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**Tax News, Views and Clues**

**Tax-effective Investment Scheme**

In a recent Federal Court decision, a taxpayer was disallowed deductions arising from a sandalwood plantation investment scheme on the basis that the general anti-avoidance rules in Part IVA of the *Income Tax Assessment Act 1936* applied.

As part of the scheme, the taxpayer was required to make payments to the promoter totalling \$80,000 for the purchase of seedlings.

The taxpayer claimed deductions for \$80,000, which generated tax refunds that funded two initial cash payments to the promoter of \$14,000 each. The balance of the \$80,000 investment was to be paid on completion of the project.

The Court found that \$3,000 was a reasonable purchase price for the seedlings, not \$80,000.

The Court noted that the promotion of the tax-effectiveness of the project had a significant influence on the taxpayer's decision to participate in the scheme, especially as the tax refunds were to fund the initial payments and the taxpayer would incur no real cash outgoing.

The Court held that Part IVA applied to the seedling purchase and that the dominant intention of the taxpayer was to obtain a tax benefit. Consequently, the deductions were denied.

➤ **CAUTION:** Although the scheme in this case did not come with an ATO product ruling, investment schemes of this type often do. An investor can rely on a product ruling to determine whether or not a tax deduction from an investment is available. However, a product ruling only applies if the promoter implements the arrangement in the manner specified in the product ruling. Investors may seek assurance from the promoter that this has been done.

**Shareholder Loan Reviews**

The Tax Office has announced that it will review loan arrangements between private companies and their shareholders (or associates), checking for compliance with Division 7A of the *Income Tax Assessment Act 1936*.

Loans that do not comply with Division 7A may be deemed to be taxable dividends for shareholders and result in losses of company franking credits.

It is understood that the Tax Office will initially send letters to selected private companies asking them for the following information:

- the names and addresses of all shareholders;
- copies of company loan accounts;

- copies of loan agreements;
- calculations of interest charged on each loan;
- details of repayments made;
- copies of financial statements; and
- other particulars of loan transactions.

We will keep you informed of further developments.

## Partnership Capital Gains

The Tax Office has issued an interpretive decision (ID) confirming that the capital gains tax laws apply when a partner contributes an interest in land to the capital of a partnership.

The ID covers situations in which two individuals acquire one block of land and subsequently contribute the land to a partnership of four individuals (including themselves).

The ID notes that when a partner contributes assets into a partnership, the partner disposes of part of their interest in the property to the new partners. Consequently, the landowners must determine whether a capital gain or loss has arisen on the disposal.

- **CAUTION:** When there is a partial disposal of an interest in an asset, the cost base of the asset must be apportioned.

Contact our office for assistance.

## ATO Compliance Targets

The ATO has released its draft compliance program for 2002/03 indicating various areas of focus across a range of market segments including the following:

- Large business — a review of transitional benefits

arising under consolidation and demerger reforms, treatment of low cost assets, utilisation of offshore banking unit concessions and an ongoing review of transfer pricing between international related parties.

- Small to medium enterprises — PAYG withholding, utilisation of capital gains tax (CGT) concessions, FBT, tax losses and R&D. The ATO will also focus particular attention on the building and construction industry.
- Micro business — ABN integrity including invoicing and registration checks, PAYG withholding and reconciliation of income tax returns to BASs.
- Individuals — income tax deductions including work related and interest and dividend deductions, CGT, prior year losses, rental properties, foreign source income, partnership loss distributions, data matching, share trading and linked bonds.
- International — transfer pricing, foreign losses, compliance with controlled foreign corporation (CFC) rules, thin capitalisation and consolidations.
- GST — input tax credit claims.

In addition to the above, the ATO has identified aggressive tax planning as a high priority area

## Registration for GST

An entity must be registered for GST if it is carrying on an enterprise and its current or projected annual turnover exceeds \$50,000 (or \$100,000

for non-profit entities). An entity that does not meet the turnover threshold may still register if it is carrying on an enterprise or intends to at a future date.

A penalty may be imposed by the ATO where an entity is required to be registered and does not do so, or where an entity remains registered for GST despite not carrying on an enterprise.

- **TIP:** GST registrations are a current area of focus for the Tax Office as part of its compliance program. The Tax Office has issued a number of recent interpretative decisions in the area and care should be taken to ensure that GST registration requirements are properly addressed.

## GST Exemption – Going Concern

The sale of a business may be a supply of a going concern which is GST-free. A going concern is, broadly, an operating enterprise which the vendor carries on until the date of sale when the purchaser is provided with all things necessary for its continued operation.

To obtain the going concern exemption, the buyer must be registered for GST and must provide consideration for the acquisition. In addition, there must be written agreement confirming that the sale is one of a going concern. This is an area of some focus for the Tax Office and it has recently issued a number of interpretative decisions.

- **TIP:** The purpose of the going concern exemption is to provide cashflow relief because the purchaser does not need to pay the GST and subsequently claim an input tax credit.

Parties to the transaction should take care in planning, as the technical application can be

quite complex. If you are planning on buying or selling a business, please contact us for further advice.

### A Further Look at Demergers

Demerger relief rules became legislation on 24 October 2002, with effect from 1 July 2002. The new legislation provides demerger tax relief for all entities other than discretionary trusts and superannuation funds. The rules can apply to a group restructure involving the transfer of at least 80% of the shares in a subsidiary (which is at least 20% owned) to all original shareholders of the head entity.

The legislation provides various CGT rollover relief including relief to shareholders who might otherwise have a capital gain from the disposal of their interest in the head entity to acquire new shares in the demerged entity.

Where ownership interests have pre-CGT status, this will be maintained to ensure that owners are not disadvantaged when there is no change in underlying ownership.

- **TIP:** The demerger rules provide concessions which will be useful in a broad range of restructures, for both large and smaller taxpayers. The concessions apply now.

### Property and GST Compliance Audits

Given the complexity surrounding GST compliance for property related businesses, property owners may increasingly find themselves under Tax Office scrutiny.

Property owners should take care when applying GST rules to their business transactions for the following reasons:

- The application of GST rules to property transactions such as subdivisions and developments are very complex.
- Property transactions are generally significant in value and are rarely identical, calling for the application of complex GST rules in a broad range of circumstances.
- The property sector was greatly affected by the transitional rules for GST. Many long-term arrangements spanned the GST start date and disputes are arising as to when the tax becomes payable and by whom.

Please contact us for further details or planning opportunities.

### 82.5% Tax on Subsequent Dividends

A private company loan to a shareholder can be deemed to be a dividend in certain circumstances.

Where a deemed dividend arises, and the loan is ultimately repaid by the declaration of an actual franked dividend, tax can apply at an overall rate of up to 82.5%. This occurs because tax is paid on the company profit, then on the deemed dividend, and then on the actual franked dividend.

- **TIP:** Take great care when making loans to shareholders. Also, avoid subsequent franked dividends to offset loans without very careful consideration.

### Non-commercial Losses and Activities Carried on in Partnership

The Tax Office has issued a draft ruling dealing with the application of the non-commercial loss rules to businesses conducted through a partnership.

The non-commercial loss rules prevent individuals from offsetting losses from business activities against other assessable income, unless one of four business tests is satisfied. The loss is deferred and may be offset in a later year against profits from the same activity or, in certain circumstances, against other income.

The draft ruling provides that where an individual taxpayer carries on multiple business activities in partnership, they are required to identify their share of the assessable income and allowable deductions from each separate business activity.

Resulting losses on each separate business activity will be subject to the non-commercial loss rules, unless one of the business tests is satisfied for that activity.

- **CAUTION:** Further complexity arises where an individual who conducts multiple partnership business activities also carries on a primary production or professional arts business.

Please contact us for details.

### Share Ownership at Tax Time

The Tax Office has raised concerns about shareholders correctly treating their share transactions in tax returns. In particular, shareholders should be careful to declare dividends and claim imputation credits and recognise capital gains or losses on the sale of shares

- **TIPS:** Taxpayers should keep records for at least five years for deductions claimed (such as FID, fees for investment advice and account keeping fees). Records must also be kept for CGT purposes.

Taxpayers may be entitled to claim the 50% CGT discount for shares held for at least 12 months.

Please contact us for further information.

### Want to Claim a Loss Made by a Trust?

The Tax Office recently released an Interpretative Decision (ID) that denied a beneficiary any entitlement to a loss made by a trust.

The relevant trust made a capital loss some years ago when it ceased trading. The taxpayer sought to offset the capital loss against a capital gain made by the taxpayer personally on the disposal of some property, although the basis of the taxpayer's claim was not clear from the ID.

The Tax Office ruled that the capital loss was not available for use as the law does not allow a capital loss made by a trust to be transferred to a beneficiary of the trust.

- **CAUTION:** Taxpayers must remember that losses made by a trust, whether capital or revenue, cannot be distributed and utilised by trust beneficiaries.

### Review of International Tax

The Treasury has released a consultation paper concerning possible international tax reforms. The review considers a number of key areas including:

- various options for tax relief concerning foreign dividends;
- the application of a range of specialist international tax rules and the appropriateness of further concessions;
- tax treaty policy and processes; and
- taxation of foreign expatriates.

We will keep you informed of further developments

### Strata Titling of Residential Property

The Tax Office has recently changed its view on whether the strata titling of a residential property makes the strata-titled property 'new residential premises'.

The Tax Office previously held that the strata titling of existing residential properties, notably residential apartments, turned them into new residential premises.

This meant that the subsequent sale of a newly strata-titled unit by an entity registered for GST would be a taxable supply and the vendor would pay 1/11th of the sale price in GST — if this could not be passed on to the purchaser.

The Tax Office now acknowledges that the strata titling of residential premises does not in itself create new residential premises.

The effect of this change is that, generally, the sale of a strata-titled residential property by an entity registered for GST will be an input taxed supply and no GST liability will apply.