

— Opinion

# ‘Feels like the commissioner is sitting at the kitchen table’

What was once a relatively simple formula has become a maze of complex decisions with potentially severe tax consequences.

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The Australian Tax Office is poring over succession strategies, including estate planning for the ultra-wealthy, but its deputy commissioner for private wealth, Louise Clarke, has made it clear that the spotlight is on all taxpayers.

The largest intergenerational wealth transfer in history highlights the fact that what was once a relatively simple formula for passing on wealth to the next generation has become a maze of complex decisions, resulting in the establishment of even more complex family arrangements and structures.



ATO commissioner Rob Heferen. Alex Ellinghausen

And, while these structures work well to preserve assets for the next generation, when it comes to transitioning wealth and control, they can lead to a hefty serving of tax if not dealt with appropriately.

There are important [tax risks associated with succession planning](#), and the standout is not to rely on all-too-common myths and assumptions about what’s taxable.

## Giving while living

It is becoming increasingly popular – and necessary – for parents with the financial means to provide a loan or gift to their child to support their first home aspirations or some other purpose. Instead of following the traditional hands-off approach of memorialising accumulated wealth in wills and trusts, parents are choosing “giving while living”, otherwise (somewhat morbidly) known as “giving with a warm hand”.

## **If you think a gift or loan is tax-free, think again**

For example, let's say you are a foreign resident, but your daughter is an Australian tax resident. To fund a gift, you need to first obtain funds from a related offshore company or trust. Depending on the circumstances, the use of those company or trust funds to then make a gift may cause the amount to be taxable in your daughter's hands because of certain integrity provisions within our tax acts (and the same may hold true if the gift was a loan).

It makes no difference that the recipient has no knowledge of where the money has come from, which can often be the case in families who consider it culturally inappropriate to discuss the source of any gift or loan.

The ATO well and truly cruelled this assumption last year when it took Australian resident Rene Cheung to court for failing to declare taxable income derived from millions of dollars gifted from his Vanuatu-based sister.

In this case, the Federal Court found in Cheung's favour, accepting that the transfer of money was in line with the taxpayer's "cultural or family norm". But the tax commissioner has since launched an appeal to the Full Federal Court.

Undocumented gifts or loans can be especially problematic. If the ATO is not satisfied that what has been received is a true gift or loan, it is the taxpayer who bears the onus of proving everything. In the absence of appropriate documentary evidence, contemporaneous or otherwise, this can be challenging, with the ATO's default position often being that such receipts are income and should be taxed.

Again, the ATO fired a well-targeted warning shot to taxpayers last year when it successfully challenged whether bank deposits made by the Chinese parents of Australian-based husband and wife restaurateurs Zhi Dong Liang and Lai Chu Yeung were gifts or income.

The taxpayers ran restaurant businesses (in trading trusts) and conducted a property investment business (property trust). The property trust received seven large unexplained deposits (\$735,825), which the taxpayers used to purchase property. The ATO amended the property trust's assessments to include the deposits as assessable income.

# Inheritance or estate taxes

So, you think there is no tax on death in Australia because we don't tax estates or inheritances?

Well, in some circumstances, you might be surprised to know that an immediate income tax liability can arise upon death. Some examples include:

- ♦ Asset transfers on death to a charity, a superannuation fund or a foreign resident.
- ♦ When a discretionary trust deed provides that the trust is to vest on a specific date or on the death of the specified individual (often the parents).
- ♦ When benefits in an Australian complying superannuation fund are [paid to non-dependents on death](#).
- ♦ When distributions of accumulated profits in foreign trusts or companies are made to an Australian resident beneficiary on the death of the foreign controller.

## Pre-CGT assets

One of the last vestiges of our old-world tax system is the concept of a pre-CGT asset. If you have one, it's like gold because any capital growth is tax-free.

However, there are integrity provisions that ensure effective control of pre-CGT assets can't change without the pre-CGT status of the asset also changing.

For example, let's assume dad established a company in 1970 to acquire land. The shares in that company and the land are pre-CGT, so, assuming the status quo has remained since 1970, the sale of those shares or the underlying land should be tax-free.

But let's say, as part of dad's succession plan, 51 per cent of the shares were transferred to his two children 20 years ago. Dad may be surprised to know that his succession plan has caused the land to no longer retain its tax-free status and the shares his children acquired have also become taxable assets.

## Out of sight, out of reach

Offshore arrangements, particularly in tax havens or jurisdictions with banking and financial secrecy, have become a sharp focus area for the ATO in its broader compliance strategy. In the context of succession planning, the ATO is zeroing in on:

- ◆ Offshore bank accounts, including debit and credit cards.
- ◆ Unreported foreign income and assets.
- ◆ Transactions with offshore structures.

Something as simple as tax residency can have significant implications. For example, an individual who has never lived in Australia but appoints one of their Australian-resident children as an executor of their estate, will cause the entire estate to be brought within the Australian tax net.

With increasingly sophisticated data analytic tools and strengthening administrative powers, it is starting to feel like ATO commissioner Rob Heferen is sitting at the kitchen table while families try to nut out how to pass on hard-earned wealth.

And this article only scratches the surface of issues.