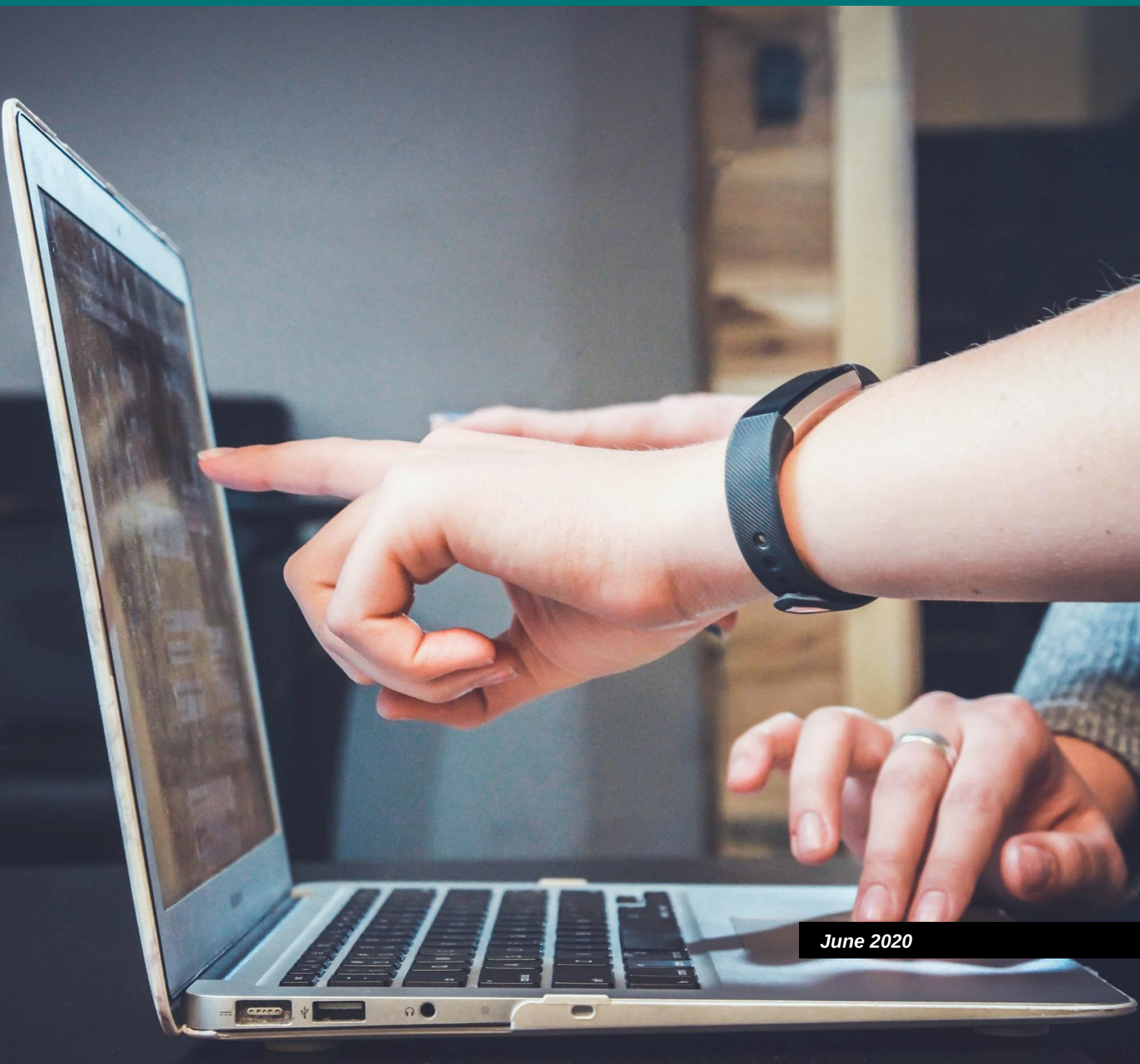
PITCHER PARTNERS

# *COVID-19 impacts on year-end tax planning*

Considerations for 30 June 2020



*June 2020*

## Contents

# Overview

While tax planning is always important for taxpayers each 30 June, COVID-19 has brought about several additional complexities and challenges that need to be considered as part of your year-end tax planning. This guide has been put together to raise specific COVID-19 issues that you should consider in your tax planning for this 30 June 2020.

This guide is broken down into two main sections. In section A, we cover the critical issues of trust distributions, Division 7A and franked distributions. As a minimum, we believe that all taxpayers should at least be considering these issues. In Section B, we cover additional considerations for taxpayers. We note that the application of these additional sections is likely to depend on the taxpayer and their circumstances.

We do not purport that this guide is complete and that it covers all year-end tax planning considerations. The purpose of this guide is to assist you in your considerations, amongst any other items you find relevant to your entity. As tax planning may involve a change to the tax position of an entity, care always needs to be taken to ensure that you have considered all relevant anti-avoidance provisions.

## *Disclaimer*

Please note that this document is prepared for informational and discussion purposes only. The information provided in this document is of a general nature and has been prepared without considering your objectives, circumstances, financial situation, or needs. This guide does not constitute personal or financial advice.

This guide has been prepared by Pitcher Partners Melbourne in the ordinary course of our profession. In providing this guide, we are not purporting to act as solicitors or provide legal advice. Appropriate advice should be sought prior to acting on anything contained in this document or implementing any transaction or arrangement that may be referred to in this document.

*SECTION A*

# *A1: Trust considerations*

### (a). Planning for tax and accounting differences due to COVID-19

Under COVID-19, there may be impacts to both 'income of the trust estate' and 'net income' for tax purposes. As outlined in this guide, this can arise due to issues such as:

whether income that is in dispute has been derived before 30 June.

whether doubtful debts can be written off.

whether you will need to recognise an unrealised loss for trust accounting purposes (e.g. impairments).

These issues may give rise to significant differences between the accounting profit or loss position and the final tax position for 30 June 2020 income year.

Many entities may run the risk of having no income of the trust estate or may grossly under or overestimate their taxable income for the trust. This could result in higher tax risks for 30 June 2020, for example from trustees paying tax at the top marginal tax rate (e.g. where there is no income of the trust estate); that the group pays more tax than it otherwise should (e.g. where tax losses are not identified and are not recouped through trust distributions or where errors in the determination of income of the trust result in more taxable income being attributed to higher tax paying entities).

#### *Consideration*

It is therefore important to properly understand and consider your 30 June 2020 trust law and tax position. This will require careful planning for all entities in the group. Identifying issues may help to manage any difference as well as potentially creating opportunities to minimise those differences for tax purposes.

### (b). Implications of negative assets

Many trusts may end the year with a negative net asset position for accounting purposes but may still have taxable income. The negative assets may arise due to accounting write-offs that are not booked for tax purposes (e.g. investment value impairments, provisions for doubtful debts, trading stock obsolescence).

#### *Consideration*

In such cases, where the trust has taxable income, it will be important to ensure that such amounts can be attributed to beneficiaries and that the trust has 'distributable income' as defined under the trust deed.

### (c). Consider any restrictions placed on unpaid present entitlements

Be mindful of any restrictions that may be imposed on the trustee on paying unpaid present entitlements (UPEs), both new and existing, to beneficiaries. A present entitlement is a present legal right of a beneficiary to demand and receive payment of the income. Adding restrictions to a present entitlement may give rise to issues of the validity of a trust distribution for income tax purposes.

#### *Consideration*

In such cases, consider whether this situation is overcome by refinancing UPEs as loans by performing legal offsets to the beneficiary (e.g. by performing a legal offset to a loan account in the name of the beneficiary that may constitute a payment of the debt[1]). This is because restrictions on a loan (i.e. debt subordination) account should not give rise to this issue[2]. Division 7A should be considered for any changes to UPEs.

### (d). Consider any other trustee issues with making distributions

Where a trust has negative assets and external liabilities, trustees may need to consider issues with the administration of the trust, such as issues of solvency and whether it is in the best interests of the trust to make trust distributions or pay creditors of the trust. Trustees may also need to consider whether income of the trust needs to be first applied to make good losses incurred under COVID-19, or whether it can be distributed to beneficiaries[3]

#### *Consideration*

To the extent that a trustee is concerned with making distributions to beneficiaries for 30 June 2020, we recommend that the trustee seek legal advice. As outlined in the previous point, beneficiaries may need to consider refinancing their UPEs as subordinated debt (via a repayment of the debt).

[1] *East Finchley Pty. Limited v. FC of Taxation* 89 ATC 5280.

[2] While there is a risk that the ATO could impose section 100A, we have requested guidance from the ATO to ensure that this will not be the case.

[3] The rule in *Upton v Browne* (1884) 26 Ch D 588.

*SECTION A*

# *A2: Division 7A*

### (a). Ability to pay dividends when a company has losses

Taxation Ruling TR 2012/5 provides rules on whether a company can pay a dividend. Essentially the ruling requires a company to have profits to pay a dividend (and thus a franked distribution). Many companies may not report profits for the year due to COVID-19 (e.g. impairment of investments, provision for doubtful debts, loss of trading profits, etc). Accordingly, there may be restrictions on paying a franked distribution under TR 2012/5 even though the company has franking credits. This could give rise to a deemed unfranked dividend for the minimum yearly repayment (MYR) amount.

### *Consideration*

Identify any companies in the group that pay dividends to satisfy Division 7A obligations where profits may have been impacted by COVID-19. Consider whether there are any other strategies that may assist. For example, the payment of dividends from other entities in the group to meet the Division 7A loan repayments or whether franked dividends can be paid to the affected company to increase its retained earnings or profits (e.g. via other companies and trusts in the group). Finally, you should consider whether you may need to make an application to the ATO to extend your MYR.

### (b). Distributable surplus

Many companies may have negative net assets due to COVID-19 related matters. However, the fact that a company is in a negative net asset position does not necessarily mean it has no distributable surplus as net assets will be nil rather than negative.

In addition, some items in the balance sheet may not actually reduce the value of net assets in calculating the distributable surplus under section 109Y (such as impairments).

Forgiven debts could still give rise to deemed dividends as these amounts (under section 109F) are added to the distributable surplus calculation that is otherwise calculated. Accordingly, if the entity has negative assets, the starting point for the distributable surplus calculation may be nil, with the forgiven debt amount being added to this nil amount. This is the same for payments that are subject to the deemed dividends under section 109C (including payments under section 109CA).

However, where there are loans or MYRs, a deemed dividend may not occur where the company's distributable surplus is nil. Where this is the case, you may consider whether MYR can be deferred until a later year.

### *Consideration*

The distributable surplus rule may not reduce dividends to nil and may trigger deemed dividends in subsequent years. It is also not equivalent to a net asset position in the balance sheet. We note that where a taxpayer relies on the distributable surplus rule, this will generally be of a higher risk. In such cases, ensure that you are comfortable with your assessment, you have considered the issues raised in this guide and that you have also considered the potential application of the interposed entity rules.

### (c). Extension of minimum loan repayments

The ATO is considering whether it can provide extra time for certain taxpayers to make MYRs where they have been significantly impacted by COVID-19.

### *Consideration*

To the extent that you identify as a taxpayer that may not be in a position to make a MYR for 30 June 2020, consider whether you are able to discuss your situation with the ATO.

### (d). Assigning debts

Groups may need to consider restructuring their debts, which may involve repayments or assignments of debts. However, where the transfer of property is used as a part repayment of a Division 7A loan, this may give rise to issues if the debt does not have full market value.

***Consideration***

It is important to ensure correct valuations have been determined appropriately prior to assigning receivables (or other assets) for the purposes of satisfying Division 7A obligations.

### (e). Deferral of loans

Arrangements to defer repayments of related-party loans involving a private company lender may result in a debt forgiveness for Division 7A purposes if it can be concluded that the company will not insist on payment or rely on the borrower's obligation to pay. This could apply to pre-1997 loans, complying loans as well as non-complying loans that did not give rise to deem dividends in prior years (i.e. because there was no distributable surplus).

***Consideration***

Ensure that any payment deferrals are documented to make clear that the company intends the debt to be repaid at some point in the future.

### (f). Valuations for 25-year loans

The requirement that the market value of the secured property at the time the loan is made be at least 110% of the amount of the loan may mean that lower amounts could be borrowed under a 25-year loan in the current property market.

***Consideration***

Ensure that you properly consider loan valuations where you intend to use a 25-year loan arrangement under Division 7A.

### (g). Variation of Division 7A loan agreements

Consider the potential implication of section 109R in relation to the refinancing of any intra-group debt or any variations required to Division 7A loan agreements (e.g. where they may be required by a financial institution). Consider if a variation amounts to a new loan as this could trigger section 109R issues such that the old Division 7A loan remains unpaid despite there being a new replacement loan.

***Consideration***

Be very careful of variations that occur to Division 7A agreements. For material amounts seek legal advice and ensure that the variations do not amount to a new loan.

### (h). Guarantees offered by companies

COVID-19 may require many companies to guarantee debts or may result in guarantees provided by companies (with profits) being enforced by financial institutions.

***Consideration***

Consider the application of guarantee rules (sections 109U and 109UA) where a private company guarantees loans of associates or provides company property as security for such loans, including loans made by third parties (e.g. banks).

*SECTION A*

# *A3: Managing tax offsets and franking credits*

### (a). Franking credits trapped in a trust

To the extent that a trust receives (either directly or indirectly) franked distributions during the year, it may be able to pass out those franked distributions if it has at least $1 of distributable income (excluding franking credits). It is critical to be mindful of this issue, especially where the relevant trust may otherwise make a loss from an accounting perspective or tax perspective due to COVID-19 related issues.

***Consideration***

Review trusts that you expect to receive franked distributions and ensure that you are comfortable that the trust will be able to pass through the franking credits for 30 June 2020.

### (b). Managing non-refundable tax offsets to reduce wastage

Due to COVID-19, taxable income of many entities may not be sufficient to be able to fully utilise their non-refundable tax offsets. This could result in a wastage of such offsets. An example of this is a foreign income tax offset (FITO).

***Consideration***

Consider whether there are opportunities to reduce wastage of such offsets. For example, with reference to FITOs, consider making trading stock elections to increase assessable income, deferring deductions, bringing forward income or avoid writing off bad debts before year end. Additionally, for companies, consider whether you are able to choose not to deduct prior year losses (within certain limits) in order to preserve for later years rather than lose some or all of the FITO for the current year[4].

### (c). Understand impact of other offsets and credits

Not all offsets and credits will give rise to adverse implications. For example, non-refundable R&D offsets may be carried forward and excess franking credits of a company can be converted into a tax loss.

For base rate entities, use of franking credit offsets in the 30 June 2020 income year may offer a permanent benefit, instead of carrying them forward as a tax loss. This is because the value of a carried forward tax loss may reduce if tax rates fall in future years. That is, an excess franking credit of $27,500 carried forward as a tax loss of $100,000 (27.5% tax rate) would only be worth $26,000 when the corporate tax rate reduces to 26%.

***Consideration***

It is important to consider and review each offset and credit to determine whether there will be wastage and how this could be avoided for 30 June 2020.

[4] Section 36-17

### (d). Implications of varying PAYG instalments

Any reduction in PAYG instalments because of COVID-19 may result in a larger than normal final tax liability (even though the ATO may waive penalties for PAYG variation under the '15% rule'). However, where interim dividends were paid prior to a refund of PAYG instalments being obtained, the franking account may go into deficit on 30 June 2020 and may result in potential franking deficit tax (FDT), which will be payable on 31 July 2020.

This may have significant impacts on company cash flow and may reverse the benefit of the refund of PAYG instalments. In addition, while any FDT paid will become a refundable tax offset available for future use, for companies in a tax loss position, the FDT payment may be made years before income tax would be due.

***Consideration***

The ATO cannot defer or disregard FDT but has a discretion to disregard the 30% offset penalty. If you are expecting an FDT issue, consider whether you can make franked distributions to the company from elsewhere in the group (e.g. via a discretionary trust).

### (e). Properly consider your ATO payment plan arrangements

Many taxpayers have entered payment plans with the ATO that will not result in the tax amounts having been paid. Like the previous point, a franking credit is only provided where income tax or PAYG instalments are paid. Where franked dividends have or will be paid for 30 June 2020, this may result in FDT issues.

***Consideration***

The ATO cannot defer or disregard FDT but has a discretion to disregard the 30% offset penalty. If you are expecting an FDT issue, consider whether you can make franked distributions to the company from elsewhere in the group (e.g. via a discretionary trust).

*SECTION B*

# *B1: Losses*

### (a). Distributions made to loss entities

Entities should review the currency of distribution plans to ensure that distributions are made to the most appropriate entity in the group, taking into account tax losses generated during the year and reduction of management fees in service entities (for example, under arrangements entered into pursuant to *PCG 2020/1*). Prior year standard distribution patterns may not be appropriate as new loss entities may have emerged during the year. However, care should be taken to ensure that income injection rules in Schedule 2F and Division 175 are not breached (which can deny tax losses where income is injected into such entities to use the tax losses).

### (b). Changes to business due to COVID-19

Businesses may have substantially changed their activities due to government restrictions on operations. If you are utilising prior year tax losses, or have tax losses in the current year, consider whether the company has satisfied the continuity of ownership test and the same (similar) business tests.

### (c). Continuity of ownership breaches due to injections of capital

Many companies or unit trusts may seek additional capital to support their business during COVID-19. An issue of shares or units may breach the continuity of ownership provisions. Ensure that you have considered the impact of these transactions on losses in the structure or group.

### (d). Unrealised losses due to falling asset values

Care should be taken to consider the impact of falling asset values due to COVID-19. If a change occurs in the ownership or control of a company that has an unrealised net loss, the company may lose access to the unrealised net loss when the amount is subsequently realised, unless it satisfies the business continuity test (Subdivision 165-CC). Similar restrictions apply under Subdivision 165-CD for unrealised debt / equity losses.

# B2: Financing

### (a). Ensure there is no "in-substance" debt forgiveness

Care should be taken to ensure that there is no 'in-substance' debt forgiveness caused by entering arrangements that may result in debts not being called upon. While letters of comfort may not trigger in substance debt forgiveness[5], other forms of arrangements that modify intra-group loans would need to be properly considered.

### (b). Consider deferring bad debt deductions

Deferring bad debt write-offs may be preferable to push tax losses into a later income year. However, if a bad debt deduction is being sought for the current year, ensure that debts are written off as bad prior to year-end (e.g. not waiting until preparation of accounts) and that the amount being written off is clear. If the debt is not written off until the subsequent year it may have ceased to exist prior to being written off (e.g. settled with the debtor) such that the deduction nevertheless arises in the year in which it ceases to exist (under normal deduction rules).

Don't forget to consider the continuity of ownership rules in Subdivision 165-C for companies and Schedule 2F for trusts writing off bad debts. Further Division 243 needs to be considered if the debt was a limited recourse debt and used to fund capital allowance deductions (as a subsequent forgiveness can adjust capital allowance claims that have been made).

### (c). Consider implications for interest deductibility if restructuring

Many groups may consider restructuring their assets at a time of suppressed values. However, many of those assets are funded by interest-bearing debt. If assets are transferred intra-group or at their lower values (e.g. asset replaced by intra-group debt) then interest on the original debt may no longer be deductible if the nexus is broken with the original income-earning activities or if there is an inability to repay the debt.

### (d). Consider implications for changing the terms of the debt arrangement

When the parties to an existing contract enter into a further contract by which they vary some of the terms of the original contract, the effect of the second contract may be to bring an end to the first contract and replace it with the second.. This could trigger certain forex, CGT or debt forgiveness provisions. One of the determining factors is the intention of the parties as disclosed by the later agreement. Accordingly, ensure that you properly consider this issue on any modifications made to debt arrangements.

### (e). Debts and guarantees that are personal use assets

A capital loss will be denied for losses arising from debts or guarantees that are personal use assets. Broad definitions apply to debts for these purposes, to include any debt that does not arise in the course of gaining or producing assessable income or from carrying on a business.

### (f). Consider whether there is a material change for debt / equity purposes

For the purposes of determining whether a financing arrangement is a debt interest, any material change to the terms of the arrangement could result in a reconsideration of the debt and equity tests such that debt interests may convert to equity interests, in particular where the term of a loan is greater than 10 years or extends to more than 10 years and the loan is changed to interest only.

In particular, consider the implications for intra-group debt where financial institutions may require debt to be subordinated and placed on terms where the loans are not to be repaid and/or interest is not to be charged on the loan.

[5] *Tasman Group Services Pty Ltd v FC of T [2009]* FCAFC 148.

### (g). Revisit interest rates to reduce assessable income

Where loans are provided to group entities by trusts or individuals (where such loans are not themselves funded by interest bearing debt), consider switching off or reducing interest if the income would be assessable but would only increase tax losses of the borrower entity.

If loans are themselves funded by interest-bearing debt, ensure that any reduction in interest is such that the entity lending to the group is still able to make a margin on its borrowing to finance such a loan in order to preserve interest deductibility at that level or so that it doesn't jeopardise its ability to argue that it is in the business of money lending.

### (h). Consider whether non-collectible interest can be reduced for money lenders

For money lenders who accrue interest on a daily basis for tax purposes, consider whether the lender can revise its recognition of interest on impaired loans based on a bona fide assessment that there is little or no likelihood that the accrued interest would be received (e.g. in cases of default)[6]. This may have the effect of bringing forward tax recognition of the loss as compared to a later year write-off.

[6] See ATO ID 2013/44.

SECTION B

# B3: Capital maintenance

### (a). Paying dividends when entity has incurred losses

If you are paying dividends for the 30 June 2020 income year (or have already paid dividends), consider whether there are sufficient profits from which to pay dividends (under section 254T). The ATO's ruling TR 2012/5 provides strict rules to comply with in such situations.

### (b). Capital returns

Where a company does not have profits to pay to its shareholders, it may consider returning capital. However, there are several issues to consider as a buy-back may trigger gains for tax purposes. If there is a share buy-back, consider the market value of any shares bought back. There may be opportunities to conduct such transactions in the current economic climate where values may be suppressed.

### (c). Converting debt to equity

Entities with losses for accounting purposes may consider converting their debt to equity. This may be done for commercial reasons (e.g. to improve the balance sheet reported to banks etc). However, this can give rise to several tax issues.

Any debt-to-equity conversions must be done at market value to ensure that the company's share capital account does not become tainted (where the amount of debt exceeds the market value of the shares) or a commercial debt forgiveness does not arise (where the market value of the shares exceeds the amount of debt).

If capital is required via the debt / equity swap and franked dividends are also being paid for the income year, consider whether such dividends may be taken to be sourced from the capital of the entity. Where this is the case, the purported payments may not meet the definition of a dividend (TR 2012/5) or may be taken to be sourced from share capital and therefore become unfrankable.

### (d). Using share capital to replenish losses

Like the previous point, such entities with losses for accounting purposes may also consider applying their share capital to reduce the retained losses in the entity. This is facilitated by section 258F of the Corporations Act. However, the ATO takes the view that unless the capital is applied to losses that are permanent (i.e. lost assets), this can give rise to future dividends that are unfrankable. If considering this strategy, review the losses to ensure that the losses are permanent[7] and to reduce this risk.

### (e). Injecting capital into loss entities

Companies with losses may be required to issue new capital to help support the business. However, review the implications of any capital injections and non-arm's length transactions. Such transactions can give rise to issues in relation to the continuity of ownership test, implications for the available fraction of any prior year transferred tax losses in a tax consolidated group and may also give rise to a deemed dividend where any return of capital is preceded by capital injections (including conversions from debt-to-equity)[8].

### (f). Capitalising revenue debts to loans

Taxpayers may enter into certain arrangements where debts that are on revenue account (e.g. trade debts, interest receivable, etc) are converted into loans. This can have the effect of converting a revenue debt into a capital debt, whereby bad debt deductions could be disallowed in the future. Care should be taken when restructuring debt to ensure that a deduction is not inadvertently characterised as a capital rather than revenue loss[9].

### (g). Restructuring loans that are traditional securities

Many loans are regarded as traditional securities and thus a loss on such loans may be deductible under section 70B. However, the availability of a loss can be reduced or limited where the disposal is attributable to an apprehension or belief by the holder of the loan that the borrower would unable or unwilling to discharge its liability to make payments under the security. A loss can similarly be denied for financial arrangements under section 230-465.

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[7] See ATO ID 2010/25 and PBR 1012647497563.

[8] See section 6(4) of the ITAA 1936.

[9] See this point discussed in the Federal Court case of *BHP Billiton Finance v FCT* [2009] FCA 276. This issue was not part of the subsequent decisions in the Higher Courts.

SECTION B

# B4: Maintaining deductions

**(a). Deductions for vacant land where business suspended due to COVID-19**

Where the business use of land has been suspended due to COVID-19 (e.g. required to be closed under "stay at home" orders for a nail salon), there may be a technical risk that changes enacted in 2019 deny a deduction for costs of holding that land. These rules do not apply to companies, superannuation entities (other than self-managed superannuation funds) or managed investment trusts.

**(b). Period of inactivity**

Consider whether rent and other costs associated with business premises incurred by a sole trader during a period while activity was relocated to the individual's home due to restrictions continue to be deductible.

SECTION B

# B5: Depreciation

### (a). Consider whether the entity really needs additional deductions

Each taxpayer will have different circumstances for the 30 June 2020 income year. Some will have a tax payable, while others would have been significantly impacted due to COVID-19 such that they have a tax loss. To that extent, depreciation claims may help to reduce taxable income, but are not of a great benefit if the entity is expecting tax losses for the 30 June 2020 income year. Accordingly, taxpayers need to consider their strategies around some of the items in this section that may require physical outlays of cash (that may provide no tax benefit where the entity is otherwise in a tax loss position).

### (b). Bring forward purchase of assets to claim accelerated write-off

The instant asset write-off threshold has been extended to depreciating assets costing less than $150,000, for businesses with an aggregated turnover less than $500m, until 30 June 2020 (if first used or installed for use between 12 March 2020 and 30 June 2020). On 9 June 2020, the Federal Government announced that it would further extend the application of the increased threshold until 31 December 2020 (yet to be legislated).

Further, businesses with an aggregated turnover of less than $500m, can immediately deduct an additional 50% of the cost of assets purchased between 12 March 2020 and 30 June 2021 (regardless of cost).

Consider bringing forward asset purchases to the 30 June 2020 income year, to bring forward deductions. Falling tax rates in future years could result in a permanent advantage from bringing forward deductions.

### (c). Small business pool and review of fixed asset registers

Small business entities should review fixed asset registers to determine if assets can be immediately written off under the simplified depreciation rules. Until 30 June 2020, the entire value of the small business pool can be claimed as a deduction where the balance of the pool (prior to depreciation) is less than $150,000 (the instant asset write-off threshold). Consideration should be given to the potential benefits of opting in to simplified depreciation rules, allowing for instant asset write-off and pooling, particularly while the threshold has been increased.

### (d). Scrapping assets no longer in use

If you are not subject to the simplified depreciation rules, consider whether a balancing adjustment event occurs in relation to your depreciating assets (for example, where you expect never to use it again) that could result in further deductions by scrapping depreciating assets.

### (e). Reconsider effective life of depreciable assets

Where the use of certain depreciating assets has accelerated above normal levels in response to a changing business environment (e.g. where demand for a particular item has resulted in increased production and use of machinery) consider recalculating the effective life of an asset to bring forward deductions. Note this is not available for intangible assets.

SECTION B

# B6: Trading stock

**(a). Review valuation of trading stock to bring forward deductions**

Consider whether the value of the trading stock remains appropriate in the current market. Businesses may elect to value an item of trading stock below the lowest value of cost, market selling value, or replacement value because of obsolescence or any other special circumstances, if it is reasonable to do so. Where stock is no longer useable, it could be written off prior to 30 June 2020 to ensure a deduction will be available.

# B7: International tax issues

### (a). Transfer pricing considerations

It is important to consider the extent to which benefits have not been obtained (or provided) under international related party agreements due to COVID-19 and whether charges continue to reflect arm's length prices. You may need to consider revising the terms of international related party financing arrangements so that interest charges reflect arm's length prices. You may also need to consider whether appropriate arm's length fees are charged for financial support provided to international related parties.

### (b). Thin capitalisation

The thin capitalisation rules may limit the deductibility of interest and other debt deductions due to impaired asset values resulting from COVID-19. Taxpayers in that situation should consider opportunities that could help their thin capitalisation calculations. This could include, amongst other things, using the 'more frequent measurement method' to calculate the safe harbour gearing ratio and may also include considering whether refinancing intragroup debts to become interest-free could improve results.

### (c). Residency status and virtual meetings

The ATO has indicated that it will not apply compliance resources to determine if the central management and control of a foreign incorporated company is in Australia if board meetings are held in Australia or directors attend board meetings from Australia due to travel restrictions.

### (d). Permanent establishment

The ATO has indicated that it will not apply compliance resources to determine if a foreign entity has a permanent establishment in Australia due to the presence in Australia of employees who are temporarily relocated or restricted in their travel as a consequence of COVID-19 if that entity that did not otherwise have a permanent establishment in Australia before the effects of COVID-19.

### (e). Significant global entity (SGE) penalty

Significant penalties apply to SGEs that fail to lodge approved forms on time. The ATO has indicated the failure to lodge on time penalty will be remitted for a period of 30 days from the lodgment date of the approved form if all of the following apply:

**the entity** is an SGE that is required to lodge an approved form (including the general-purpose financial statement (GPFS)) on or before 31 May 2020;

**the failure to lodge** that form (including the GPFS) is due to circumstances beyond the entity's control that arise as a direct result of COVID-19; and

**the failure to lodge on time** SGE penalty is incurred after 23 January 2020 and on or before 31 May 2020.

An SGE that lodges the form more than 30 days late, should contact the ATO to discuss their specific circumstances.

SECTION B

# B8: Goods and services tax

### (a). Reviewing GST apportionment models

GST apportionment models are required where an entity has mixed supplies (e.g. where some of its supplies are taxable and others are input taxed). The choice of apportionment methodologies can have a direct revenue impact and a business is entitled to determine a methodology that is fair and reasonable in their particular circumstances. Any change in circumstance may mean the current methodology no longer reflects the enterprise's current trading environment. Businesses affected by COVID-19 should consider changes to the mix of supplies and changes in use and values of inputs to determine if the input tax credit recovery percentage is reasonable and/or if an alternative model is more appropriate.

SECTION B

# B9: Other considerations

### (a). Recognition of deferred tax assets in financial statements

Where the business is in a substantial loss position due to COVID-19, consideration should be given to the likelihood that unused losses or other deferred tax asset balances will be utilised in the future. This may require an adjustment of the deferred tax asset amount. This could have a direct impact on the profit and loss statement.

### (b). General anti-avoidance rules

The definition of tax benefit under the tax-avoidance provisions is wide enough to cover a deferral of income tax that could arise out of certain restructuring arrangements. Care should be taken in considering any restructuring or other arrangements put into effect during or post COVID-19 (e.g. a restructure) to ensure that tax-avoidance provisions are not breached. Several anti-avoidance or integrity provisions are outlined for your consideration in the Tax Administration and Integrity section of the YETP.

### (c). Stamp duty considerations

Care should be taken towards the stamp duty implications of any asset changes that may occur under COVID-19 (e.g. real property, shares, contracts, etc).

### (d). Considering demergers

If demergers had previously been considered but abandoned due to the difficulty in obtaining demerger relief and the associated tax cost, the current environment may result in no gains being made from the demerger. Accordingly, it may be an opportunity to consider a restructure under the current economic climate.

### (e). Considering tax consolidation.

Due to suppressed asset values, there may be a good opportunity to consider forming a tax consolidated group. That is, if market values of assets such as goodwill and intellectual property have been significantly reduced, with trading stock and depreciating assets less affected, a formation at this time may result in a better spread of the ACA and avoid step-downs which may have previously arisen. However, care needs to be taken, as suppressed asset values held on revenue account (such as trading stock) can result in revenue losses being converted to capital losses[10].

[10] Refer to CGT events L4 and L8.

SECTION B

# B10: Stimulus items

### (a). Income tax treatment of cash flow boost

Cash flow boost payments are treated as non-assessable non-exempt (NANE) income to the recipient. For a company, distribution of these amounts to shareholders could give rise to unfranked dividends taxable in the hands of the shareholders at their marginal tax rates (dealt with through payroll as an assessable wage or bonus). Franking these distributions may reduce the pool of available franking credits. If the company has surplus franking credits from prior years (i.e. where the rate of imputation has reduced) this could be an opportunity to use these excess credits that may otherwise be trapped.

For a trust, receipt of the cash flow boost could result in a greater accounting profit than taxable income. In the case of a unit trust, there is an exception to CGT event E4 for the non-assessable part that relates to NANE if paid to unit holders (capital gain or reduced cost base). Consider tracking reserves to preserve this exception for distributions of NANE in future years. Consider the treatment of the cash flow boost in a trust deed with an income equalisation clause as it may result in NANE income being left with the trustee (i.e. as corpus of the trust).

### (b). Deductions relating to cash flow boost

Professional fees relating to the cash flow boost (e.g. advice) may not be deductible as they have a nexus to NANE income and are not considered a cost of managing tax affairs under section 25-5.

Private companies who pass on the cash flow boost to associates as a wage or bonus should also consider whether a deduction for these payments would be limited under section 109 of the ITAA 1936. For partnerships, section 26-35 limits deductions for payments to related entities to an amount the Commissioner considers reasonable.

### (c). Treatment of JobKeeper payments (to the entity)

Receipt of the JobKeeper payment for eligible employees will be assessable income of the recipient as a subsidy (assessed on receipt) unless it is also ordinary income (assessed when derived). While these payments will generally be offset by deductions for the payment to employees (other than in the case of eligible business participants), there may be a timing difference between receipt of the income and deduction of the expense (e.g. June wages to employees reimbursed by JobKeeper payments in July). The point of derivation may occur in the month following the JobKeeper fortnight rather than at the end of the relevant fortnight due to various requirements needing to be performed after month end to satisfy the conditions of entitlement. Cash basis taxpayers may derive the amount on receipt. ATO clarity around this issue is being sought.

Normal rules for deductibility will apply to the payment of wages to employees covered by JobKeeper payments. Where the payment is made to an associated person, you should also consider whether a deduction would be limited under section 109 of the ITAA 1936 for the company. For partnerships, section 26-35 limits deductions for payments to related entities to an amount the Commissioner considers reasonable.

Where a business has received JobKeeper payments for an eligible business participant, distribution of that payment to the relevant individual is not required. Instead, the entity may choose to retain the funds, or use for any purpose. Please note that the payment of this amount by a company could give rise to a deemed dividend.

Accordingly, please ensure you appropriately consider the tax consequences where the amount is on paid to business participants.

SECTION B

# B11: Struggling businesses

**(a). Corporations Act and shadow and de facto directors.**

Individuals should take care when managing the affairs of a company to avoid becoming personally liable for company tax liabilities under the Director Penalty Notice (DPN) regime. That regime imposes an obligation on directors to ensure that the company complies with its obligations. This regime applies to persons who are 'directors' as defined in the *Corporations Act* (i.e. it extends to de facto directors and shadow directors).

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