Tax planning for 30 June 2020

Year end tax planning ideas with a focus on COVID-19 considerations

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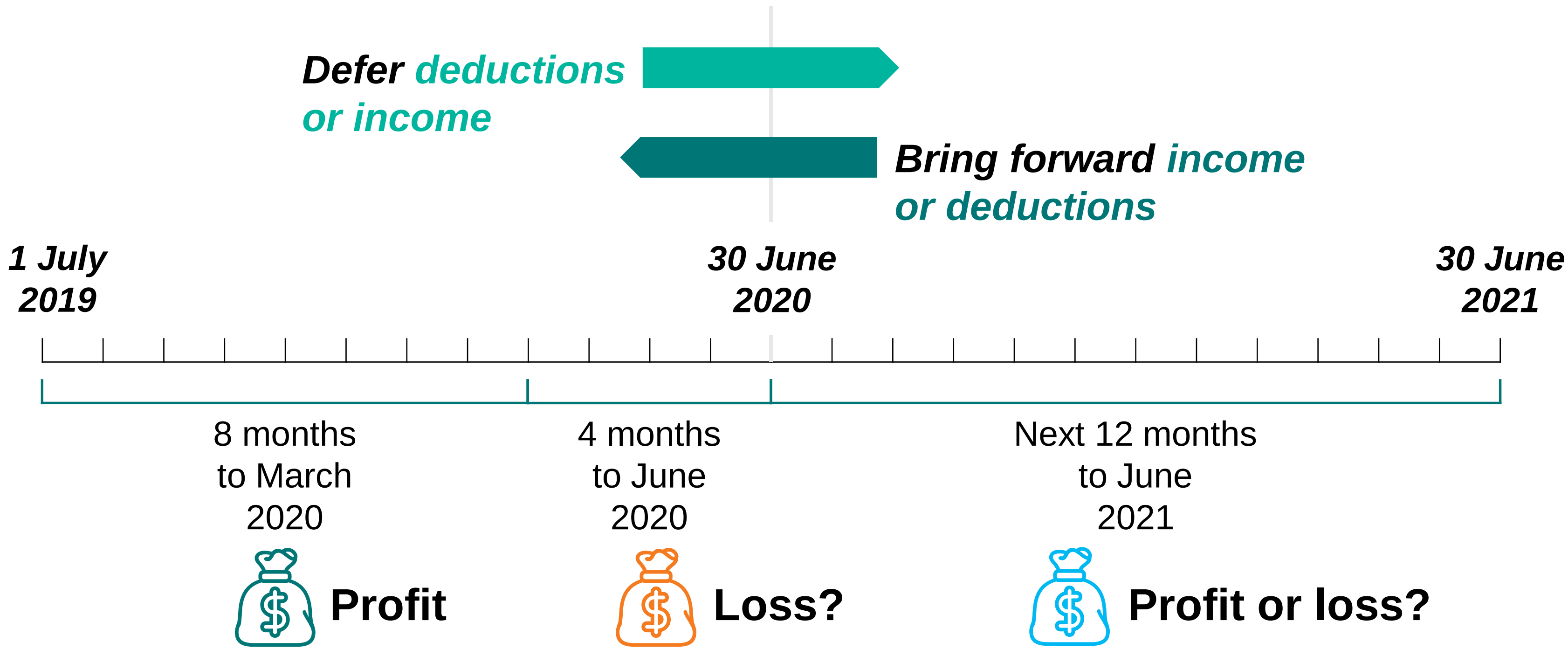
Tax planning around COVID-19 for 30 June 2020

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 does not replace your normal year end tax planning, but are specific items that we believe should be considered

Consider your circumstances for 30 June 2020



Should you lodge your returns early?

Overview

Number of key items for consideration

Stimulus measures

Impact on trust distributions

Division 7A considerations

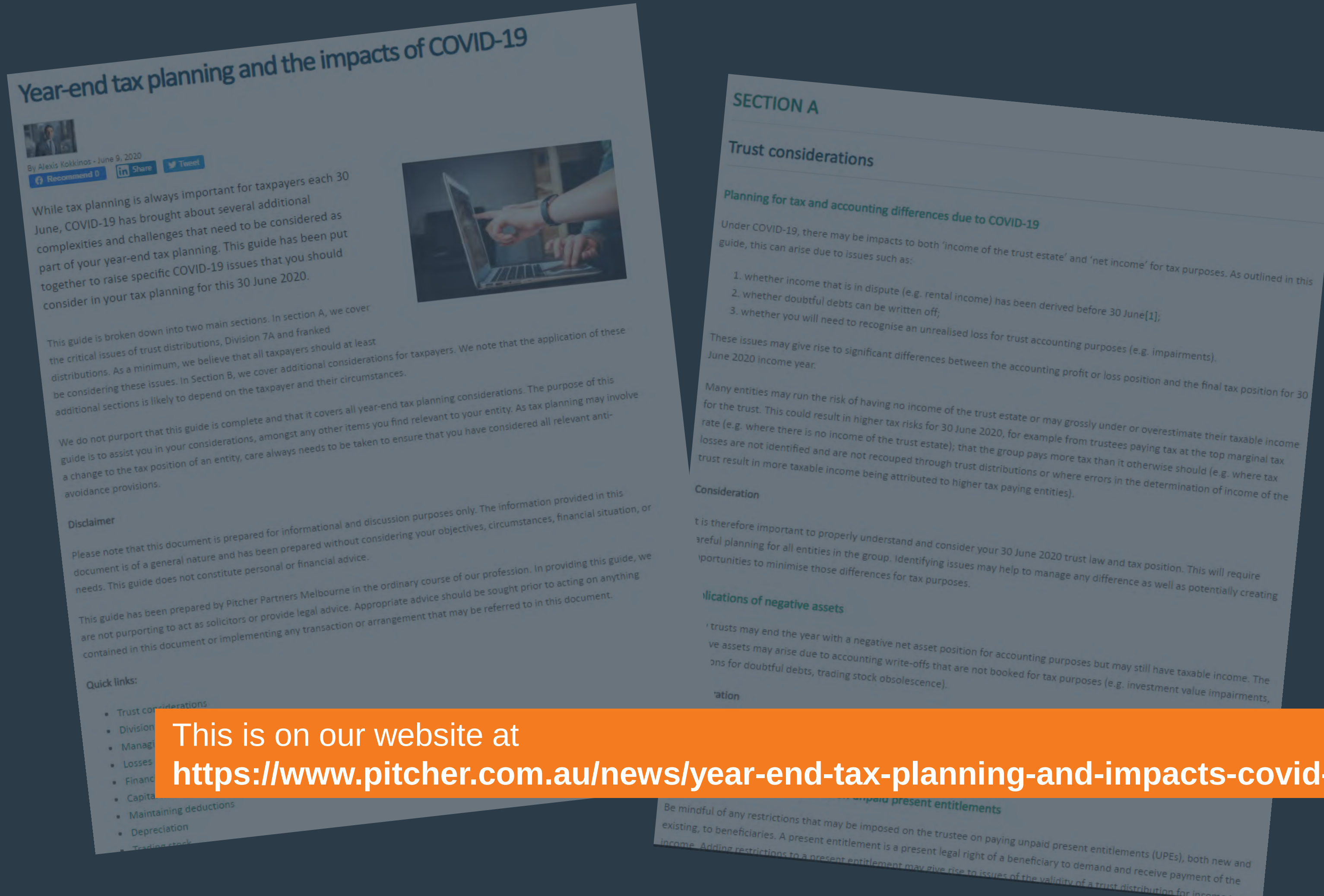
Impact on tax offsets

Loan rationalisation and refinancing

Capital maintenance

Other issues

Information on the above items plus more are contained in the PP guide



Year-end tax planning and the impacts of COVID-19

By Alexis Kokkinos - June 9, 2020

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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.

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Quick links:

- Trust considerations
- Division
- Manag
- Losses
- Financ
- Capita
- Maintaining deductions
- Depreciation

SECTION A

Trust considerations

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:

1. whether income that is in dispute (e.g. rental income) has been derived before 30 June[1];
2. whether doubtful debts can be written off;
3. 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

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

lications of negative assets

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

ation

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

This is on our website at
https://www.pitcher.com.au/news/year-end-tax-planning-and-impacts-covid-19

Stimulus measures

Stimulus measures

Tax planning around COVID-19

Jobkeeper payments

Timing for accounting purposes

Timing of assessability to employer

Cash flow boost

First and second boost

Treatment of income receipts

Deductibility of costs (e.g. advice)

Payments to owners of companies and trusts

Depreciation claims

Instant asset write-off and accelerated investment allowance

Review capital expenditure plans

Review depreciation schedules for assets that can be written off

Trust considerations

Trust distributions

Key issues for consideration

Accounting and tax differences	There may be large accounting and tax differences due to the nature of certain expenses (e.g. rent relief, disputed income, provision for doubtful debts, asset impairments) ***How does this impact on income of the trust and resolutions for 30 June 2020?***
Negative assets	Trusts may fall into a deficiency of asset position but may have a taxable position for 30 June 2020 ***What is the impact of making a distribution?***
Dealing with UPEs	Banks may place restrictions on repaying UPEs ***Does that impact on whether there is a present entitlement?*** ***Is a refinancing of a UPE subject to s100A?***

Trust distributions

Considering differences between accounting and tax

ITEMS	ACCOUNTING	TAX
Sales income	$100,000	$100,000
Provision for doubtful debts	($20,000)	-
Impairment of investment assets	($75,000)	-
Expected reductions due to rent relief	($10,000)	-
Professional fees for cash flow boost	($2,000)	-
Other expenses	($25,000)	($25,000)
Net amount	**($32,000)**	**$75,000**

- What is the income of the trust estate (trust law definition v s.95 definition)?
- Is it impacted by the ATO view on calculating trust income (i.e. TR 2012/D1)?
- What is the distributable income at 30 June 2020?
- Will distributing this amount result in a deficiency of net assets?
- Can this issue be managed or minimised?

Division 7A considerations

Division 7A considerations

Understanding distributable surplus

BALANCE SHEET OF ACO AT 30 JUNE 2020	$
Cash	$100,000
Loans to shareholders	$200,000
Investments	$800,000
Provision for impairment of investments	($100,000)
Loans to financial institutions	($700,000)
Net assets	**$300,000**
Share capital	$300,000
Prior year retained earnings	$100,000
Current year losses	($100,000)
Equity	**$300,000**

Aco made payments to shareholders ($50,000), loans to shareholders ($200,000) and forgave a debt ($25,000)

Does Aco have a distributable surplus?

Division 7A considerations

Understanding distributable surplus

Net assets cannot be less than nil

Total assets – legal liabilities – Provisions*

*Only provisions for annual leave, long service leave and depreciation can be taken into account

Net assets		**Paid up capital**		**Deemed dividends from payments**		**Deemed dividends from debt forgiveness**		***Distributable surplus amount***
$400K	-	$300K	+	$50K	+	$25K	=	*$175K*

In addition, ATO can revalue assets upwards if undervalued. ATO can also argue that non-repayment of loans is a debt forgiveness which is added to the distributable surplus noting that the starting point is always nil, even if there are negative net assets

Division 7A

Other issues for consideration

- **Companies paying dividends** and section 254T profit restriction
- **Franking credit position** from PAYG variations and deferral plans
- **Assigning debts or other assets** as repayment of debts (value of assets)
- **ATO ability to extend MYRs**
- **Deferring** the repayment of loans and debt forgiveness risks
- **Valuations for 25 years loans**
- **Variation of Division 7A agreements** and risk of deemed dividend
- **Guarantees** offered by companies for debts of individuals or trusts

Managing tax offsets and credits

PAYG variations

Tax planning around COVID-19

MONTH		AMOUNT PAID $
Sept 2019	Instalment paid	$2.5M
Dec 2019	Instalment paid	$2.5M
March 2020	Varied instalment	($5.0M)
June 2020	Varied instalment	-
Dec 2020	**Final liability**	**$X**

Taxpayers may also consider lodging tax returns early to obtain access to refunds. ATO looking at system improvements to ensure pre-fill is available

Plan for any final payment that may be due on the lodgement of tax

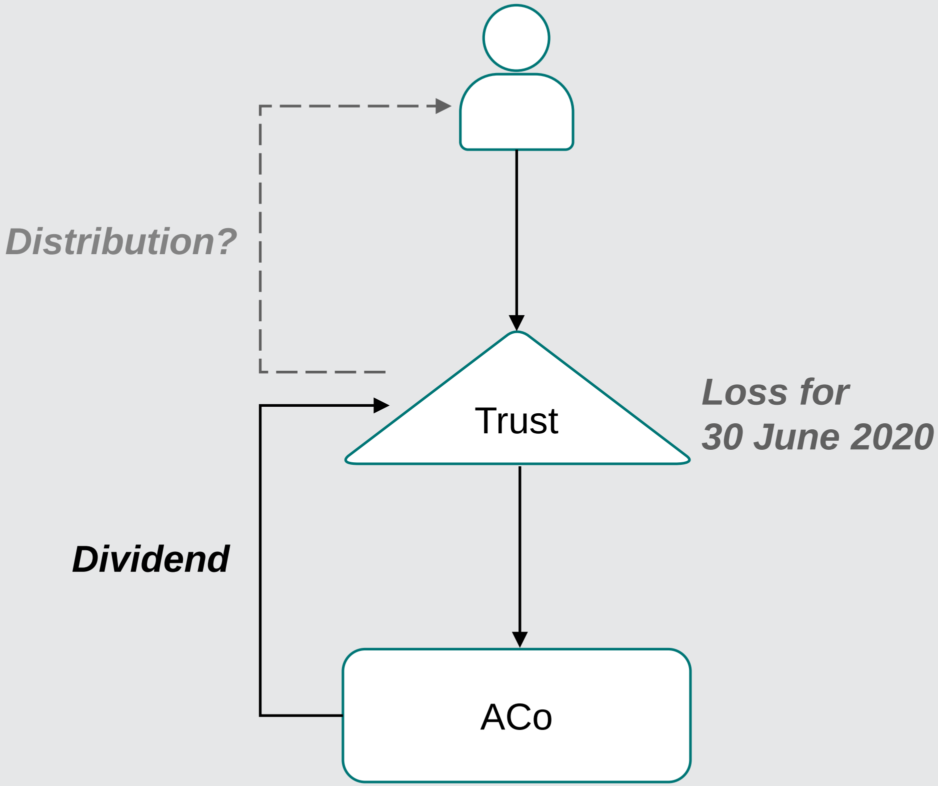
Understand the impact of deferring tax payments on the franking credit balance

Consider whether dividends have already been paid or need to be paid (e.g. for Division 7A purposes)

Trapped franking credits

Tax planning around COVID-19

Losses incurred in a trust may result in dividends being trapped in the trust and a wastage of franking credits



Managing tax offsets and credits

Other items for consideration

Consider
other offsets and credits available for the year

Identify
non-refundable non-carry forward credits (FITOs)

Strategies
to minimise wastage

Financing considerations

As a part of COVID-19, many groups will seek to rationalise, refinance and reorganise loans

Many groups may be required by financial institutions to place ***intra-group loans*** on certain term

Loan rationalisation may give rise to a number of taxation issues and considerations

Financing considerations

Tax planning around COVID-19

1	▶	**Deferring loan arrangements** – ‘in substance’ forgiveness?
2	▶	**Restructuring finance** – implications for interest deductibility
3	▶	**Varying terms** – new loan? – tax implications
4	▶	**Claiming bad debt deductions** and timing
5	▶	**Changing loan arrangements** – debt / equity rules – material changes
6	▶	**Revisit interest rates** charged to loss entities
7	▶	**Interest on an accruals basis** – ability to stop interest for tax purposes
8	▶	**Call on guarantees** and personal use asset exclusion

Capital management considerations

As an alternative to debt finance, many groups may be required to look to equity capital as a part of managing their way through COVID-19

This could include, for example, converting debt to equity or replacing losses with equity

These ***commercial transactions*** can have significant tax implications if not managed correctly

Capital management

Tax planning around COVID-19

1	▶	**Section 254T,** Corporations Act and Taxation Ruling TR 2012/5
2	▶	**Section 258F,** Corporations Act cancelling lost capital
3	▶	**Debt for equity swap** – debt forgiveness issues and capital tainting
4	▶	Paying returns of capital in lieu of dividends – **45B considerations**
5	▶	Fresh **issue of capital** – consider impact on losses
6	▶	**Restructuring funding arrangements** – may not result in a revenue loss

Consider the taxation issues where strategies are put in place
to help improve the balance sheet of an entity

Other issues to consider

Other issues to consider

Tax planning around COVID-19

1	**Trading stock elections** and ability to use lower values
2	**Tax losses** (carry forward issues, business continuity and injection rules)
3	**International tax issues** (transfer pricing, thin cap, residency status)
4	**Goods and services tax** and apportionment models
5	**Stamp duty** considerations on restructuring
6	**Impact on deferred tax balances** for tax losses and other DTAs
7	**Opportunities** to restructure, consolidate, demerge
8	Consider **anti-avoidance provisions**

Q&A

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