

The Act provides a mechanism for suppliers to negotiate with recipients for the adjustment of the price, to reflect the inclusion of a GST amount.

Four potential outcomes that can occur post-1 July 2005 for non reviewable contracts are:

1. If the parties do not take any positive action, supplies made after 1 July 2005 will be subject to GST and the supplier will need to remit one eleventh of the consideration it receives to the ATO. The recipient may be entitled to claim an input tax credit for one eleventh of the amount it pays to the supplier.
2. The parties may renegotiate the contract price, either voluntarily or through arbitration.
3. The GST will become payable by the recipient directly to the ATO if they do not accept an arbitrated offer from the supplier.

4. The recipient of the supplies makes an irrevocable written election to pay the GST to the ATO directly.

The Act provides for an arbitration procedure, referred to in point 2 above, which involves three steps:

- (i) The supplier makes an initial offer in writing, setting out the proposed change to the contract price, which must remain open for 28 days.
- (ii) If the recipient does not accept or respond to the offer within the 28 days, the supplier can apply for an arbitrator to appoint an independent assessor, who will determine the appropriate change to the contract price.
- (iii) The supplier then makes a final offer, using the independent assessor’s determination, which must remain open for at least 21 days.

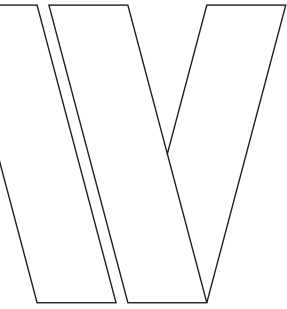
However, suppliers would be best served by negotiating directly with the recipient to either:

- (i) accept an increase in the price by 10% (or greater) and have the supplier provide a tax invoice; or
- (ii) make an election to pay the GST directly to the ATO.

Recipients, on the other hand, may prefer to have an independent assessor determine the change to the consideration, since the determination may be above or below 10% GST on the contract price. If the assessment is less than 10%, the recipient should accept it. If it is greater than 10%, the recipient can reject the assessment and pay 10% GST on the original price directly to the ATO.

By utilising the arbitration provisions, the worst case scenario for the recipient is that they will have to pay 10% GST on the original price.

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Tax office raids and searches

How far is too far?

If the tax man knocks on your door with a section 263 or 264 notice, it is important to know where you stand, both for you and your clients.

In the recent Full Federal Court case of *JMA Accounting v Commissioner of Taxation* (“*JMA Accounting*”), the Court held that the tax officers overstepped the boundaries set by section 263 of the *Income Tax Assessment Act 1936*. A few important points come out of the Court’s decision:

1. The Commissioner of Taxation (“the Commissioner”) may not indiscriminately take documents under sections 263 or 264.
2. The Commissioner must act reasonably and may not refuse occupants entry into premises while the search is being conducted.
3. The review of potentially privileged documents will not necessarily breach privilege, if the purpose of the review is to determine whether the document might be covered by privilege. The review is a “lawful violation”.

What happened in *JMA Accounting*?

The Commissioner received information that JMA Accounting and over 200 of its clients were involved in a tax scheme. The Commissioner believed that JMA Accounting would destroy all records relating to the scheme if the Commissioner gave a section 264 notice to inspect the relevant documents. Instead, the Commissioner decided to use his powers under section 263.

Section 263 gives the Commissioner “full and free access to all buildings, places, books, documents and other papers for any of the purposes of [the two income tax Acts]”. The relevant officers must have an authority signed by the Commissioner stating that the officers are exercising the Commissioner’s powers under section 263. The relevant occupants must then “provide the Commissioner or the officer with all reasonable facilities and assistance for the effective exercise of powers under this section”.

JMA Accounting had two premises that were raided together. An officer, in respect of one premise, took control of all documents, including computer databases, under the section

263 notice. Another officer, in respect of the second property, performed a cursory review of the available documents, by using a search facility, and only took documents that the officer thought were relevant to the scheme.

After the first day, the officers denied JMA Accounting’s staff access to any documents, systems and premises whilst the officers continued their work under the section 263 notice.

Decision

The Full Federal Court held that section 263 did not extend to prevent occupants from entering premises and that their actions could potentially have amounted to trespass.

Further, the Court held that the indiscriminate copying of documents was not allowed and the Commissioner was required to have some procedure in place to determine whether the documents were relevant to the current investigation. For example, the Commissioner should have reviewed computer folder names or opened sample documents (eg. performed a cursory review of the available documents) before copying the relevant folders or documents, instead of simply copying an entire disk drive. This was because some documents could potentially have been subject to legal professional privilege and the indiscriminate copying prevented the relevant taxpayers or their agents to claim privilege on such documents. It was not because privilege had been breached. The Court held that the documents taken from the property, where no cursory review had been performed, had to be returned. However, the Commissioner could retain documents obtained after a cursory review.

Finally, the Court noted that copying or inspecting a privileged document, in some instances, does not breach privilege, as long as it was for the purposes of determining privilege.

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Interest Deductibility Issues

Interest deductibility will probably always be a hot issue for people with investments. In this article we discuss two recent cases on the issue.

Domjan case: draw-backs of redraw facilities

The first case, *Domjan*, highlights the need to manage and trace the flow of borrowed funds through different accounts, to ensure that the borrowed funds are being applied for an income earning purpose, otherwise, the interest deductions will be lost. The case highlights some of the traps.

Trap 1: In this case, a husband and wife had taken out a loan jointly to acquire a rental property. They made repayments on a loan in excess of the minimum required by the bank. The wife subsequently re-drew an amount, most of which she paid into an account she used predominantly, though not exclusively, for personal expenses. As a result, the tribunal held that the interest on the bank loan had to be apportioned, with no part of the interest on the amount paid into the account, used predominantly for personal expenses, being deductible.

Trap 2: An amount roughly equal to the re-drawn amount was quickly repaid, but the tribunal held that the repayment could not be counted exclusively as a repayment of the re-drawn amount that had not been applied for deductible purposes. The repayment was apportioned between the amount of the loan that had been applied for deductible and non-deductible purposes, in proportion to the relative amount of each part of the loan.

Trap 3: The husband had received a redundancy pay-out and used part of it to pay-off what the husband and wife thought was his share of the loan they had jointly taken.

Nevertheless, the tribunal held that as the loan was in joint names, the wife could only claim half of the interest deductions available.

Solution: There would have been a very different result in this case, if separate accounts had been kept. If the wife had deposited at least part of her draw down into an account used specifically for income earning purposes, rather than the mixed account used predominantly for personal purposes, then at least interest on that part of the draw down would be deductible. By taking draw-downs for personal

purposes from a mortgage offset account (rather than a redraw facility) it could be made clear that the subsequent repayment was of the amount used for the personal purposes and not a repayment of the investment loan. This would enable full interest deductions on the investment loan.

Economedes case: Good news about on-lending borrowed funds to your family company

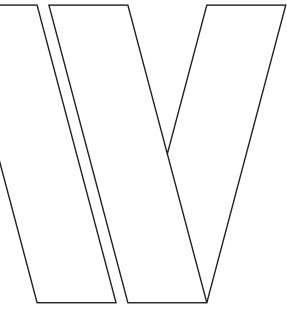
The second case, *Economedes*, is good news on the contentious issue of whether a husband and wife are entitled to interest deductions on funds they borrowed and on-lent to their family company.

The tribunal held that a husband and wife could claim interest deductions on borrowed funds that they on-lent to the company they owned, even though there was no written loan agreement between them and their company. The tribunal accepted that there was an unwritten understanding and a reasonable expectation that the company would pay the husband and wife interest, at a rate at least equal to the rate charged by the bank, and pay dividends in addition to a salary to the husband and wife.

The company only made interest payments to the husband and wife for a short time before it ceased its business and winding up proceedings commenced. It took the husband and wife a further seven years to repay the bank loan. The tribunal held the husband and wife were still entitled to claim interest deductions during that time.

Economedes is significant because it is the first case that a taxpayer has been successful in extending the principle established in 1977 in *Total Holdings*, which allowed a holding company interest deductions on funds borrowed and on-lent interest free to its wholly-owned subsidiary.

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Change of trustee transfers

Stamp duty free?

Three cases have recently been decided by the Victorian Civil and Administrative Tribunal (“VCAT”), where the Commissioner has denied the “change of trustee” exemption in section 33 of the *Duties Act*.

These cases indicate that the Commissioner is trying to prevent the exemption from being overused or misused. VCAT, however, has been drawing a line in the sand to make it clear that a change in trustees will always be for some purpose or another and should result in a transfer of land being dutiable, where the *transfer* is solely to change the trustee.

Challenger’s case

Challenger’s case dealt with arrangements regarding the trustee of a unit trust that owned a property. Prior to the relevant transactions, members of the Leighton group held all of the issued units in the unit trust, managed the unit trust and acted as trustee for the unit trust.

The following important changes took place on 27 June 2002:

- ◆ Two companies in the Challenger group subscribed for 50% each of the units in the unit trust;
- ◆ The Leighton Group’s units were redeemed;
- ◆ A challenger company became the new manager of the unit trust;
- ◆ The Leighton corporate trustee retired and a Challenger company became the new trustee; and
- ◆ A transfer of the property was executed to transfer the property from the Leighton corporate trustee to the new trustee, “Challenger”.

Challenger contended that the transfer was executed solely as a result of appointing a new trustee and was, therefore, exempt under section 33(3).

Counsel for the Commissioner contended that the transfer of the property was merely a step in “an elaborate dance” to avoid stamp duty. Though it is no longer the law, at the time, the acquisition of the units in the unit trust in two 50 percent parts by separate companies in the Challenger group meant that land rich duty was avoided, because neither of the companies acquired a “majority interest” in the unit trust.

VCAT agreed that the various transactions undertaken could be properly characterised as “an elaborate dance”, but noted that the most obvious objectives of this “dance” could be, and were, attained without a change of the trusteeship of the unit trust. The purchase and sale of the beneficial interest in the property (through the change in ownership of the unit trust) had been given full effect before the retirement of the existing trustee and the appointment of the new trustee.

The Challenger group of entities obviously preferred to have “one of their own” act as trustee of the unit trust, once the Challenger group held all of the units. The Leighton corporate trustee preferred not to have the burden and responsibility of acting as trustee, once none of the Leighton group companies had a beneficial interest. However, the change in trustee was not *necessary*, as the Leighton corporate trustee could have remained as the trustee of the unit trust.

Counsel for Challenger submitted, and VCAT accepted, that “whenever one trustee resigns and another is appointed there is a wider agenda. The items on that agenda may include the promotion of the commercial interest of the incoming trustee, relief from personal burdens for the outgoing trustee, an acknowledgment by the outgoing trustee that it has lost the confidence of the beneficiaries or unit holders under the trust etc.”.

VCAT appeared to accept the submission that the proper approach was to enquire whether “the only purpose of the

transfer is to give effect to the change in trusteeship” rather than enquiring as to why the trustee resigned. This is good news for those wishing to utilise the change of trustee exemption, because it confirms that it is the sole purpose of the *transfer* that needs to be considered, rather than the purpose for the *change in trustee*. Challenger was successful and the transfer was held to be exempt from duty.

The Commissioner’s appeal against this decision was recently heard before a single judge of the Supreme Court. The decision has not yet been handed down.

Tearle’s Case

Tearle was a trustee of a superannuation fund that held units in a property trust. It was not successful.

The corporate trustee of the property trust was also a trustee of other trusts. It breached its obligations as trustee and mixed the funds into a “common pool”. The Federal Court directed that the common pool be unwound.

Tearle held a 45% interest and the common pool held a 55% interest in the property, known as 27 Bay Road, Sandringham. By deed of settlement, 55% interest held by the common pool was transferred to Terry Earle, the sole member of the fund, and in turn, Terry would:

- ◆ make a cash payment;
- ◆ discharge a mortgage over the Bay Road property; and
- ◆ surrender any further interest in the trust property.

The Bay Road property was transferred to Tearle as trustee of the fund. The consideration was expressed to be pursuant to the deed of settlement, outlined above.

Kringas’ Case

Kringas’ case involved a change of trustee, as part of a family law settlement. Kringas was successful in claiming the exemption.

In this case, Hennasham Pty Limited was the trustee of a family trust, which owned the family home of Kringas and

her husband (“Denis”). As part of the Family Court consent orders, Kringas and Denis agreed to remove Hennasham and appoint Kringas as the new trustee, and remove Denis as a beneficiary and appointor of the family trust.

Later, Kringas decided to auction the house and realised that the house was still in Hennasham’s name, so the changes were then made.

VCAT held that the transfer was exempt because it was solely for the purpose of changing the trustee of the family trust. The other events that occurred around the same time as the transfer, such as the auction, were not the cause for making the change in trustee, but, rather, the occasion for changing the trustee.

The decision stated that “it is a big jump to conclude that a change in the beneficiary was a cause of the transfer. The change in a beneficiary may have been an act that did happen contemporaneously with the change of trustee and the transfer, but the change of trustee and the transfer is in no way dependent upon the change of beneficiary”.

Conclusion

These cases provide some guidance as to when the Commissioner is likely to deny the application of the change of trustee exemption and what the end result is likely to be. However, a cautious approach should be taken to ensure that the *sole purpose* for the transfer is a change in trustee. Where there may be another purpose for the *transfer*, as distinct from the purpose for the *change in trustee*, the transfer will be assessed for duty.

We await further clarification when the appeal in the Challenger case is handed down. Watch this space!

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News Alert

Ex-Allens partner joins Hall & Wilcox

Ex-Allens commercial partner Deborah Chew has joined the Hall & Wilcox partnership in the Corporate & Commercial practice area.

Deborah said she was positioning her practice to concentrate on medium-sized, high-growth companies and private equity firms. She believes both client segments are searching for the same quality of legal services and level of attention as the larger corporations, but most cannot afford the big firms.

Deborah said that Hall & Wilcox offered clients a tailored, commercially focused and more cost-effective service, while still providing the levels of technical expertise and service standards that her clients expect.

"I approached Hall & Wilcox because the firm provides an excellent platform for servicing clients within my target markets. I was particularly impressed by their exemplary tax expertise and their track record of acting for a host of large private companies and high-net-worth family groups.

Deborah brings with her a wealth of corporate and commercial experience, having worked on and led many major transactions, including the successful bid by Telecom New Zealand for the telecommunications outsourcing work of the CBA and the float of Melbourne IT.

Before joining the firm, Deborah was a partner at Allens Arthur Robinson for three years, and practised for more than a decade with the San Francisco-based firm Orrick, Herrington & Sutcliffe and the New York firm Debevoise & Plimpton.

For Deborah's complete profile, visit www.hallandwilcox.com.au/pages/people/pages/partners/chewd.asp

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