

## NEWS HEADLINES

### GST "KING-HIT" ON OUR SPORTSPERSONS

The owner of November's \$2.4 million Melbourne Cup winner will be hit with a \$218,000 GST bill on the winner's cheque, and another bill on the \$60,000 trophy. Tax experts say the new Tax Office ruling will not only affect some of our most popular and largest sporting events, but any Australian sports person that wins a cash prize or medal, trophy or other gifts. The tax applies to any person or body that is GST registered.

### CORPORATE TAX IMPACTS FOREIGN INVESTMENT OPPORTUNITY

Australia risks losing significant foreign capital investment if it fails to cut its corporate tax rate, the Association of Chartered Certified Accountants has warned. Since the release of the Federal Government's discussion paper for its Review of International Taxation Arrangements, there has been widespread disagreement to the current rate of 30 percent being "internationally competitive". At a time when Australia should be positioning itself to be the economic focus for Asia Pacific business activity, the government is being criticised for not being more aggressively competitive against alternative destinations for corporate migration. In comparison, Hong Kong's corporate tax rate is 16 percent and Singapore is 22 percent, while Malaysia is offering 10 year tax exemption for multinationals setting up shop on their soil.

### ARE YOU A SHARE TRADER OR SIMPLY A SHAREHOLDER?

Investors who consider themselves to be share traders rather than ordinary shareholders, for tax purposes, will have to convince the ATO before legitimately claiming their trading losses as tax deductions. The amount of capital invested is not considered to be a determining factor in whether an investor is carrying on the business of share trading, according to the ATO. However, the volume and frequency of trading does influence consideration.

Share traders should be in a position to:

- Declare receipts from the sales of shares as income;
- Declare purchased shares as trading stock;
- Have allowable deductions for cost incurred in buying and selling shares;
- Include dividends and other similar receipts in their assessable income.

### BABY BONUS ON OFFER

Parents who are eligible for the Government's new baby bonus could claim a bigger share by reshaping their strategies, according to our tax experts. The new bonus available through the tax system provides families with up to \$2,500 each year for up to five years after the birth of a child. If you have a baby or have been given legal responsibility for a baby (or child) under the age of five, after June 30, 2001, you could be eligible for the baby bonus, according to the tax office.

In a discretionary trust, taxable income is distributed at the discretion of the trustee. For example, if a married couple with a discretionary trust had a combined taxable income of \$70,000, a greater portion could be transferred to the wife, who would have a bigger taxable income based on which to claim a bigger baby bonus. Specialist advice should be sought on this strategy.

### TAX RELIEF FOR DROUGHT AFFECTED

People affected by the drought who think they will have difficulty meeting their tax obligations are being encouraged to contact the Tax Office as soon as possible to get help. Tax Commissioner Michael Carmody said the Tax Office recognises that the current drought could have a significant impact on some people's ability to meet their tax obligations on time. Businesses will still need to lodge Business or Instalment Activity Statements by the due date, but can phone 13 1142 from 8am to 6pm weekdays to discuss a payment arrangement or deferment.

## OUR VIEW

WELCOME TO THE FIRST EDITION OF TAX IQ MONTHLY, Tax IQ's exclusive monthly newsletter that gives our subscribers the latest news and views in tax, and more importantly updates to changes in tax rules, tips and deductions. During the year, our focus will be drilling down to the real and relevant issues. To give you the information that has allowed our editor's clients to save thousands of dollars a year in tax.

Since the introduction of the GST and Tax Reform in Australia, those that have been worst hit include small and medium sized business owners, especially those operating in industries with tight margins.

As advisers we spend a lot of time with clients working with them to create products and services that are market focused, drive sales through customer management and increase profitability through procurement strategies, outsourcing and human resource initiatives. In fact, so much time is dedicated to creating wealth it leaves little time to understanding how to preserve wealth. We all know that paying tax is compulsory – but nobody said you have to leave a tip.

We have learnt that the key to paying less tax is being a well informed tax payer. And we are prepared to give you the information you need.

**Get smart – Get Tax IQ.**

Thanks for your support –  
Editorial Director

# CONTENTS

A Word From The Author	2
Accountants Threaten Strike Action	2
Tax Office "Super Cop"	2
Pension Gifting Rules	2
Judges v. ATO	3
ATO Targets	3
Sun Protection Products	3
Personal Services Income	3
Simplified Dividend Imputation	3
Inter Corporate Dividend Rebate	3
Taxpayer Win – Split Loans	4
Family Trust Reprieve	4
Taxpayer Alerts	4
Depreciation – Motor Vehicles	5
Spread Betting	5
Charter Boats	5
Personal Superannuation	6
Dividend and Interest Statements	6
General Interest Charge	6
Loans to Shareholders	6
ATO on Strike	6
Mass Marketed Tax Schemes	7
Tax Value Method	7
Reasonably Arguable Position	7
Black Hole Expenses	8
Hire Purchase	8
Computer Software	8
Depreciating Assets (Plant & Equipment)	8
Lodgement Penalties	9
Business Activity Statements	9
GST – Motor Vehicles	9
GST – Capital Assets	10

# A WORD FROM THE AUTHOR

WELCOME TO THIS INAUGURAL ISSUE OF TAX IQ MONTHLY. This newsletter will come to you every month and bring with it all the latest information and changes to Australian tax law and administration.

The *Australian Taxation Manual* gives you a brief summary of Australian taxation law as it is comprised in 8,500 pages of taxation legislation contained in two Acts, the Income Tax Assessment Act 1936 and in the Income Tax Assessment Act 1997. When we make reference to these Acts we will use the abbreviation *ITAA 1936* or *ITAA 1997*.

These Acts are the basis of Australian tax law. There are numerous other official and semi official directives, rulings, determinations and so on issued by the Australian Taxation Office (the abbreviation for this is ATO) as well as thousands of decided cases heard by Australian Courts and Tribunals.

Where there is a dispute between a taxpayer and the ATO this dispute can be reconsidered by the ATO as the result of an objection. If the result of the objection is not to the liking of the taxpayer it can be appealed to the Administrative Appeals Tribunals (AAT) or to the Federal Court. Appeals from the

Federal Court go to the full Federal Court and only on rare occasions to the High Court. Special leave has to be sought for that.

So our rather formidable task is to condense all of that information into a language which can be quickly assimilated by people who are so busy running their businesses that they have little time to digest the voluminous information which emanates from all of these sources.

The ATO itself has three websites which are [www.ato.gov.au](http://www.ato.gov.au); [www.taxreform.ato.gov.au](http://www.taxreform.ato.gov.au) and [www.law.ato.gov.au](http://www.law.ato.gov.au).

You can access these to obtain information sheets, forms, etc for any particular topic, however be prepared to spend considerable time finding what you are looking for and downloading the material.

*Tax IQ Monthly* is a digest of tax news and developments bringing you the latest tax news in condensed form. With it is a reader query service where you can write, fax or email your tax query to the publishers and we will answer it in the next issue.

## ACCOUNTANTS THREATEN STRIKE ACTION

Accountants, generally regarded as conservative and law abiding, have threatened to take action which will seriously disrupt ATO administration.

Led by the Institute of Chartered Accountants and supported by the National Tax & Accountants Association tax agents have called upon the ATO to improve its service and support performance by 28 October or face retaliation.

If their demands are not met tax agents will file tax returns manually rather than electronically and swamp the ATO with an avalanche of paperwork.

Tax agents are fed up with the bureaucratic attitudes and conflicting advice given by poorly trained staff and the increasing administrative burden of the tax system.

In response the ATO has launched a tax agent portal website which is intended to give them secure access to detailed information about clients and other services.

This is intended to substantially reduce the necessity for tax agents to telephone the ATO for information about clients or to correct errors.

Whilst welcoming this launch the Institute of Chartered Accountants remains in "alert mode" in relation to its work to regulation threat.

## TAX OFFICE "SUPER COP"

In a bid to allay the concerns of taxpayers concerning the excessive powers of the ATO the Government has announced that it proposes to appoint an Inspector General of Taxation who will have sweeping powers to investigate the activities of the ATO, including administration of public and private rulings, penalties and audit guidelines.

The Inspector General will be independent of the ATO and other Government bodies and will be able to report and advise Government in relation to recommended amendments to the law and tax administration. The Inspector General will be able to hold the ATO accountable for what it does.

## PENSION GIFTING RULES

Means test pension rules enabled single pensioners or couples to gift up to \$10,000 of assets each year thereby reducing assets and income and enabling them to receive higher pensions.

These rules have been tightened from 1 July 2002.

Whilst pensioners can still gift \$10,000 each financial year, they cannot gift more than \$30,000 over a rolling five year period otherwise the excess will be assessed as a deemed asset for five years from the date of gifting.

## JUDGES V. ATO

One of the more onerous and unfair taxes is the termination payment surcharge of up to 15% which is levied on termination payments in addition to the standard ETP tax.

More than 100 judges have bankrolled a constitutional test case arguing that the surcharge should not be imposed on them because their payments are not superannuation.

The case had to go directly to the High Court because of the difficulty in finding judges in a lower Court without a conflict of interest.

In hearing the case, judges described the ridiculously complex legislation as "a maze" and an "Orwellian fantasy".

## ATO TARGETS

Concerned about increasing work related expense claims and negative gearing deductions the ATO targeted salary and wage earners, investors and rental property owners by sending schedules requiring details of tax claims for their 2002 income tax returns.

Key areas of concern to the ATO are:

- increasing work related expense claims
- high rental property deductions
- undeclared interest & dividends from investments, &
- unreported capital gains on sale of shares.

## SUN PROTECTION PRODUCTS

Following a recent test case which found in favour of the taxpayer (*Morris & Ors v. FCT*) you can now claim a deduction for sunscreen lotion, sunglasses and hats if you are an outdoor worker.

These claims will need to be substantiated as a work related expense however for the 2002 financial year you can claim an amount up to \$85 per year without substantiation.

You can also claim an additional \$340 to allow for claims not made during the last four years.

## PERSONAL SERVICES INCOME

Contractors in the building construction, cleaning, car repair and road transport industries previously operating under the PPS system were given a two year extension before being caught by the personal services income rules.

This extension expired on 1 July 2002. If you are an ex-PPS subcontractor operating through a partnership, company or trust you now have to pass the personal services income rules.

To pass the *results test* your entity must:

- receive income in return for producing a result;
- be required to supply plant and equipment or tools of trade (if any) needed to perform the work; and
- be liable for the cost of rectifying any defect in the work performed.

If unable to pass that test, there are other tests which are available if 80% or more of the personal services income does not come from one client.

In this event your entity need satisfy only one of the following tests:

- *Unrelated Client's Test* – the entity has two or more unrelated customers or clients and work is gained through advertising to the public.
- *Employment Test* – at least 20% of principal work is undertaken by an employee (who could be an associate).
- *Business Premises Test* – the entity has exclusive use of business premises which are physically separate from your home and also separate from your client's premises.

If unable to pass these tests the gross income after deducting only the following expenses:

- normal work related expenses;
- entity maintenance deductions such as filing fees, accounting fees, etc;

must be attributed to yourself and full personal tax paid.

## SIMPLIFIED DIVIDEND IMPUTATION

New franking rules for companies have been introduced. These apply from 1 July 2002.

Key features are:

- The franking account will operate on a tax paid basis. Credits will be on the basis of tax actually paid.
- The franking balance at 1 July 2002 must be converted by the fraction 30/70.
- All dividends must be franked at the benchmark franking percentage. This is the percentage allocated to the first frankable distribution made in the year.
- If dividends are over franked, over franking tax will be payable. If under franked, there will be an additional debit to the franking account.
- Companies will gross up dividends received by adding the imputation credit to assessable income and then claiming a corresponding credit of the amount of the imputation credit. This is similar to the existing rules for individuals and trusts.

Companies receiving franked dividends can also apply the imputation credit to its franking account.

## INTER CORPORATE DIVIDEND REBATE

The inter corporate dividend rebate under Section 46 *ITAA 1936* will cease to apply to non wholly owned companies from 1 July 2002.

These companies now come under the imputation system in the same manner as all other entities. Assessable income will be grossed up by the amount of the imputation credit attached to dividends received and a franking rebate will be available.

Wholly owned companies can continue to claim the inter corporate rebate until 30 June 2003 at which stage they must either consolidate under the new consolidation legislation or suffer the penalty of double tax.

If there is a holding and subsidiary company within your group and income is being earned by the subsidiary company which flows through to the holding company and onto the shareholders by means of fully franked dividends you may be caught by these rules. In this case you have two choices which must be exercised by 30 June 2003:

- consolidate those two entities leaving out other entities such as unit trusts and discretionary trusts which may form part of your whole group, or
- issue additional shares to ensure that the subsidiary company is no longer wholly owned.

## TAXPAYER WIN – SPLIT LOANS

Banks and financial institutions can provide loan facilities which are divided into two accounts. One account is for non tax deductible borrowings (your own home) whilst the other is for tax deductible borrowings (an investment property).

Under the terms of these loans you can direct all payments to the home loan account thereby reducing the non deductible borrowing quickly whilst the investment property loan is actually increasing by the amount of interest being charged.

These arrangements can produce excellent taxation benefits and were well in vogue until the ATO issued *Taxation Ruling TR 98/22* which denies tax deductibility for the "further interest" – the interest on capitalised interest.

In *Hart v. FCT* the Full Federal Court considered this type of arrangement and by unanimous decision held in favour of the taxpayer.

The Court decided that interest on capitalised interest was deductible and the provisions of Part IV A (the anti avoidance provision of *ITAA 1936*) did not apply because the main purpose the taxpayers entered into the arrangement was a commercial one – the borrowing of money to use for financing the two properties.

The ATO has announced that it will seek special leave to appeal this decision to the High Court. If the ATO fails, we can expect to see a substantial increase in the number of taxpayers taking advantage of the benefits of split loan facilities.

## FAMILY TRUST REPRIEVE

Two years ago the ATO mounted a concerted attack on family trusts. This attack was contained in legislation planned to be introduced and styled *entity taxation*.

The rationale was that all entities whether they are companies, unit trusts or family trusts should be taxed in the same way.

Whilst this was promoted as being equitable, it was really meant to target the 450,000 family trusts which are used by small businesses and farmers throughout Australia. After succumbing to pressure from the "big end of town" and exempting the unit trusts utilised by fund managers the real target became clear.

The proposals had nothing to do with fairness and equity – they were simply an attack on family trusts. The outcry from farmers, business organisations and the profession reached a crescendo and the proposal was shelved.

There have been recent moves to re-open this sensitive matter with an announcement that the newly appointed Advisory Board of Taxation is considering new measures aimed to stop the so called abuse of trusts by the wealthy.

This announcement brought an immediate response from the National Farmers' Federation. Mr Geoff Crick, the Tax Working Group Chairman said "farmers are sick and tired of this constant pursuit of the perception that trusts are set up for tax avoidance."

Tax experts have called upon the ATO and the Board of Taxation to specify exactly what avoidance transactions they are aiming to stop.

Stay tuned!

Many years ago our present Prime Minister, whilst he occupied the Treasurer's chair, made the mistake of suggesting that too much tax was being lost through the operation of partnerships. This statement promptly brought the wrath of the Housewives' Association on his head and he quickly decided discretion was the better part of valour. It seems to me that family trusts are now in this category and the ATO will not succeed in its continuing endeavours to squash them.

## TAXPAYER ALERTS

On top of the public rulings, private rulings, draft rulings, draft determinations, final determinations, interpretive decisions, fax sheets, product rulings, bulletins and practice statements, the ATO has commenced issuing yet another communication medium.

This time it is the *Taxpayer Alert*. This is designed to provide an "early warning" of significant new and emerging tax planning issues or arrangements that the ATO has "under risk assessment". In plain English, that means the ATO wants them stopped.

*Taxpayer Alerts* have no legal standing nor do they even represent a final ATO view. They are a warning from the ATO that it has concerns about a particular scheme or transaction.

Be aware that if you enter into any arrangement declared as unacceptable in a *Taxpayer Alert* you are likely to have an argument on your hands so make sure you obtain expert advice before proceeding.

Alerts issued to date are:

**Home Loan Unit Trusts** (TA 2001/01) - A unit trust is established and the taxpayer borrows funds personally and uses those funds to acquire units in the unit trust.

The unit trust then acquires a residential property and leases it to the taxpayer as his main residence. The trust derives rental income, claims deductions for the property expenses and distributes the surplus to the taxpayer who is a unit holder. The taxpayer claims a negative gearing loss in relation to his borrowing and investment in the unit trust.

The ATO considers such an arrangement is unacceptable. *Taxation Ruling TR 2002/18* has also issued in relation to these arrangements. The ATO's views have not yet been tested in the Courts. Keep in mind that if your main residence is purchased by a unit trust you will lose the CGT main residence exemption.

**Internet Marketing Expenses Scheme** (TA 2002/01) - This arrangement involves a taxpayer entering into a marketing arrangement with a tax haven based internet marketer. It involves the prepayment of a substantial marketing fee, most of which is borrowed from the tax haven entity. Subsequently *Taxation Determination TD 2002/23* issued disallowing any expenses claimed in relation to these schemes.

**Scrip Loan and Option Arrangement** (TA 2002/02) - A taxpayer borrows a parcel of shares on which a franked dividend has been declared but not yet paid. Conditions are that the taxpayer cannot deal with the shares or exercise any voting power, etc but is entitled to receive the franked dividend together with the franking credits.

The taxpayer pays a transaction fee to the lender which approximates the value of the cash dividend and the parcel of shares is returned to the lender after the dividend has been paid.

The taxpayer returns the grossed up dividend as income, claims the franking credits and also claims a deduction for the transaction fee.

**Preserved Superannuation Benefits** (TA 2002/03) - A self managed super fund is established by a promoter which accepts a rollover of the taxpayer's preserved superannuation benefits from an existing super fund.

The newly established super fund then invests the assets in an entity (sometimes an offshore entity) which then makes an interest free or low interest loan to the taxpayer or, alternatively, pays consultancy fees, etc to him. Substantial fees are deducted by the promoter for his services.

The ATO considers that a super fund established in these circumstances is contravening the sole purpose tests and would therefore be treated as a non complying super fund.

**Personal Services Income and Partnerships** (TA 2002/04) - Two or more unrelated taxpayers receiving personal services income which is subject to the PSI rules purport to form a partnership. If the arrangement succeeded these partnerships would meet the tests in the legislation and the entity would be classified as a personal services business.

The ATO considers that such arrangements are shams and not effective.

**Prepaid Service Warrants** (TA 2002/05) - A taxpayer claims significant tax deductions for partnership losses created by the acquisition of prepaid service warrants.

These are endorsed in favour of a client for a fee and redeemed for financial and wealth creation seminars. Needless to say, such an arrangement is not acceptable to the ATO.

**Education/Scholarship Trusts** (TA 2002/06) - Education or scholarship trusts established to provide support for students are exempt from paying tax. This Alert relates to taxpayers establishing an education trust for the benefit and to provide education support for a child or relative of the settlor.

The trust income is then distributed to the student as a scholarship or similar and the income earned by the trust is claimed to be exempt income.

Overseas Visitors and Living Away From Home Allowances (TA 2002/07) - The ATO is to scrutinise arrangements which it states purport to re-characterise up to 40% of casual earnings by backpackers and overseas visitors as tax free living away from home allowances.

The arrangement involves the interposing of a company which receives a fee for provision of the visitor's services and then pays a salary plus a living away from home allowance to the visitor.

## DEPRECIATION – MOTOR VEHICLES

In a move likely to cause angst among many business people the ATO has announced that the *effective life* for motor vehicles acquired from 1 July 2002 is increased to eight years (previously 6½ years).

This means that the depreciation rate (diminishing value method) for motor vehicles purchased from 1 July 2002 will be 18.75% p.a. (down from 22.5% p.a.).

## SPREAD BETTING

They say putting your money into the stock exchange is akin to gambling. Well here's a new arrangement which claims exemption from tax.

Spread betting resembles a futures contract which allows you to speculate on whether a share price, share index, commodity price or foreign exchange rate will rise or fall within a given period of time. This is claimed to be a tax free alternative to normal share trading.

The ATO has announced that it is currently investigating these arrangements and will shortly announce its official view on the matter.

What's the betting that tax exemption will be denied?

## CHARTER BOATS

In a move set to devastate the charter boat industry the ATO has issued a *Draft Ruling TR 2002/D9*.

For many years it has been the practice in the charter boat industry, similar to serviced apartments, that the boats are not owned by the operator. They are managed on behalf of numerous investors who have acquired the boats by purchase or lease and have placed them on charter with an operator.

After accepting these arrangements for decades the ATO has had a change of heart and now considers that each investor should be undertaking the activity on a sufficient scale to provide a reasonable expectation of making a profit.

The ATO further states that if a taxpayer has acquired the boat under lease largely for eventual personal pleasure or to obtain tax benefits, the taxpayer is not operating a business. The mere leasing of a boat to a charter operator will also not fall within the required indicators.

The charter boat industry has made strong representations to Government objecting to the proposed attack on arrangements which have been in operation since 1974 and to the fact that there has been no consultation prior to issue of the draft ruling.

The Government has indicated that it will seriously consider industry concerns prior to issue of a final ruling.

## PERSONAL SUPERANNUATION

Let's be thankful that our tax system includes, as final arbiters, Tribunals and Courts which create a balance between desires of taxpayers and excess bureaucratic thinking combined with Scrooge like attitudes sometimes displayed by the ATO.

In a recent case the ATO attacked one of its own but lost in a hearing before the Administrative Appeals Tribunal. (*AAT Case (2002) AATA 749, re Norris and FCT*).

The taxpayer was an ATO employee who took leave without pay to work for the Fiji Islands Revenue and Customs Authority.

After eight years in Fiji he decided he didn't want to come back to Australia and resigned from the ATO.

He had obtained a private ruling from the ATO indicating that while he was on leave without pay he could make a personal superannuation contribution.

He did this but later, the ATO told him that if he wanted his severance pay on resignation he would have to return to work prior to departing. He did this and worked for the ATO for two days.

The ATO disallowed his claim for his personal superannuation deduction on the grounds that he had worked during the year and that his wages plus his termination payments caused him to exceed the 10% limit of employment income.

The ATO lost the case before the AAT which held that the counting of termination payments as employment income undermined the objectives of the legislation. The taxpayer was entitled to his tax deduction.

## DIVIDEND AND INTEREST STATEMENTS

All companies are required to lodge with the ATO statements in the prescribed form providing details of dividend and interest payments they have made during the year. Interest payments to recognised banks and financial institutions do not have to be included in these statements.

The ATO has issued a reminder that these statements must be lodged by the due date for lodgement of the company tax returns but in any case no later than 15 May 2003.

If the company return is lodged electronically the statement can be forwarded by mail to the ATO, PO Box 2090, Chermside Centre Qld 4032.

## GENERAL INTEREST CHARGE

The ATO has announced that the General Interest Charge (GIC) rate for the quarter ended 31 December 2002 is 11.96%. The rate for the quarter 30 September 2002 was 11.84%.

## LOANS TO SHAREHOLDERS

Division 7A was inserted in *ITAA 1936* nearly five years ago. Under this Division, payments and loans to shareholders or their associates or the forgiving of debts are deemed to be dividends unless subject to a loan facility agreement.

If caught under this Division, the amounts are taxed to the shareholder but are not deductible to the company. Worse still, whilst treated as unfranked dividends, the deemed tax component is debited to the company's franking account. The deeming provisions take effect to the extent of any distributable surplus in the company.

To determine whether there is a distributable surplus you need to look at any retained profits either of an income or capital nature and for this purpose you need to revalue all of the company's assets.

You can avoid the dire consequences of Division 7A by having a loan facility agreement between the company and the shareholder. This agreement must be in writing entered into prior to the payment or loan and at a rate of interest not less than the benchmark interest rate.

The loan must be repaid over a period of 25 years (if fully secured on real estate) or over seven years (if unsecured).

The ATO has announced that it is undertaking a pilot project to determine whether companies are complying with the requirements of Division 7A.

Letters are being sent to selected private companies to obtain details of transactions between the company and its shareholders and associates.

If you have a company with loans to shareholders or associates get expert advice immediately. If your company is the beneficiary of a family trust and there are unpaid distributions of profit from the trust, Division 7A will be triggered if the trust makes any loans at all to shareholders or associates.

## ATO ON STRIKE

ATO members of the Community and Public Sector Union (CPSU) went on strike over efforts by the ATO to introduce compulsory rosters and weekend work.

ATO members complained about "having to choose between work and family".

Poor dears! With all the flexi time and other benefits they enjoy, ATO employees cannot bear the thought of having to work when told to do so.

## MASS MARKETED TAX SCHEMES

The ATO is having somewhat of a field day in relation to what it terms mass marketed tax schemes. Some of these are designated as "aggressive" whilst others are relatively "benign".

During the early to mid 1990s many thousands of taxpayers invested in these schemes. Years later, to their horror, the ATO decided that it would revisit the claimed deductions and disallow them. Relevant cases are now being heard and in the Budplan cases, decisions have been in favour of the ATO.

Another case involving investment in a cattle breeding project went before the Federal Court. The decision was that the deduction was allowable under Section 51 (the general provision enabling deductions for expenses incurred in producing income) but Part IV A (the anti avoidance provision) applied to disallow the expenditure claimed.

The case went on appeal to the Full Federal Court which completely reversed the earlier decision. (What hope do we poor mortals have!)

The Court held that this particular investment did not involve the carrying on of a business and was therefore on capital account and not deductible under Section 51. Because of this Part IV A did not apply.

Interestingly the Full Federal Court decision, whilst disallowing the deduction under Section 51 was a win for the taxpayer because the four year time limit for disallowing deductions under Section 51 had expired (*Vincent v. FCT (2002) FCAFC291*).

## TAX VALUE METHOD

During the last two years we have been through massive tax reform, most of which originated from a report handed down by a committee headed by leading businessman, Mr John Ralph.

In June 1999, Mr Ralph called a top secret meeting of 30 leading business representatives, tax accountants and experts, each of whom had to sign a confidentiality agreement not only about the nature of the discussions but even that the meeting actually took place.

This meeting discussed the genesis of the *tax value method*. This proposal was to involve a completely new way of working out the income which would be subject to tax. The proposal involved scrapping most of the legislation and practices which had evolved during the last 60 years and calculating taxable income by looking at cash receipts less cash payments then adjusting the result to allow for changes in value of assets and liabilities and then making further adjustments to allow for any Government concessions or penalties such as CGT discounts, livestock profit deferrals and

quarantining of capital losses. The measure was strongly supported by big business and some tax experts but was looked at in horror by others.

When considering the utter mess made of the introduction of GST by the ATO, tax professionals were aghast at the thought of the ATO being involved in the design and preparation of a completely new tax system.

After much debate the Treasurer recently announced that the Government has decided not to proceed with the tax value method.

The Board of Taxation reported that there was significant industry concern about the cost and uncertainty associated with the proposal and that it was expected that the proposal would generate greater complexity and uncertainty and would result in substantial transitional costs for tax advisors and business generally.

## REASONABLY ARGUABLE POSITION

A self assessment system applies in Australia. This means that as a taxpayer you are responsible for lodging a tax return which correctly discloses your taxable income. If the ATO subsequently discovers that you have made a false or misleading statement, taken a position which is not reasonably arguable, failed to make a required statement or disregarded a private ruling you will be liable to a tax shortfall penalty.

Assuming you haven't made any false or misleading statements or disregarded a private ruling it is important that you have a reasonably arguable position in relation to any information included in your income tax return.

A matter is reasonably arguable if it would be concluded in the circumstances and having regard to the relevant authorities that what is argued is "as likely to be correct as incorrect, or is more likely to be correct than incorrect."

In *Reeders v. FCT (2001 ATC 244)* the AAT remitted in full a 25% tax shortfall penalty imposed by the ATO in relation to a claim for flying lessons because the claim for the flying lessons was reasonably arguable based on information provided by the employer and evidence provided that the lessons enhanced his promotion prospects.

To establish a reasonably arguable position in relation to a claim which you think may be disputed by the ATO you should:

- conduct a review of relevant taxation rulings, cases and legislation,
- obtain specialist tax or legal advice where the amount of the claim warrants it,
- obtain all necessary supporting evidence such as expert reports, letter from employer, etc, and
- maintain detailed working papers supporting the conclusion and reasons therefore.

## BLACK HOLE EXPENSES

What are these? Payments which could not be claimed as deductions, and do not create assets, are colloquially called black hole expenses. Some categories of these expenses which are incurred from 1 July 2002 can now be written off over a five year period.

Categories which are now deductible are:

- expenditure to establish a business,
- expenses of converting to a different structure,
- expenses of equity raising,
- expenses incurred in defending the business against a takeover,
- expenses in unsuccessfully attempting a takeover of another business,
- business cessation expenses, and
- expenses you incur in liquidating a company in which you are a shareholder.

## HIRE PURCHASE

New Division 240 has been inserted in ITAA 1997. Whilst receiving Royal Assent on 30 June 2001 this Division has retrospective application to February 1998.

The only significant changes to previous practice are:

- the *Rule of 78* or a flat rate apportionment of interest can no longer be used
- interest apportionment over the term of the hire purchase agreement must be calculated actuarially
- you cannot bring forward interest deductions by prepaying any instalments
- you cannot estimate the interest or gross up the cost of the goods to cover the interest component.

If you purchase an item under hire purchase you are not the legal owner until the last instalment is paid. However, consistent with past practice, Division 240 provides that:

- you are a notional owner as from the date of the hire purchase agreement,
- the notional sale of the goods to you is being treated as having been financed by a loan made by the finance company,
- you are treated as the owner of the property for capital gains tax purposes,
- you will not be entitled to deductions for the hire purchase instalments but will be able to claim deductions for depreciation and interest payable under the hire purchase agreement.

## COMPUTER SOFTWARE

In-house software is defined as software which you acquire or develop to be used mainly in your business. It does not include software which would be trading stock of a software retailer.

From 1 July 2001 in-house software comes under new capital allowance divisions in Division 40 of ITAA 1997.

Software costing less than \$1,000 can be added to your *low value pool*. Items in this pool are depreciated under the diminishing value method at the rate of 37.5%. If added to the pool during the year the rate is 18.75% for that year.

An effective life of 2.5 years has been allocated to in-house software and hence items costing \$1,000 or more will be depreciated on a prime cost rate of 40% or diminishing value rate of 60% with the first year's claim pro rated for the part year it has been held.

STS taxpayers can claim an immediate deduction for in-house software costing less than \$1,000. Items costing \$1,000 or more can be allocated to the *general STS pool* which is depreciated at the rate of 30% (15% in the year of acquisition).

There is no longer an immediate deduction for in-house software costing less than \$300. This concession can only be utilised by taxpayers deriving non business income (and by STS taxpayers who can claim an immediate deduction for items costing less than \$1,000).

Subscriptions to "read only" products such as legal, tax or engineering libraries are not treated as in-house software and can be claimed in the year of payment. However keep in mind the prepayment rules applicable to non STS taxpayers.

If you acquire software as part of a package and there is no price dissection it will be necessary to attribute a cost to the software on a reasonable basis. For example you might acquire computer equipment with the software or alternatively acquire software which includes training, back-up support and maintenance.

In these circumstances you will need to apportion the total cost on a reasonable basis.

If you decide not to continue using software previously acquired you can claim a balancing adjustment by writing off the balance of the written down value. Be sure to un-install the software from your computer.

The cost of acquiring, developing or constructing a website is regarded as expenditure on in-house software where the website is used as part of a commercial venture carried on for the purpose of earning assessable income. Hence the expenditure is depreciable over 2.5 years.

Ongoing operating expenses relating to the website will usually be deductible in the year incurred. These expenses would include costs of updating, hosting fees, registration costs, ISP fees and domain name registration costs.

## DEPRECIATING ASSETS (PLANT & EQUIPMENT)

Significant changes took place on 21 September 1999 in relation to the tax treatment of depreciating assets.

At that time accelerated depreciation rates were removed for all except small business taxpayers. Accelerated rates were removed for small business taxpayers from 1 July 2001 leaving only STS taxpayers only to claim concessional rates. The balancing charge offsets applicable to the disposal of depreciating assets was also removed.

Additionally, disposals of plant and equipment were removed from the CGT regime and the excess of sale proceeds over the index cost base as at 30 September 1999 is now taxed as a balancing adjustment.

As a result of these changes business taxpayers can no longer claim the 50% CGT discount on capital gains on disposal of plant and equipment nor can they claim the small business CGT concessions (50% active asset reduction, retirement exemption and rollover relief).

It is important to allocate values to individual assets involved in the sale of a business as the tax treatment of these assets will differ.

Goodwill is subject to active asset exemptions and the 50% discount. The excess of the sale price over written down values of plant and equipment is fully taxed with no concessions. The value applied to trading stock is also fully subject to tax.

It is important to, not only have the values clearly expressed in contracts, but also to have supporting evidence as to these values. This will overcome any possibility of the ATO refusing to accept contract figures and arguing that the values have not been allocated on an arms length basis. In that event the ATO would require independent valuations.

From a purchaser's point of view, he or she may prefer the values not to be apportioned in the contract thereby enabling the obtaining of an independent valuation with possible higher values put on plant and equipment and trading stock. This will result in a more favourable taxation position for the purchaser.

## LODGEMENT PENALTIES

Yet another layer of penalties has been added to a system already excessively skewed in the ATO's favour. This time it is the Failure to Lodge on Time (FTL) penalty.

When a return, notice, statement or other document is not lodged with the ATO in the approved form by its due date the FTL penalty can apply.

The penalties are as follows:

**Small Businesses.** \$110 for each period of 28 days (or part thereof) subject to a maximum of \$550.

**Medium Businesses.** (Assessable income or current GST annual turnover between \$1 million and \$20 million) \$220 for each period of 28 days (or part thereof) subject to a maximum of \$1,100.

**Large Businesses.** (Assessable income or GST annual turnover \$20 million or more) \$550 for each period of 28 days (or part thereof) subject to a maximum of \$2,750.

In *Practice Statement PS2002/8* the ATO outlined its current approach to remission of FTL penalties. The ATO conceded that the implementation of the new tax system is not yet fully settled in and it will continue to remit penalties where taxpayers have made a genuine attempt to comply with tax obligations.

However from 1 July 2002, the ATO is moving to a new phase and documents not lodged on time may have an FTL penalty notice automatically issued. The ATO has stated that FTL penalty notices will not generally be issued unless the taxpayer has received a prior warning for lodging documents late.

The ATO has also advised that it will apply filters to its computer systems to ensure that automatic FTL penalty notices will not issue in respect of:

- taxpayers who are entitled to a refund or have minimal debt,
- non taxable individuals and activity statements where the overall liability notified is zero,
- taxpayers excluded from the automated system because they represent a low level risk (eg senior Australians), and
- periods of grace allowed for postal or electronic transmission delays.

If you do receive an FTL penalty notice all is not lost. You can apply for remission if you have a good compliance record or if the delay in lodgement occurred due to circumstances beyond your control and it would be fair and reasonable to remit the penalty. You should also be entitled to remission of the penalty if you have not received a prior warning.

## BUSINESS ACTIVITY STATEMENTS

Now that more than two years have passed since the introduction of GST, the ATO is moving from an education phase to compliance mode. Audits are planned and penalties will apply where mistakes occur.

The ATO has found a number of common errors in BAS preparation due mainly to lack of experience in staff members preparing BAS, staff turnover, the manual nature of some aspects of BAS preparation and reliance on data coming from other staff members not familiar with GST requirements.

The ten most common errors occurring in preparation of BAS are:

- GST is paid or input tax credits are claimed in the wrong tax period
- input tax credits are wrongly claimed in respect of non tax deductible expenses
- unauthorised adjustments or corrections are being made
- tax invoices are not made out to the correct entity particularly where there is a group of companies involved
- non monetary transactions not brought to account
- poor BAS reconciliation processes and no cross checking with profit and loss
- claiming of input tax credits where there is no entitlement
- GST included on creditor invoices not correctly taken up
- input tax credits applicable to employee reimbursements not correctly calculated
- transactions not correctly classified leading to mistakes in GST or input tax credits

## GST – MOTOR VEHICLES

The ATO has recently reviewed GST compliance in the motor vehicle industry and has found that there is a general failure of GST registered businesses to account for GST on the trade-in of their vehicles.



## QUESTION & ANSWERS

Please send all tax related questions into us at: [info@tax.miq.com.au](mailto:info@tax.miq.com.au)

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