BRIEFINGS

WATERHOUSE
CHARTERED ACCOUNTANTS

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Happy New Year

We hope you enjoyed a refreshing break over the Christmas/New Year period and that you're looking forward to the year ahead. The team here at Waterhouse Chartered Accountants is looking forward to working with you.

Is "Downsizing" Worth it?

From 1 January 2023 those aged 55 and over can make a "downsizer" contribution to superannuation.

Downsizer contributions are an excellent way to get money into superannuation quickly. And now that the age limit has reduced to 55 from 60, more people have an opportunity to use this strategy if it suits their needs.

What is a "Downsizer" Contribution?

If you are aged 55 years or older, you can contribute $300,000 from the proceeds of the sale of your home to your superannuation fund.

Downsizer contributions are excluded from the existing age test, work test, and the transfer balance threshold (but are limited by your transfer balance cap).

For couples, both members of a couple can take advantage of the concession for the same home. That is, if you and your spouse meet the other criteria, both of you can contribute up to $300,000 ($600,000 per couple). This is the case even if one of you did not have an ownership interest in the property that was sold (assuming they meet the other criteria).
Sale proceeds contributed to superannuation under this measure count towards the age pension assets test. Because a downsizer contribution can only be made once in a lifetime, it is important to ensure that this is the right option for you.

Let's look at the eligibility criteria:

- You are 55 years or older (from 1 January 2023) at the time of making the contribution;
- The home was owned by you or your spouse for 10 years or more prior to the sale – the ownership period is generally calculated from the date of settlement of purchase to the date of settlement of sale;
- The home is in Australia and is not a caravan, houseboat, or other mobile home;
- The proceeds (capital gain or loss) from the sale of the home are either exempt or partially exempt from CGT under the main residence exemption, or would be entitled to such an exemption if the home was a post-CGT asset rather than a pre-CGT asset (acquired before 20 September 1985). Check with us if you are uncertain;
- You provide your superannuation fund with the downsizer contribution into super form (NAT 75073) either before or at the time of making the downsizer contribution;
- The downsizer contribution is made within 90 days of receiving the proceeds of sale, which is usually at the date of settlement; or
- You have not previously made a downsizer contribution to superannuation from the sale of another home or from the part sale of your home.

Do I have to Buy Another Smaller Home?

The name "downsizer" is a bit of a misnomer. To access this measure you do not have to buy another home once you have sold your existing home, and you are not required to buy a smaller home - you could buy a larger and more expensive one.

The ATO's Position on Risky Trust Distributions

The Australian Taxation Office (ATO) has released its final position on how it will apply some integrity rules dealing with trust distributions – changing the goal posts for trusts distributing to adult children, corporate beneficiaries, and entities with losses. As a result, many family groups will pay higher taxes because of the ATO's more aggressive approach.

Section 100A

The tax legislation contains an integrity rule - Section 100A - which is aimed at situations where income of a trust is appointed in favour of a beneficiary, but the economic benefit of the distribution is provided to another individual or entity. For Section 100A to apply, there needs to be a "reimbursement agreement" in place at or before the time the income is appointed to the beneficiary. Distributions to minor beneficiaries and other beneficiaries who are under a legal disability are not impacted by these rules.

If trust distributions are caught by Section 100A, this generally results in the trustee being taxed on the income at penalty rates rather than the beneficiary being taxed at their own marginal tax rates.

While Section 100A has been around since 1979, until recently there has been relatively little guidance on how the ATO approaches Section 100A. This is no longer the case, and the ATO's recent guidance indicates that a number of scenarios involving trust distributions could be at risk.

For Section 100A to apply:

- The present entitlement (a person or an entity is or becomes entitled to income from the trust) must relate to a reimbursement agreement;
- The agreement must provide for a benefit to be provided to a person other than the beneficiary who is presently entitled to the trust income; and
- A purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income.

High Risk Areas

Until recently, many people have relied on the exclusions to Section 100A which prevent the rules applying when the distribution is to a beneficiary who is under a legal disability (e.g. a minor) or where the arrangement is part of an ordinary family or commercial dealing (the "ordinary dealing" exception). It is the ordinary dealing exception that is currently in the spotlight.

For example, let's assume that a university student who is over 18 and has no other sources of income is made presently entitled to $100,000 of trust income. The student agrees to pay the funds (less tax they need to pay to the ATO) to their parents to reimburse them for costs that were incurred when the student was a minor. This situation is likely to be considered high risk if the student is on a lower marginal tax rate than the parents because the parents are receiving the real benefit of the income.

The ATO is also concerned with scenarios involving circular distributions. For example, this could occur when a trust distributes income to a company that is owned by the trust. The company then pays dividends back to the trust, which distributes some or all of the dividends back to the company. And so on. The ATO views these arrangements as high risk from a Section 100A perspective.

Common scenarios identified as high risk by the ATO include:

- The beneficiary is a company or trust with losses and the beneficiary is not part of the same family group as the trust making the distribution;
- A company or trust which is entitled to distributions from the trust returns the funds to the trustee (i.e. circular arrangements);
- The beneficiary is issued units by the trustee of the trust (or a related trust) with the amount owed for the units being set-off against the entitlement and where the market value of the units is less than the subscription price or the trustee is able to do this without the consent of the beneficiary; and

- Adult children are made presently entitled to income, but the funds are paid to a parent in relation to expenses incurred before the beneficiary turned 18.

Where to From Here?

If you have a discretionary trust, it will be important to ensure that all trust distribution arrangements are reviewed in light of the ATO's guidance to determine the level of risk associated with the arrangements. It is also vital to ensure that appropriate documentation is in place to demonstrate how funds relating to trust distributions are being used or applied for the benefit of the beneficiaries.

The ATO's new approach applies to entitlements before and after the publication of the new guidance, but for entitlements arising before 1 July 2022 the ATO will not generally pursue these if they are either low risk under the new guidance or if they comply with the ATO's previous guidance on trust reimbursement agreements.

SMSF Reporting Changes from 1 July 2023

If you have a self-managed superannuation fund (SMSF) with a total balance of less than $1 million, from 1 July 2023 you will need to report quarterly to the ATO instead of annually. Previously, SMSFs with a balance under $1 million reported annually at the same time a lodging their SMSF annual returns.

If you're unsure of the impact of this on you or your SMSF, please contact us.