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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.

### No Depreciation for Rental Property Items

The Administrative Appeals Tribunal (AAT) recently disallowed a taxpayer deductions for depreciation claimed on various items of property connected with the

taxpayer's rental property because the items did not qualify as 'plant'.

In particular, depreciation was denied on electrical cables, gas and telephone lines, kitchen fittings, the bathroom mirror and glass shower screen, built-in wardrobe shelving, the security system, the common swimming pool and spa, and vehicle control equipment.

In reaching its decision, the AAT considered whether the premises would be incomplete and unable to be rented if the relevant item of property was not there.

The AAT held that each item of property, except for the common pool and spa, formed part of the structure or setting of the premises and without it, the property would be incomplete and unable to be rented.

With respect to the common pool and spa, the AAT held that it served a passive role in the process of earning income from the premises and accordingly, was held not to be 'plant'.

- **TIP:** Whether or not an item of property is plant is a question of fact. It is necessary to consider each item on a case-by-case basis as different circumstances can result in different outcomes.

Contact us for further information.

### CGT Discount — 12-month Rule

In a recent AAT case, a taxpayer was disallowed the 50% discount on his capital gain arising from the sale of shares on the basis that the shares sold had not been held for more than 12 months.

The shares in question had been acquired by exercising an option. In its decision, the AAT confirmed that the acquisition of such shares occurs at the time the option is exercised, being the time that the contract to acquire the shares was entered into, and

not at the time the options were acquired.

As the taxpayer had sold the shares within 12 months of exercising the options, no CGT discount was available for the capital gain made on their disposal.

- **TIP:** The 12-month holding rule should always be carefully considered before an asset is sold.

## ABN Information Available Online

The Tax Office has announced that as of 28 January 2003, the Australian Business Register will provide businesses with online access to their ABN details with the ability to make changes and ensure the accuracy of the information. Tax agents will also be able to access their clients' ABN information to make the following changes:

- change 'secure' ABN information such as postal address and public officer and immediately see the change confirmed online; and
- add a PAYG or GST registration to an ABN record online and receive it by mail.

## Derivation of Disputed Income

The Full Federal Court overturned an earlier decision of the Federal Court and held that a gas supplier, involved in a price dispute with its buyers, was entitled to return the disputed amount as income in the year the dispute was settled, rather than in the year in which the gas was sold.

The gas supplier produced and supplied gas to various buyers.

The contract under which the gas was supplied allowed the

supplier to alter the price of gas to take into account any changes in royalties, rates, duties or levies attributable to the production or supply of gas.

Accordingly, following the replacement of the royalties and excise regime with the introduction of resource rent tax, the supplier altered the price of the gas to effectively pass on the impact of the resource rent tax. The buyers refused to pay the so called 'pass-on amounts' and the matter was referred to arbitration. The dispute was eventually settled in favour of the supplier.

The Commissioner sought to assess the taxpayers on the 'pass-on' amounts in the year in which the gas was sold. However, the Court rejected the Commissioner's arguments, stating that the taxpayers derived the income only when the dispute between the buyers and supplier was settled.

## Reliance on GST Rulings

Where the Tax Office issues a GST ruling outlining its view on the application of a particular provision, that ruling can usually be relied upon from the date of its issue.

In some instances, however, a ruling may apply from July 2000 despite being issued at a later date.

A couple of further points worth noting are:

- where a public ruling which conflicts with an earlier private ruling is issued, taxpayers may rely on the private ruling up to the date the public ruling was issued (provided that a material misstatement of facts was not given in

obtaining the private ruling); and

- where a private ruling which conflicts with an earlier public ruling is issued, the private ruling will prevail.
- **TIP:** Taxpayers should consider all GST public rulings, even if a private ruling has been obtained.

## CGT Reduction Arrangements

The Tax Office has released a draft taxation determination addressing the application of the Part IVA anti-avoidance provisions to certain capital gains tax (CGT) reduction arrangements.

Broadly, CGT reduction arrangements typically arise where a company group sells an asset to an unrelated third party by selling the shares in the subsidiary holding the asset. However, prior to the sale, the following occurs:

- There is an internal restructure or an asset revaluation that gives rise to accounting profits. (However, no tax is payable on the capital gain arising from the disposal of the asset if CGT rollover relief is obtained).
- The subsidiary then declares a dividend in favour of its holding company.
- As a result of a liability to pay the dividend, the sale price of the subsidiary's shares may be reduced (resulting in a reduced capital gain).
- Alternatively, the dividend may be used to purchase additional shares in the subsidiary, thereby increasing the cost base of the shares. Again, this has the effect of reducing any capital gain (or increasing a capital loss).

The draft determination provides that such arrangements are likely to attract the Part IVA anti-avoidance provisions.

## General Interest Charge

The Tax Office has indicated that the general interest charge (GIC) rate for the March 2003 quarter is 11.84%, down from 11.96% for the previous quarter.

## Late Lodgement of Activity Statements

The Taxation Office is now imposing penalties for late lodgement of Instalment Activity Statement (IAS) and Business Activity Statements (BAS). The penalty is \$110 for each week, to a maximum of \$550. Please ensure your BAS/IAS's are lodged on time.

## Family Trust Elections

There are many important reasons why the trustee of a discretionary trust should consider making a family trust election in relation to the trust.

Broadly, a family trust election nominates a test individual and defines the family group to which trust distributions can be made. If distributions are made outside that family group, family trust distribution tax applies at the top marginal tax rate.

Although the family trust election limits distribution flexibility, it has many potential benefits that are broadly summarised as follows:

- tax losses will be easier to utilise under trust loss rules;
  - beneficiaries may not otherwise be able to access franking credit benefits;
  - tax losses in companies which are owned by discretionary trusts will be much easier to use; and
  - claims for bad debt deductions may otherwise be lost.
- **TIP:** Trustees and their advisors should always consider the merits of making a family trust election. Often, the restrictions on the trust are quite manageable and the tax benefits can be quite significant.

March 2003

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