



Mitchell & Partners
CHARTERED ACCOUNTANTS

CLIENT ALERT

Tax News, Views and Clues

Business Acquisitions — Due Diligence

A purchaser of a business entity may find themselves inheriting unexpected tax liabilities unless a detailed tax due diligence process is undertaken to identify undisclosed liabilities.

It is prudent to work through a detailed tax due diligence checklist for any acquisition.

Common 'hot' areas for review as part of tax due diligence include:

- income tax, fringe benefits tax, payroll tax and WorkCover returns to ensure all liabilities have been dealt with;
- the entity's GST issues and compliance;
- the impact of tax consolidation — is the entity from an existing consolidated group so it may have joint and several liability for group taxes?;
- any losses in the target entity — have the losses been properly carried forward and utilised by the target entity?;
- recent acquisitions, disposals and restructures that may trigger CGT events;
- potential tax liabilities under various loan arrangements; and
- the need for tax warranties and/or indemnities from the vendor where issues arise.

We recommend seeking professional advice in relation to any acquisition to avoid the potential for nasty surprises in relation to tax.

Distributions to Certain Entities

New legislation applicable to certain loans, payments and debts forgiven by a trustee of a trust has recently been introduced into Parliament.

Under current law, if a private company has an unpaid distribution from a trust, and the trust makes a loan to a shareholder of the private company, the loan can be deemed to be an unfranked dividend. This law is designed to prevent a trustee from sheltering trust income at the company tax rate while lending the money to the ultimate owners or controllers.

The proposed changes expand the application of this law by including payments and forgiven debts, as well as loans, within its operation.

In relation to loans, an element of flexibility is also introduced by allowing a full repayment, or preparation of a loan agreement, by the tax return lodgment date.

➤ **CAUTION:** Loans in particular, out of either private companies or trusts, can result in very significant tax penalties. Please contact us to address any issues arising out of existing loans.

Joint Ventures for GST

The Tax Office has released a draft ruling setting out what it regards as the necessary characteristics of a joint venture for GST purposes, as opposed to a partnership or other arrangement.

Under GST law, a joint venture is not an entity unless it is approved by the Tax Office as eligible to register and pay GST as an entity separate from each of the participants.

An approved GST joint venture permits transactions between the joint venture partners to be exempt from GST. Only when the transactions are made with outside parties does GST apply.

The Tax Office regards the following characteristics as essential for a joint venture to exist:

- joint control;
- a specific economic project;
- a sharing of costs by the participants;
- a sharing of product not of profit; and
- a contractual agreement between the parties.

➤ **Tip:** If you are planning to enter into a joint venture with another party, it will be necessary to plan the structure to be used and obtain approval to register as a joint venture prior to the commencement of the project.

Please contact us for further information.

Taxation of Compensation Receipts

The Tax Office has recently stated its position regarding the taxation of payments received by individuals as a consequence of suffering a personal injury.

Compensation payments which are a replacement or a substitute for income are considered to be ordinary income and are therefore assessable at the taxpayer's marginal tax rate. This is based on the notion that a compensation payment bears the

same character as the replaced income.

On the other hand, a compensation payment received as a reimbursement for medical expenses is considered to be private in nature and consequentially not assessable for income tax.

Also, if a taxpayer receives a lump sum compensation payment in consequence of a 'wrong, injury or illness' that the taxpayer has personally suffered, the capital gain is disregarded and accordingly, the payment is potentially tax free.

Please contact us for further information.

ATO 'Field Visit' Activity

The ATO plans to increase the number of its GST 'field visits' in order to ensure correct compliance across all industries. Except for walk-ins (usually only to check ABN and/or GST registration), an ATO officer will contact a company's nominated representative to arrange a meeting time. The ATO says its field officers will identify themselves, explain the purpose of the call and what information is required to be available at the time of the field visit.

In recent times, the ATO has requested financial data to be available electronically for computer analysis. The ATO says this process is used when the taxpayer has kept electronic records and the audit objectives 'require the field officer to look at multiple transactions'. The ATO might want the electronic data to be provided to the ATO on a disk or CD-ROM in order to 'enable the field officer to identify discrepancies and verify transactions in a timely and cost-effective way'.

At the time of the field visit you might consider doing any or all of the following:

- obtaining the name and contact details of the ATO field officer and the officer's immediate manager or supervisor;
- having all the requested information available (but be fully aware of what you are providing);
- keeping copies of all information provided to the ATO (including electronic information); and
- seeking clarification if you are unsure about any aspect of the field visit, or why a particular question is being asked.

The ATO has wide-ranging powers to conduct its investigations and can require many types and forms of information to be provided.

➤ **TIP:** We consider a professional adviser should be present at any ATO field visit. Prior to the visit, you and your adviser might wish to examine the relevant BAS and accompanying documents to ensure correct preparation and compliance.

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Budget Overview

The Federal Budget was handed down on the evening of 11 May 2004.

For the 2004/05 financial year, the major estimates by the Government were as follows:

- \$2.4 billion cash surplus;
- GDP growth to moderate slightly to 3.5%;
- unemployment maintained around 5.75%; and
- inflation to decline to 1.75%.

The Budget includes:

- \$19.2 billion package for families (over five years);
- \$14.7 billion worth of income tax cuts (over four years);
- \$2.1 billion superannuation co-contribution scheme enhancement;
- \$5.3 billion boost to science and innovation;
- \$3.1 billion funding for AusLink, the new land transport infrastructure program;
- \$461 million to support carers (over five years);
- \$2.2 billion to the aged care sector (over five years); and
- \$755 million extra towards national security (over five years).

An outline of significant taxation announcements follows.

Personal Income Tax Cuts

Personal income tax rates will be cut from 1 July 2004 and again from 1 July 2005 as shown below.

Tax Rate Commences			Tax Rate
Curren t \$	2004/0 5 \$	2005/0 6 \$	

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6,000	6,000	6,000	17%
21,600	21,600	21,600	30%
52,000	58,000	63,000	42%
62,500	70,000	80,000	47%

For a top marginal rate taxpayer, the cuts will result in a tax saving of \$21 per week (from 1 July 2004) plus a further \$21 per week (from 1 July 2005). Medicare levy low-income thresholds will also increase marginally.

Super Surcharge Slashed

To improve the incentive for superannuation contributions, the Government proposes to reduce the surcharge rates to 12.5% for 2004/05, 10.0% for 2005/06 and 7.5% for 2006/07 and later years.

Reductions previously proposed were 13.5% for 2004/05 and 12.5% for 2005/06 and subsequent years.

Private Company Loans

Private companies will avoid the deemed dividend rules where loans to shareholders or associates are repaid, or put on a commercial basis by the due date for lodgment of the company's tax return. Currently, a potential deemed dividend arises unless a complying loan agreement exists before funds are advanced.

At the earliest, the change will apply for the 2004/05 income year.

Loss Recoupment Rules

The Government has proposed changes to the operation of the loss recoupment rules.

The continuity of ownership test will be simplified for certain widely held companies.

Broadly, eligible companies will not be required to trace underlying ownership through

interests of less than 10% or through managed funds, non-profit organisations and other widely held entities.

The changes will apply to loss years commencing on or after 1 July 2002.

In addition, companies and consolidated groups with total income exceeding \$100 million will be denied access to the same business test from 1 July 2004.

Consolidation: Greater Flexibility

The consolidation regime contains a number of irrevocable elections, including elections for the cost base of assets and recovery of losses.

To allow more flexibility in the initial years, taxpayers will be able to revoke some of these elections up until 31 December 2004.

The election to form a consolidated group remains irrevocable.

Other changes will also be made to clarify particular areas of the consolidation regime, with effect from 1 July 2002.

Retirement Income System

Initiatives for the Retirement Income System include:

- From 1 July 2005, those at preservation age (currently 55) who have not retired, will be able to access their superannuation as a non-commutable income stream.
- All eligible termination payments (ETPs) rolled into a superannuation fund on or after 1 July 2004 are to be preserved.
- Retirees under 65 will not have to work to make superannuation contributions after 1 July 2004. Those over 65 will only have to satisfy a work test on an annual basis.
- From 1 July 2004, super funds will be required to start paying benefits to members as soon as practicable after they reach 75 years of age.

Capital Gains Tax

Shareholders will now be able to realise a capital loss prior to the cancellation of shares in a company where the shares are declared worthless by any insolvency practitioner.

Currently, a CGT loss is only available when a liquidator is able to declare shares worthless.

After 20 February 2004, all taxpayers must exclude input tax credits from the CGT cost base for an asset where credits have been claimed. Previously this was not always required.

Retrospective Family Trust Elections

Concessional rules apply in relation to tax losses and franking credits for trusts which make a *family trust election* in a tax return for a relevant year.

The Government has now announced that eligible trusts will be allowed to make retrospective family trust elections at any time to access these concessions.

Imputation Changes: New Companies Benefit

The imputation rules will be changed to allow a private company to pay fully franked dividends in the first year of operation before actually paying any tax. The franking credits will be calculated on a reasonable estimate of the company's tax liability.

Increased ATO Audit Activity

The Government will provide the ATO with an additional \$216 million to fund a focus on:

- employers — PAYG, SGC and FBT obligations;
- businesses with turnover below \$100 million — CGT compliance, tax losses and complex financial arrangements;
- individuals — CGT and depreciation in relation to rental properties; and
- self-managed superannuation funds — super surcharge compliance.

FBT

The following will be FBT exempt:

- benefits provided to employees of ambulance services up to a grossed up value of \$17,000 p.a.¹;
- incidental home purchase costs incurred within four years of relocating¹;
- printers for use with portable computers and personal digital assistants (PDAs)²; and
- the cost of relocation consultants².

The FBT free ceiling for long service awards is to increase to \$1,000 plus \$100 per year over 15 years. The requirements to qualify for remote area housing will also be eased².

¹ From 1 April 2004.

² From 1 April 2005.

Family Assistance

A maternity payment will replace existing maternity and baby bonuses from 1 July 2004. The maternity payment will not be income tested. The payment will be \$3,000 per child from July 2004, \$4000 from July 2006 and \$5,000 from July 2008. Family tax benefits will also be increased with easier access.

Indirect Tax Measures

The Government has revised estimated collections of GST up by \$1.1 billion for the 2004 year and by \$560 million for 2005. A number of indirect tax changes were also announced, including:

- Entities that are voluntarily registered (with turnovers of less than \$50,000 or \$100,000 for non-profit entities) will be allowed to report and pay their GST on an annual basis.
- Small businesses (turnover below \$2 million) will now be able to annually apportion the private/business use of assets (e.g. cars, computers etc.).
- There will be changes for barter trade schemes. Supplies will no longer be input taxed financial supplies and will now be taxable.
- The Government will rebate \$290,000 p.a. of wine equalisation tax (WET) to every wine producer.
- Taxpayers who become quarterly PAYG instalment remitters as a result of registering for GST will gain an extra year to commence paying instalments as an annual remitter.