

# **Tax on the Couch**



**Notes**

**December 2016**

The information in this publication has been developed in consultation with the Australian Taxation Office.

### **ATO Disclaimer**

This general advice has been prepared by the Australian Taxation Office ABN 52 824 753 556 and does not take account of your objectives or financial, legal or taxation situation or needs. Before acting on this general advice you should consider the appropriateness of the advice having regard to your situation. We recommend you obtain financial, legal and taxation advice in making an investment strategy and investing the assets of any fund.

This material has been prepared based on information believed to be accurate at the time of publication. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information.

This material or information is not intended as a form of financial advice and should not be treated as such. The Australian Taxation Office does not provide financial, legal or taxation advice.

The above disclaimer also applies to, and in respect of, the NTAA.

### **Disclaimer**

The NTAA and their presenters do not hold an Australian Financial Services Licence to provide financial product advice under the *Corporations Act 2001 (Cth)*. This material covers general taxation information which is only one of the factors to consider when making a decision on a financial product. If you are seeking financial product advice, you should contact a person who is licensed under the *Corporations Act 2001 (Cth)*.

Tax on the Couch is intended to be a guide only. None of the comments contained in the presentation or notes are intended to be advice, whether legal, financial or professional. You should not act solely on the basis of the information contained in these notes because many aspects of the material have been generalised and the tax laws apply differently to different people in different circumstances. Further, as tax and related laws change frequently, there may have been changes to the law since the notes were written. Specific advice should always be obtained from a tax professional.

The NTAA, their directors, employees, consultants, presenters and authors expressly disclaim any and all liability to any person, whether a purchaser or not, for the consequences of anything done or omitted to be done by any such person relying on a part or the whole of the contents of this publication.

### **Copyright**

© Copyright 2016 NTAA

All rights reserved. Except as permitted by the *Copyright Act 1968*, no part of these notes may be reproduced or published in any form or by any means, electronic or mechanical, including photocopying, recording, or by information storage or retrieval system, without prior written permission from the NTAA.

### **Feedback**

Please send any questions or feedback regarding Tax on the Couch to [feedback@taxonthecouch.com.au](mailto:feedback@taxonthecouch.com.au)

# **Table of Contents**

Legislative Update.....	2
Bills that have received Royal Assent.....	2
Bills recently introduced into Parliament.....	2
Other tax-related Bills currently before Parliament.....	3
Tax-related Exposure Draft of Bills not yet before Parliament .....	4
Rulings Update.....	4
Rulings.....	4
Class Rulings .....	4
Taxation Determinations .....	5
ATO Guidelines .....	5
Practical Compliance Guidelines .....	5
Draft Practical Compliance Guidelines .....	5
Product Rulings – Notices.....	5
Legislative Determinations .....	5
PAYG Variations and Notices .....	5
ATO Interpretive Decisions .....	5
Withdrawn Interpretive Decisions .....	5
Cases Update.....	6
Appeals.....	6
Cases .....	6
Other Cases .....	7
Other Developments .....	7
Media Releases: Treasury Ministers and ATO.....	7
Speeches: Treasury Ministers and ATO.....	8
Other Developments .....	9
Hot Topic – Limited Recourse Borrowing Arrangements.....	10
Special Topic – Main Residence Exemption.....	12

## Legislative Update

### Bills that have received Royal Assent

#### Treasury Laws Amendment (Income Tax Relief) Bill 2016

This Bill received Royal Assent on 20 October 2016. With effect from 1 July 2017 this Bill increases the tax bracket for resident individual taxpayers at which the 32.5 per cent tax rates applies, from \$80,000 to \$87,000.

### Bills recently introduced into Parliament

#### Superannuation (Objective) Bill 2016

On 9 November 2016, the Government introduced this Bill into the House of Representatives. This Bill establishes a legislative framework to guide the development of future superannuation policy. It does this by enshrining the primary objective of the superannuation system in legislation and the subsidiary objectives of the superannuation system in regulation. It requires new bills and regulations relating to superannuation to be accompanied by a statement of compatibility with the objective of the superannuation system. The subsidiary objectives of the superannuation system will be prescribed by regulation. Under this Bill the 'primary objective' of the superannuation system is to provide income in retirement to substitute or supplement the age pension.

This Bill remains before the House of Representatives.

#### Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016

#### Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016

These Bills, introduced into the House of Representatives on 9 November 2016, seek to implement the following superannuation measures, the majority of which were announced in the 2016-2017 Federal Budget:

#### **(a) Introduce a \$1.6 million transfer balance cap and transitional arrangements for individuals who already have retirement phase balances above \$1.6 million**

From 1 July 2017, there will be a \$1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase. Subsequent earnings on balances in the retirement phase will not be capped or restricted. Savings beyond this can remain in an accumulation account (where earnings are taxed at 15 per cent) or outside the superannuation system.

People already retired will have to bring their retirement phase balances under \$1.6 million before 1 July 2017.

The transfer balance cap will be indexed and will grow in line with CPI, meaning the cap will be around \$1.7 million in 2020-21.

#### **(b) Lower the concessional contributions capping threshold to \$25,000**

From 1 July 2017, the annual concessional contributions cap will be \$25,000 without regard to the fund member's age. The existing concessional contributions capping threshold, for the 2016-17 income year, is either \$35,000 or \$30,000, depending on whether the fund member is aged 50 or over (with fund members currently aged 50 or over benefiting from the higher cap).

#### **(c) Lower the non-concessional contributions capping threshold to \$100,000**

From 1 July 2017 the annual non-concessional contributions cap will be \$100,000. This existing non-concessional contribution cap for the 2016-17 income year is \$180,000. Furthermore, from 1 July 2017 a fund member will only be able to make a non-concessional contribution where their total superannuation balance at 30 June of the previous financial year is less than \$1,600,000.

#### **(d) Change the taxation of concessional contributions**

From 1 July 2017, the threshold at which high income earners pay additional contributions tax (Division 293) will be lowered from \$300,000 to \$250,000.

### **(e) Allow catch-up concessional contributions for those with balances less than \$500,000**

From 1 July 2018, the government will help people 'catch-up' their superannuation contributions by allowing individuals with account balances of \$500,000 or less to rollover their unused concessional caps (for up to 5 years) to use if they have the capacity and choose to do so.

### **(f) Remove regulatory barriers to innovation in the creation of retirement income stream products**

From 1 July 2017, the government will extend the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self-annuitisation products.

### **(g) Change the treatment of transition to retirement income streams**

The government will remove the tax-exempt status of income from assets supporting TRIS. These earnings will now be taxed at 15 per cent. Individuals will also no longer be allowed to treat certain superannuation income stream payments as a lump sum for tax purposes.

### **(h) Remove the anti-detriment provision**

From 1 July 2017, the government will remove the anti-detriment provision that allows superannuation funds to claim a tax deduction for a portion of the death benefits paid to eligible dependants.

These Bills remain before the House of Representatives.

## **Other tax-related Bills currently before Parliament**

### **Working holiday maker reform package**

On 12 October 2016, a series of Bills were introduced into the House of Representatives to reform tax and other arrangements for working holiday makers:

[Income Tax Rates Amendment \(Working Holiday Maker Reform\) Bill 2016](#)

[Treasury Laws Amendment \(Working Holiday Maker Reform\) Bill](#)

[Superannuation \(Departing Australia Superannuation Payments Tax\) Amendment Bill 2016](#)

[Passenger Movement Charge Amendment Bill 2016](#)

A 'working holiday maker' is an individual who holds a Subclass 417 (Working Holiday) visa, a Subclass 462 (Work and Holiday) visa or certain related bridging visas.

These Bills:

**(a)** Apply a 19% income tax rate to working holiday maker taxable income (that is assessable income derived from Australian sources by working holiday makers less relevant deductions) on amounts up to \$37,000, with ordinary tax rates for taxable income exceeding this amount;

**(b)** Help protect working holiday makers from unfair employment arrangements by allowing the Commissioner of Taxation ('Commissioner') to disclose information that is relevant to ensuring an entity's compliance with the Fair Work Act 2009 to the Fair Work Ombudsman;

**(c)** Require employers of working holiday makers to register with the Commissioner, which will allow such employers to withhold tax at income tax rates applying to working holiday makers;

**(d)** Require the Commissioner to give the Treasurer, for presentation to the Parliament, a report on working holiday makers, which includes statistics and information derived from the register;

**(e)** Increase the rate of the departing Australia superannuation payments tax to 95% for working holiday makers;

**(f)** Reduce the visa application charge for Subclass 417 (Working Holiday) visas and Subclass 462 (Work and Holiday) visas from \$440 to \$390; and

**(g)** Increase the passenger movement charge from \$55 to \$60.

On 7 November, these Bills were introduced to the Senate after having passed the House of Representatives on 17 October 2016.

## **Tax-related Exposure Draft of Bills not yet before Parliament**

### **Treasury Laws Amendment (2017 Measures No.1) Bill 2017**

This Bill, released as an exposure draft, proposes that from 1 July 2017 taxable importations of goods valued at \$1,000 or less will be subject to GST. That is, the exemption from GST that currently exists for taxable importations that are 'low value goods' (equal to or less than \$1,000) will be removed.

## **Rulings Update**

The following lists the Rulings, Determinations, Practice Statements and Interpretative Decisions (and other related documents) issued by the ATO from 16 October 2016 to 15 November 2016.

## **Rulings**

### **Class Rulings**

<a href="#">CR 2016/73</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia Australia Trust	19 October 2016
<a href="#">CR 2016/74</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia Australia No. 2 Trust	19 October 2016
<a href="#">CR 2016/75</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia Small Caps Trust	19 October 2016
<a href="#">CR 2016/76</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia Small Caps No. 2 Trust	19 October 2016
<a href="#">CR 2016/77</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia (Private) Investment Trust	19 October 2016
<a href="#">CR 2016/78</a>	Income tax: scrip for scrip roll-over - Caledonia group reorganisation: Caledonia (Private) Investment No. 2 Trust	19 October 2016
<a href="#">CR 2016/79</a>	Income tax: Patties Foods Limited Scheme of Arrangement and Payment of Special Dividend	19 October 2016
<a href="#">CR 2016/80</a>	Income tax: 'Queensland University of Technology Early Retirement Scheme 2016'	19 October 2016
<a href="#">CR 2016/81</a>	Income tax: Asciano Limited - Scheme of Arrangement and Special Dividend	26 October 2016
<a href="#">CR 2016/82</a>	Income tax: the 'Ward McKenzie Early Retirement Scheme 2016'	26 October 2016
<a href="#">CR 2016/83</a>	Income tax: the 'Henwood Downs Early Retirement Scheme 2016'	26 October 2016
<a href="#">CR 2016/84</a>	Income tax: in specie distribution by Centuria Capital Limited and creation of a new stapled entity	2 November 2016
<a href="#">CR 2016/85</a>	Fringe benefits tax: employer clients of Community CPS Australia Limited trading as Beyond Bank Australia who are subject to the provisions of either section 57A or section 65J of the <i>Fringe Benefits Tax Assessment Act 1986</i> and make use of the Meal Entertainment Card facility	9 November 2016
<a href="#">CR 2016/86</a>	Income tax: assessable income: payments received under the South Australian Stolen Generations Reparations Scheme	9 November 2016

## **Taxation Determinations**

<a href="#">TD 2016/17</a>	Income tax: in what circumstances does a contractual right, which is subject to the satisfaction of a condition, become a right to acquire a beneficial interest in a share for the purposes of subsection 83A-340(1) of the <i>Income Tax Assessment Act 1997</i> ?	2 November 2016
----------------------------	--	-----------------

## **ATO Guidelines**

### **Practical Compliance Guidelines**

<a href="#">PCG 2016/10</a>	Fleet Cars: simplified approach for calculating car fringe benefits	19 October 2016
-----------------------------	---	-----------------

### **Draft Practical Compliance Guidelines**

<a href="#">PCG 2016/D16</a>	Fixed trusts	26 October 2016
<a href="#">PCG 2016/D17</a>	ATO compliance approach - exploration expenditure deductions	14 November 2016

## **Product Rulings – Notices**

<a href="#">PR 2016/3A1 - Addendum</a>	Income tax: TFS Indian Sandalwood Project 2016 Sophisticated Investor Offer	9 November 2016
--	---	-----------------

## **Legislative Determinations**

### **PAYG Variations and Notices**

<a href="#">Variation 51</a>	Foreign resident capital gains withholding payments - marriage or relationship breakdowns	Signed on 5 October 2016
<a href="#">Variation 52</a>	Performing Artists	Signed on 5 October 2016
<a href="#">Variation 53</a>	Body Corporate	Signed on 5 October 2016
<a href="#">Variation 54</a>	Donations to deductible gift recipients	Signed on 5 October 2016

## **ATO Interpretive Decisions**

### **Withdrawn Interpretive Decisions**

<a href="#">ATO ID 2001/182 (Withdrawn)</a>	Medical expenses tax offset - therapeutic treatment for autism	27 October 2016
<a href="#">ATO ID 2001/228 (Withdrawn)</a>	Medical expense tax offset - travel and accommodation expenses	27 October 2016

<a href="#">ATO ID 2001/243 (Withdrawn)</a>	Medical expenses tax offset - therapeutic treatment	27 October 2016
<a href="#">ATO ID 2001/669 (Withdrawn)</a>	Medical expenses tax offset - purchase of donor sperm from overseas	27 October 2016
<a href="#">ATO ID 2001/721 (Withdrawn)</a>	Medical expenses tax offset - laser eye surgery	27 October 2016
<a href="#">ATO ID 2002/1007 (Withdrawn)</a>	Medical expenses tax offset - additional payment as a result of increased medical insurance costs	27 October 2016
<a href="#">ATO ID 2002/1087 (Withdrawn)</a>	Medical expenses tax offset - expenses of collecting, processing and, testing blood and storing stem cells	27 October 2016
<a href="#">ATO ID 2002/459 (Withdrawn)</a>	Camping allowance - eligibility for the exception from substantiation	27 October 2016
<a href="#">ATO ID 2002/590 (Withdrawn)</a>	Substantiation - written evidence from a supplier that does not contain date of purchase	27 October 2016
<a href="#">ATO ID 2004/148 (Withdrawn)</a>	Medical expenses tax offset: water purification system	27 October 2016
<a href="#">ATO ID 2007/70 (Withdrawn)</a>	Medical Expenses Tax Offset: cosmetic surgery - vocal chords	27 October 2016

## Cases Update

### Appeals

#### [Commissioner of Taxation v Jayasinghe \[2016\] FCAFC 79](#)

The Commissioner of Taxation has lodged an application for special leave to the High Court to appeal against the decision of the Full Federal Court, in the case of the *Commissioner of Taxation and Jayasinghe* [2016] FCAFC 79. In this case the Full Federal Court had dismissed the Commissioner's appeal against an AAT decision that an individual taxpayer's income was exempt as the earnings of a "holder of an office in" an international organisation under the *International Organisations (Privileges and Immunities) Act 1963*.

### Cases

#### [Blank v Commissioner of Taxation \[2016\] HCA 42](#)

The High Court has unanimously upheld the majority decision of the Full Federal Court in *Blank v Commissioner of Taxation* [2015] FCAFC 154. The High Court held that a lump sum, of approximately USD 160million, paid to a taxpayer in instalments under the terms of an incentive profit participation agreement after the cessation of his employment, was income according to ordinary concepts. As such, it was assessable under S.6-5 of the Income Tax Assessment Act 1997. The taxpayer's position – rejected by the Court – was that the amount received was capital proceeds from CGT event C2 (Cancellation, surrender and similar endings) to which the CGT 12 month discount applied.

#### [FKYL v Commissioner of Taxation \[2016\] AATA 810](#)

The Administrative Appeals Tribunal (AAT) held that four residential properties, developed by an individual taxpayer, were "new residential premises" and therefore they were subject to the GST when sold by the taxpayer. The AAT concluded that none of the four premises had been held solely for making input taxed supplies for at least five years (the so-called 5-year rule). The AAT further held that the margin scheme did not apply as the taxpayer was unable to produce any written agreements with the respective purchasers, showing that there had been an agreement between vendor and purchaser(s) to apply the margin scheme.

### [Shaw v Deputy Commissioner of Taxation \[2016\] QCA 275](#)

The Queensland Court of Appeal allowed an appeal by two company directors against summary judgements from the Queensland Supreme Court in the case of *Deputy Commissioner of Taxation v Shaw* [2016] QSC 68 in relation to unpaid PAYG and penalties imposed by way of Directors' Penalty Notices (DPNs). The Queensland Supreme Court has been satisfied that the company directors had no chance of success in defending the DPNs. However, the Queensland Court of Appeal found that it was open to the directors, based on evidence provided, to make a realistic case for their defence against the DPNs. The matter has now been remitted back to Queensland Supreme Court for another trial.

## Other Cases

<a href="#">[2016] AATA 824</a>	NZ Wine Imports v. Commissioner of Taxation	19 October 2016
<a href="#">[2016] FCA 1243</a>	Rawson Finances Pty Ltd (No 3) v. Commissioner of Taxation	19 October 2016
<a href="#">[2016] FCA 1281</a>	Deputy Commissioner of Taxation v. King	8 July 2016
<a href="#">[2016] FCA 1307</a>	A v. Commissioner of Taxation	4 November 2016

## Other Developments

### Media Releases: Treasury Ministers and ATO

#### Treasurer – The Hon Scott Morrison MP

26 October 2016	<a href="#">Opinion piece: Backing SA business to drive jobs, growth and wages</a>
28 October 2016	<a href="#">Launch of the Australia and New Zealand Infrastructure Pipeline</a>
3 November 2016	<a href="#">Release of Productivity Commission draft report into Data Availability and Use</a>
4 November 2016	<a href="#">Exposure Draft: GST on low value imported goods</a>
8 November 2016	<a href="#">Labor will force Australians to pay for foreign worker tax cut</a>

#### Minister for Revenue and Financial Services – The Hon Kelly O'Dwyer MP

17 October 2016	<a href="#">Professional standards for financial advisers to benefit consumers</a>
19 October 2016	<a href="#">ASIC Enforcement Review Taskforce</a>
19 October 2016	<a href="#">Government releases revised life insurance remuneration regulations for consultation</a>
26 October 2016	<a href="#">Consultation on making Employee Share Schemes more user-friendly</a>
3 November 2016	<a href="#">Consultation on collective investment vehicle non-resident withholding taxes</a>
8 November 2016	<a href="#">Government moves to protect client monies</a>
8 November 2016	<a href="#">Labor's super backflip to hit women, carers, small business and farmers</a>

### ATO

- 17 October 2016 [ATO warns small businesses: time running out to meet super payment compliance](#)
- 24 October 2016 [Giddy up and get your tax done](#)
- 24 October 2016 [Seven ways a deduction will not work](#)
- 2 November 2016 [Commissioner clarifies tax arrangements for working holiday makers](#)
- 7 November 2016 [Terrific tax results](#)

### Speeches: Treasury Ministers and ATO

#### Treasurer – The Hon Scott Morrison MP

- 24 October 2016 [Keeping home ownership within reach – Address to the Urban Development Institute of Australia \(UDIA\), Sydney](#)
- 4 November 2016 [Address to the Fintech Australia Summit, Melbourne](#)

#### Minister for Revenue and Financial Services – The Hon Kelly O’Dwyer MP

- 10 November 2016 [Video message, Flexible Packaging & Label Manufacturers Association conference](#)
- 11 November 2016 [Address at the Association of Superannuation Funds of Australia \(ASFA\) Conference 2016, Gold Coast](#)

### ATO

#### Treasury

- 19 October 2016 [Opening Statement - Senate Economics Legislation Committee](#)
- 21 October 2016 [Australia's Economic and Fiscal Outlook](#)
- 26 October 2016 ['The economic and fiscal context and the role of longitudinal data in policy advice'](#)

## Other Developments

### What attracts the ATO's attention

The ATO has published information available on its website, explaining the behaviours, characteristics and tax issues that are likely to attract the ATO's attention (i.e., heightened risk of being selected for an audit/review) for taxpayers that are privately owned and wealthy groups.

### PAYG withholding variations (note this heading is NOT a hyperlink)

The ATO has issued various Legislative Instruments in relation PAYG withholding variation in October 2016 – refer to matters listed under heading Legislative Determinations/PAYG Variations and Notices (above).

### Crowdfunding

The ATO has published information available on its website, explaining the ATO's views in relation to the taxation and GST implications of crowdfunding arrangements. The ATO describes "crowdfunding" as "the practice of using internet platforms, mail-order subscriptions, benefit events and other methods to find supporters and raise funds for a project or venture".

### Seven ways a deduction will not work

The ATO has published on its website, a document called *Seven ways a deduction will not work*, in which it provides various examples of individual taxpayers claiming "dodgy deductions". Assistant Commissioner Graham Whyte reminds taxpayers to consider three golden rules when making a work-related expense claim:

- you must have spent the money yourself and not been reimbursed
- it must be directly related to earning your income
- you must have a record to prove it.

# Hot Topic – Limited Recourse Borrowing Arrangements

## An overview of the LRBA requirements

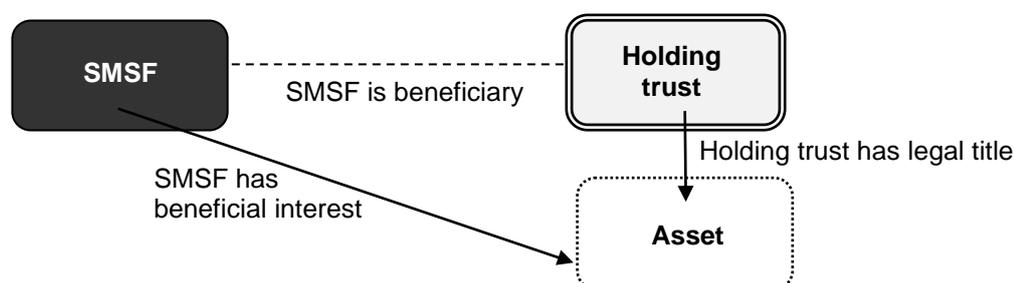
Subject to certain exceptions, the SIS Act prohibits superannuation fund trustees from borrowing money. One such exception is S.67A, which permits fund trustees to borrow money on a *limited recourse* basis provided the requirements set out below are satisfied.

- (a) The money is, or has been, applied for the acquisition of a **‘single acquirable asset’** being broadly, a single asset that is not money and is one which the trustee is permitted to acquire (e.g., a rental property acquired from a third party). In certain limited circumstances, separate bundles of proprietary rights (e.g., a factory situated over *two* blocks of land) can constitute a single acquirable asset. Refer to SMSFR 2012/1.

The legislation also provides a special rule allowing a ‘collection’ of certain assets to be acquired under the one LRBA including, for example, a parcel of shares (provided the shares are of the same type, in the same company and that they are ‘dealt with’ together).

An SMSF trustee can also use monies borrowed under an LRBA to fund expenses incurred in connection with the borrowing or acquisition (e.g., conveyance fees, stamp duty, brokerage or loan establishment costs) and/or in maintaining or repairing the acquirable asset. An LRBA can also be used to refinance a borrowing (including accrued interest) to which S.67A applied (but only in relation to the acquirable asset or permitted replacement asset). Note that an LRBA *cannot* be used to make improvements to the acquirable asset.

- (b) The acquirable asset is **held on trust** (referred to as a ‘holding trust’) so that the fund trustee acquires a *beneficial interest* in the acquirable asset. This can be represented as follows:



The law does not prescribe the nature of a holding trust; however, to satisfy the requirements of S.67A, it must be a fixed trust (but not a unit trust) and it cannot be a discretionary trust. A number of questions have recently arisen in relation to the nature of the holding trust, some of which are discussed under heading 5 below. For example, questions have arisen over whether a corporate trustee of an SMSF can also be used as the trustee of a holding trust, and whether the same company can be the trustee of multiple holdings trusts.

- (c) The fund trustee has a **right to acquire legal ownership** of the acquirable asset by making one or more payments after acquiring the beneficial interest.
- (d) The rights of the lender or any other person against the fund trustee for, or in connection with, or as a result of, (whether directly or indirectly) default on the borrowing (or charges related to the borrowing) **are limited to rights relating to the acquirable asset**.
- (e) If the fund trustee has a right relating to the acquirable asset (other than a right described in paragraph (c) above), the rights of the lender or any other person against the fund trustee for, in connection with, or as a result of, (whether directly or indirectly) the trustee’s exercise of the trustee’s right are **limited to rights relating to the acquirable asset**.
- (f) **The acquirable asset is not subject to any charge** (including a mortgage, lien or other encumbrance) except for as provided by (d) or (e) above.

It is important to note that S.67A applies in respect of LRBAs entered into from 7 July 2010. An LRBA entered into between 24 September 2007 and before 7 July 2010 is *generally* governed by former S.67(4A).

### Can the same company be used as the corporate trustee of the SMSF and the corporate trustee of the holding trust?

The short answer here is no. The same company *cannot* be used as the corporate trustee of the SMSF and of the holding trust. Rather, (at least two) different entities must be used for this purpose. This is because of S.67A(1)(b) and (c), which respectively require that:

- the acquirable asset is held on trust so that the regulated superannuation fund trustee acquires a beneficial interest in the acquirable asset; and
- the regulated superannuation fund trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest.

Together, these provisions effectively require that the SMSF trustee not hold legal ownership of the relevant asset at the beginning of the arrangement (i.e., it can only acquire legal ownership after having made one or more payments). It is evident that this requirement would not be satisfied if the same entity were to act as trustee of the holding trust (which initially acquires legal ownership of the asset), and also as trustee of the SMSF.

### Are the costs associated with establishing the holding trust deductible?

Borrowing under an LRBA will inevitably see the SMSF trustee incur some fairly significant up-front fees, one of which is the cost of establishing the holding trust and trustee (which holds the single acquirable asset acquired under the LRBA). The costs involved will generally include the cost of the legal documentation and associated legal advice required to set-up the structure. The question of how these costs should be treated for tax purposes has been a vexed issue for trustees and advisors since the inception of the LRBA provisions.

Generally, expenditure incurred in “*borrowing money*” (a borrowing cost) is deductible over a period of the loan or five years, whichever is shorter. Refer to S.25-25 of the ITAA 1997. Unfortunately, the ATO is of the view that the set-up of a holding trust is a requirement of the SIS Act, and not the borrowing itself and, thus, is not deductible under S.25-25.

Further, these expenses do not constitute ‘black hole’ expenses for the purposes of claiming a deduction under S.40-880 ITAA 1997 (e.g., over 5 years) because the costs do not relate to a business that was, or is, proposed to be carried on for a taxable purpose. These costs are also not eligible for inclusion in the cost base of an asset. In summary, therefore, the costs associated with establishing a holding trust represent true, non-deductible, ‘black-hole’ costs.

## Special Topic – Main Residence Exemption

### When the main residence exemption applies

Broadly, the main residence exemption applies where an **individual** (i.e., generally not a company or trust) disposes of a **dwelling**, or an ownership interest in a dwelling, which was their **main residence** during all or part of the period that the taxpayer owned the dwelling (i.e., the 'ownership period'). Refer to S.118-110.

Importantly, any **capital loss** from the sale of an individual's main residence is also disregarded. Therefore, to the extent that the exemption applies, the taxpayer **cannot** offset the capital loss against any other capital gains (e.g., a capital gain from the sale of shares). Furthermore, where a taxpayer satisfies the requirements for the main residence exemption, the taxpayer cannot choose **not** to apply the exemption. Refer to ATO ID 2003/257 (withdrawn but still applicable).

### The temporary absence rule – extending the main residence exemption

Where a dwelling ceases to be used as a taxpayer's main residence (i.e., the taxpayer moves out), the taxpayer can choose to continue to treat the dwelling as their main residence for all or part of the period that they are not living in the dwelling. This choice is often referred to as the '**temporary absence rule**' or, sometimes, as the 'six-year rule'. Refer to S.118-145.

Specifically, the maximum period over which a taxpayer can continue to treat a dwelling as their main residence under this rule depends on whether or not the dwelling is used for income producing purposes when the taxpayer is not living in it, and is summarised as follows:

- (a) **If the dwelling is not used for income producing purposes when the taxpayer moves out** – the taxpayer can treat the dwelling as their main residence indefinitely.
- (b) **If the dwelling is used for income producing purposes (e.g., it is rented out)** – the dwelling can be treated as the taxpayer's main residence for a **maximum** period of up to **six years** whilst it is used for that purpose during a period of absence.

If the temporary absence rule is chosen, the taxpayer **cannot** generally treat any other dwelling as their main residence during the same period that this rule applies. Refer to S.118-145(4).

Therefore, from a planning perspective, taxpayers should carefully consider whether to make a choice to apply the temporary absence rule to their existing home or whether to treat a new home as their main residence from the time they moved into it.

As a general rule, the main residence exemption should generally be **maximised** for the dwelling that is **likely to generate the greatest taxable capital gain** for the taxpayer when it is sold.

#### **TAX WARNING – Dwelling must first be taxpayer's main residence**

The temporary absence rule in S.118-145 can only apply if a taxpayer's dwelling ceases to be used as their main residence. Implicit in this condition is that a dwelling must first become the taxpayer's main residence. A taxpayer **cannot** cease to use a dwelling as their main residence if the dwelling was never used as their main residence in the first place.

As such, the temporary absence rule cannot apply for the period prior to the dwelling first being used as main residence.

Whether a dwelling has become a taxpayer's main residence is a question of fact which can only be determined by reference to all the circumstances surrounding each case, as previously discussed. Furthermore, a taxpayer's intention to move into a dwelling without actually doing so is **not** sufficient for the dwelling to be considered their main residence.

Where a dwelling that has been used exclusively as the taxpayer's main residence, is used for income producing purposes after the taxpayer moves out, a partial main residence exemption will generally apply upon its subsequent sale, which may be extended, or otherwise converted to a full exemption, under the temporary absence rule. However, the rule can **only** apply for a maximum of six years while the dwelling is used for that purpose during a period of absence.

Where a dwelling is used for income producing purposes (e.g., rented out) for *more than* six years during a period of absence, the main residence exemption by virtue of the temporary absence rule can still apply for the first six years (i.e., a pro-rata exemption applies). In other words, the exemption is **not** lost altogether.

### **Interaction between the temporary absence rule and the market value rule**

Where a taxpayer ceases to occupy a dwelling as their main residence and the dwelling is then used for income producing purposes (e.g., it is rented to tenants) for the *first time after 7.30pm on 20 August 1996*, the market value rule in S.118-192 can apply. If it applies, the taxpayer is taken to have acquired the dwelling for a cost equal to its market value at the time it is first used for income producing purposes ('the first income time'). Refer to the previous discussion.

However, the market value rule in S.118-192 will **not** apply if the taxpayer has chosen to apply the temporary absence rule and this results in a **full** CGT exemption when the dwelling is eventually sold (e.g., where the dwelling is rented to tenants for no more than six years). Refer to ATO ID 2003/1113.

#### **EXAMPLE – Interaction with market value rule**

Rodney bought his home in April 1998 for \$300,000. In April 2008, Rodney moved interstate for work and rented the house to tenants for the next five years. When he returned in April 2013, Rodney lived in the house for one year before selling it in April 2014. The market value of Rodney's home in April 2008 (i.e., the first income time) was \$400,000.

If Rodney chooses to apply the temporary absence rule, the house is taken to be his main residence for the 5-year period it was rented. Therefore, as the dwelling was Rodney's actual main residence at all other times during the period he owned it, a **full** CGT exemption will apply on the sale of the house. As a result, the market value rule will **not** apply.

#### **What if Rodney does *not* choose to apply the temporary absence rule?**

If the temporary absence rule does not apply, the market value rule will apply. As a result:

- (a) Rodney is taken to have acquired his house for its market value of \$400,000 in April 2008 (i.e., the first income time) – this is used as the basis for calculating any capital gain or capital loss on the sale of the house; and
- (b) Rodney's ownership period will now commence in April 2008 (i.e., the first income time) and end in April 2014 – basically, a period of six years.

Therefore, as the house was Rodney's main residence for only part of this six year period (i.e., for one year between April 2013 and April 2014), only a partial main residence exemption will apply. This means that only 1/6<sup>th</sup> of any capital gain will be disregarded.