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In this edition of bush lawyer we look at three recent developments that could impact on many farming businesses.

The first is unlikely to have an adverse impact and the second is likely to have a beneficial impact. However, the third is likely to signal the end of a long standing tax minimisation strategy for family trusts.

Taxing free use of company assets

The Tax Laws Amendment (2010 Measures No 2) Bill 2010 ("Bill") was introduced into Parliament on 17 March 2010.

The Bill implements the treasurer's announcement in the 2009 budget that the government wants to clamp down on the free use of company assets by shareholders and their associates.

The basic aim of the changes is to stop people avoiding tax by purchasing private use assets in companies and allowing them to be used free of charge by shareholders.

There has been a trend in recent years for people to purchase private use assets such as cars, boats and holiday houses within companies and for shareholders to use those assets free of charge in order to avoid paying tax on dividends. To someone in the highest marginal tax bracket of 46.5% buying the assets within the company rather than paying dividends and buying the assets personally results in a tax saving of 16.5%.

However, as originally announced by the treasurer and set out in the Exposure Draft Legislation released in January 2010 the proposed changes would have not only caught the free use of company owned leisure assets they would also have caught the free use of company owned business assets.

We have a large number of clients who, mainly for historical reasons, own significant proportions of their farming land, and their main residence, in a family company. These clients would have been affected by the proposed rules.

However, due to lobbying by JMA Legal and many others the Bill now includes a number of exceptions which provide direct benefits to small businesses and farmers.

The main exceptions relevant to farmers are:

1. the otherwise deductable exception; and
2. the dwelling exception.

The otherwise deductible exception works on the basis that if the entity using the company's assets free of charge is using those assets in its business and would be able to claim a 100% tax deduction on any rent or licence fee paid to the company for its use of the assets then the new provisions will not apply.

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This exemption will apply to all company owned rural land and any other company owned assets used in a farming business. However, it will not apply to the use of assets for non-business purposes such as a house used for residential purposes.

The dwelling exemption applies to the use of a house on company owned land for residential purposes in circumstances where the use of the house is connected with the use of the land for business purposes.

Unfortunately the new rules will impact on clients with company owned dwellings where the house yard exceeds 2 hectares as the term dwelling only includes a house and garden with an area of up to 2 hectares.

If your house yard is greater than 2 hectares the rules will apply to the excess over 2 hectare. In these cases the user of the residence will need to pay the company a market value fee for its use of the excess otherwise the value of the right to use the excess will be a taxable dividend in the user's hands.

As the rules are based on the principle of self-assessment it will be up to the company and that the user of the land to ensure the benefit of the excess over 2 hectares is dealt with correctly.

A beneficial interpretation gives a WorkCover reprieve

Up until recently farmers were placed in a very difficult predicament if there was a workplace accident on their property. Basically, if there was an accident WorkCover deemed the workplace to be unsafe and the courts applied the provisions of the legislation accordingly resulting in fines being payable. WorkCover and the courts application of the law in this manner had gone largely unchallenged.

However, a recent decision of the High Court (*Kirk v Industrial Relations Commission; Kirk Group Holdings Pty Ltd v WorkCover Authority of NSW (Inspector Childs) [2010] HCA 1 (3 February 2010)*) ("Kirk's Case") has the potential to provide significant benefits to farmers in the area of workplace safety, particularly when there is a workplace accident on their farm.

The case involved the death of a farm manager who rode a four wheel bike loaded with fencing materials off a formed road and down a steep incline. The four wheel bike overturned killing the farm manager.

WorkCover took action against both the company owning the land and, as allowed by the Act, its director under the *Occupational Health and Safety Act 1983* ("Act") and its action was successful on all counts. The company and the director appealed against the findings all the way to the High Court of Australia and in the end their appeals were both successful.

The case revolved largely around sections 15 and 16 of the Act. Both sections are drafted in general terms. Section 15 required an employer to ensure the health, safety and welfare at work of all the employer's employees by:

- providing safe and maintained plant and equipment and work systems;
- providing appropriate training and instruction and supervision; and
- providing a safe working environment.

Section 16 required an employer to ensure that its employees were not exposed to risks to their health or safety while carrying out their activities at the employer's place of work.

WorkCover, in submitting its charges, essentially quoted the provisions of sections 15 and 16 and substituted some of the words in the Act with names and circumstances relevant to its case.

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The High Court held that the WorkCover charges were insufficient. The Court held that WorkCover had to do more than simply summarise the provisions and, instead, had to articulate its charges and set out why the employer had failed to comply with the requirements of the Act and what the employer could or should have done to avoid the accident occurring. In particular the High Court stated:

"The statements of the offences as particularised do not identify what measures the Kirk company could have taken but did not take. They do not identify an act or omission which constitutes a contravention of ss 15(1) or 16(1).

The Court held that as WorkCover had not set out its charges correctly the Industrial Court could not, as if did, rule in favour of WorkCover against the company and Mr Kirk. It also held that as WorkCover did not set out what, in its opinion, the company and Mr Kirk should have done that they were at a disadvantage in defending themselves against the charges.

The High Court was also critical of the trial judge's interpretation of the Act which for compliance would require an employer to supervise employees on a daily ongoing basis. On that point Justice Heydon stated:

"A great many farms in Australia are owned by natural persons who do not reside on or near them, and a great many other farms are owned by corporations the chief executive officers of which do not reside on or near them. The suggestion reflects a view of the legislation which, if it were correct, would justify many of the criticisms to which counsel for the appellants subjected it as being offensive to a fundamental aspect of the rule of law on the ground that it imposed obligations which were impossible to comply with and burdens which were impossible to bear."

And further:

"the proceedings should never have been instituted…… It is absurd to have prosecuted the owner of the farm and its principal on the ground that the principal had failed properly to ensure the health, safety and welfare of his manager, who was a man of optimum skill and experience - skill and experience much greater than his own - and a man whose conduct in driving straight down the side of the hill instead of on a formed and safe road was inexplicably reckless."

The Occupational Health and Safety Act 1983 has been repealed and replaced with the Occupational Health and Safety Act 2000, however, the new act contains provisions similar to section 15 and 16 and the principles laid down in Kirk Case apply to the new legislation.

A word of warning

While, in the particular circumstances of their case, the company and Mr Kirk were successful the case should certainly not be interpreted as in any way lessening the obligation an employer has with regard to the safety their employees.

We would expect that WorkCover's charges will be much more comprehensive in future regarding what can and should have been done by an employer to avoid injury to an employee.

While this will provide the benefit of enabling an employer to better defend charges against them it will also highlight any areas not covered by the employer's workplace safety regime which WorkCover believes should have been covered.

Unfortunately what WorkCover believes is required in order to comply with the legislation will not be known until further charges are laid.

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Tax minimisation minimised

It is common for family trusts to have company beneficiaries. As income derived by companies is only taxed at 30%, profit distributions are often made to the company beneficiaries as a means of minimising the tax payable on the net income drive by the trust.

Usually these distributions of profit are credited to the company in the trust's books, however, they are not paid. The distribution, usually less the tax payable by the company, is kept in the trust and as a result an unpaid present entitlement arises in favour of the company. The unpaid present entitlement is payable upon a demand for payment by the company.

Up until the recent release of Draft Taxation Ruling TR 2009/D8 the ATO's view of these tax planning practices, and in particular whether or not Division 7A of Part III of the 1936 Tax Act applied to them was somewhat unknown.

However, the ATO's position is now clear and it generally spells the end of using, so called, "dump companies" as a tax planning strategy.

The draft ruling makes it clear that in most closely held family situations the ATO will, in future, view unpaid present entitlement's has being loans from the family trust to the company and that Division 7A will apply to the loans to make them a deemed taxable dividend to the family trust.

The harsh consequences of Division 7A can be avoided if either:

1. the unpaid present entitlement is converted into a loan that complies with the requirements of Division 7A (maximum 7 year term unless secured, annual interest at the benchmark rate and minimum annual repayments); or
2. assuming the trust deed allows it, the trust invests the amount of the unpaid present entitlement specifically for the benefit of the company and not for the benefit of the trust itself or the beneficiaries generally.

Neither of the above solutions is likely to be acceptable in most closely held family trust situations where the intention is to keep the money in the trust for use in the business.

Thankfully the ATO is not, in most instances at least, going to apply its view retrospectively. So, unpaid present entitlements owing to companies that were created before the release of Draft Taxation Ruling TR 2009/D8 will not be adversely affected and will have the protection of the ATO's prior comments on the subject.

However, that protection will only be available in situations where the trust balance shows the unpaid present entitlements in the "beneficiary accounts" part of the balance sheet.

The protection will not, we believe, be available to trusts where the balance sheet shows the amount of the unpaid present entitlement in the liabilities section of the balance sheet as an amount owing to the company beneficiary.

To avoid any confusion over past and, if they are created, future unpaid present entitlements we recommend the existing unpaid entitlements be quarantined in the beneficiaries account area of the balance sheet and dated to avoid any confusion in future.

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