

DEPRECIATION & EFFECTIVE LIVES

This month we will try to explain the conundrum relating to effective lives for trucks, buses and trailers.

In *Tax IQ Monthly* December 2004, we reported new effective life determinations by the Tax Office for trucks, buses, light commercial vehicles and trailers. Effective lives were lengthened causing reduced depreciation rates.

Yet *Weekly Tax Bulletin* (reported in *Tax IQ Monthly* January/February 2005) advised much lower effective lives. We said we would look into the reasons for the variation.

It appears that the Government has legislated effective life caps for these vehicles which are to operate from 1 January 2005. Notwithstanding this the Tax Office has seen fit to issue a Determination showing effective lives at nearly double those in the legislation!

So, we have the Gilbertian situation where there are effective lives set out in the Tax Laws Amendment (2005 Measures No. 1) Bill and effective lives as per the Tax Office Determination. The effective lives shown in the legislation and the Determination differ substantially but both commence as from 1 January 2005.

Where the legislated capped life is shorter than the Tax Office Determination it is the shorter life which will be the effective life of the asset.

Accordingly, you can adopt the following effective lives and ignore the Tax Office Determination.

Vehicle	Effective Life	Diminishing Value Rate	Prime Cost Rate
Buses with gross vehicle mass (GVM) of more than 3.5 tonnes	7.5 years	20%	13.33%
Light commercial vehicles with carrying capacity of 1 tonne or more and GVM of 3.5 tonnes or less	7.5 years	20%	13.33%
Mini buses with GVM 3.5 tonnes or less and designed to carry 9 or more passengers	7.5 years	20%	13.33%
Trailers with GVM greater than 4.5 tonnes	10 years	15%	10%
Trucks with GVM of more than 3.5 tonnes (other than mini trucks)	7.5 years	20%	13.33%

Other effective life caps already included in the legislation are as follows:

Asset	Effective Life	Diminishing Value Rate	Prime Cost Rate
Aeroplanes used predominantly for agricultural spraying or dusting	8 years	18.75%	12.5%
Other aeroplanes	10 years	15%	10%
Helicopters used predominantly for mustering, agricultural spraying or dusting	8 years	18.75%	12.5%
Other helicopters	10 years	15%	10%

(Section 40-105 ITAA(1947))

FAMILY TAX BENEFIT

One of the election commitments made by the Government was to increase the Family Tax Benefit (FTB) Part B by \$300.

The Minister for Family and Community Services, Senator Kay Patterson, recently announced that due to positive response she had received from parents receiving lump sum payments last year she had decided to deliver this commitment in a lump sum as well. The benefit will be brought forward by 6 months to 1 January 2005 so families receiving FTB Part B will be eligible for a cash bonus of up to \$150 from 1 July 2005 after lodging their tax returns. Each following year families will be eligible for the \$300 annual increase after lodgement of their tax returns.

FBT – EXEMPTIONS

Legislation has been introduced into Parliament to expand FBT exemptions available to employers.

Relocation

If an employer pays the following expenses to relocate an employee they will be exempt from FBT.

- Relocation travel costs including meals and accommodation en route for the employee and family members;
- Removal of furniture and personal effects including insurance and storage;
- Temporary accommodation, both at the old locality and the new;
- Leasing of furniture for temporary accommodation;
- Telephone, electricity and gas connections to temporary accommodation;
- Necessary meal costs at a hotel/motel, etc;

OUR VIEW

From the sublime to the ridiculous! Last month we were glad to report some good news about the self-assessment review by the Government, about the easing of draconian rules relating to non-commercial loans and family trust elections and about making it more attractive for small businesses to elect to become STS taxpayers.

This month, we report on a situation which would fit nicely into a modern day Gilbert & Sullivan opera! Politicians, listening to their constituents, enacted a law fixing the effective lives for trucks and buses. The Tax Office decided that the politicians were too generous so issued a Determination halving the legislated depreciation rates!

This is yet another instance where the Tax Office fell into the trap of thinking it is above the law. Of course, it isn't. Its Determination is ineffective.

We also publish a critique by a reader about the self-assessment review. Concern is expressed about long overdue reforms not being made retrospective.

We publish complimentary comments from a Supreme Court judge, but balance this with a light-hearted story about Santa trying, but failing, to come to grips with Australian taxation bureaucracy!

Salary packaging is frequently used to provide some benefits to employees. With today's high personal tax rates (said to be the second highest in the world), it is important that employees seek and obtain the benefits available through salary packaging. This month, we publish an indepth article about this important topic, together with a separate article providing details of the many FBT exemptions available.

Yet more good news emanating from Canberra. A tax rebate available to workers aged 55 and over, some easing of the pension means test, bringing forward the start date for easing of loan conditions by companies, and expanded FBT exemptions are reported in this issue.

Tony Lovett

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- Advances to cover rental bonds, electricity and gas deposits provided the advance is repayable within one year;
- Stamp duty, legal fees and agent's commission incurred in selling an existing home and purchasing a new home.

A new exemption is provided to cover the engagement of a relocation consultant to assist in the relocation of the employee.

Exemption is available if:

- It is necessary for the employee to live away from home for work purposes;
- The employee returns to their usual home, having previously been relocated from that home and continues working for the same employer;
- The employee returns to their home, having previously been relocated from that home for work purposes and ceases employment; or
- In order to fulfil work duties the employee moves from his or her usual home.

Work Related Items

The following work related items provided to an employee are exempt from FBT:

- A mobile phone or car phone primarily used for work purposes;
- Protective clothing;
- Briefcase;
- Calculator;
- Tools of trade;
- Computer software used for work;
- Electronic diary or similar; and
- A notebook computer, laptop computer or similar portable computer (limited to one per year per employee).

These items have been expanded to cover:

- Personal digital assistants (PDA's); and
- Portable printers designed for use with portable computers.

Remote Area Housing

The exemption covering remote area housing provided to employees is to be expanded to cover employees in industries where employer-provided housing is not customary.

This means that all housing provided to employees in remote areas will be exempt from FBT. A remote area is a place which is 40 km or more by road from a town or city with a population of at least 14,000 and is 100 km or more from a town or city with a population with at least 130,000.

If the area is in Zone A or Zone B the population of the smaller town or city increases to 28,000.

If the employer is the police service, a charitable institution or hospital carried on by a non-profit society or association or a public hospital, eligibility is determined only in relation to the larger towns of 130,000 or more.

Other Exemptions

- Recreation and child care facilities on employer's business premises (including leased premises);
- Contributions to approved worker entitlement funds;
- Use of employer's staff amenities;
- Use of employer's equipment (excluding motor vehicles);
- Living away from home accommodation;
- Fly in/fly out arrangements when working in a re-

mote area;

- Travel cost to attend the funeral of a close relative or visit a close relative suffering from a serious illness;
- Travel costs attending employment interviews and selection tests
- Newspapers or periodicals required for work related purposes
- Long service leave awards to the value of \$500 per employee for service in excess of 15 years (to be increased to \$1,000 and an additional \$100 for each additional year of service as from 1 April 2005);
- Safety awards to a value of \$200 per employee per year;
- Food and accommodation for trainees engaged under the Australian Traineeship system;
- Staff accommodation and meals provided to live-in domestic workers employed by religious institutions or practitioners;
- Accommodation and meals for live-in help employed to care for elderly or disadvantaged people;
- Food and drink for non live-in domestic employees employed by a religious institution or a natural person;
- Unregistered motor vehicles used wholly or principally for business purposes (eg a farm vehicle);
- Benefits to employees of a public benevolent institution (limited to a grossed up taxable value of \$30,000);
- Benefits provided to employees of public hospitals or of Government operated public benevolent institutions (up to a grossed up taxable value of \$17,000);
- The first \$500 (per annum) of the value of in-house fringe benefits and airline transport benefits;
- Airport lounge memberships;
- Corporate credit card membership fees.

MATURE AGE WORKER TAX OFFSET

Isn't that a typically bureaucratic title! What it means is that a tax rebate of up to \$500 is available for people 55 or over who are employed or personally operating their own businesses.

Key features are:

- You must be 55 or over at the end of the relevant tax year;
- Your *net income* must be less than \$58,000 in 2004/05 or \$63,000 in 2005/06;
- You will receive a rebate of 5% of your *net income* up to a maximum of \$500;
- The rebate will phase out at the rate of 5% for income above \$48,000 in 2004/05 or \$53,000 in 2005/06;
- This means that in 2004/05 to get the full \$500 rebate your *net income* must be between \$10,000 and \$48,000. In 2005/06 it must be between \$10,000 and \$53,000;
- For the purpose of the rebate *net income* is defined to include:
 - ◊ Personal services income;
 - ◊ Income from a business carried on personally or in partnership;
 - ◊ Income from a company or trust that is personal services income attributed to the taxpayer;
 - ◊ Farm management withdrawals;
 - ◊ Reportable fringe benefits less related tax deductible expenses.

Eligibility for the mature age worker tax offset will be effective from 1 July 2004.

PENSIONS AND MEANS TEST

From 1 July 2005 an accommodation bond paid to an aged care facility will not be counted as an asset for means test purposes. The exemption will remain until it is refunded or when the pensioner leaves aged care. Where the bond is being paid by periodic payments the pensioner will be able to rent out his or her former home without the rental payments being caught under the means test provisions. These changes have been made as a result of promises made during the election campaign.

GST - OPERATING AN ENTERPRISE

You are required to account to the Tax Office for GST on a sale if you are registered or required to register for GST. Registration is compulsory if you are carrying on an enterprise and your annual turnover is \$50,000 or more (\$100,000 for non-profit entities). What does *carrying on an enterprise* actually mean?

An enterprise is defined in the GST Act as any activity or series of activities done:

- In the form of a business;
- In the form of an adventure or concern in the nature of trade;
- On a regular or continuous basis in the form of a lease, licence or other grant of interest in the property;
- By a trust, authority or institution which is a deductible gift recipient;
- By a complying superannuation fund;
- By a charitable institution of charitable fund;
- By a religious institution; or
- By the Commonwealth, State or Territory or a statutory body.

The definition specifically excludes activities done:

- By an employee, company director or persons employed under labour hire arrangements;
- As a private recreational pursuit or hobby;
- By an individual or partnership without a reasonable expectation of profit or gain; or
- As a member of a local Government body

The Tax Office has recently issued draft Miscellaneous Taxation Ruling MT 2004/D3 which discusses the meaning of the words *carrying on an enterprise*. According to the draft Ruling, activities done by an entity that are preliminary to an enterprise commencing and are part of a process of starting, beginning or bringing an enterprise into existence, are activities in carrying on an enterprise.

Feasibility studies and similar activities conducted by an entity before a business commences may be activities done in carrying on an enterprise. These may be considered to be commencement activities even if the eventual enterprise is different from the one originally contemplated.

Carrying on an enterprise also includes anything done in relation to the termination of the enterprise. This occurs when all activities cease. Usually this occurs when all assets are sold or converted to another purpose and all obligations or liabilities satisfied. The enterprise also terminates where outstanding obligations cannot be satisfied and other activities have ceased. A change in purpose or use of all assets could also cause termination.

CGT – 15 YEAR EXEMPTION

A full exemption from CGT applies to the disposal of business assets held continuously for 15 years. The following conditions apply:

- The taxpayer must be at least 55 years of age and intend to retire or else be incapacitated;
- The asset must be an active asset at the time of its disposal;
- The asset must have been active for at least half of the previous 15 years;
- The asset must have been held continuously for 15 years;

- If the asset is represented by company shares, trust units or other membership interests, the above rules will apply to the entity's assets;
- The net value of all assets of the taxpayer (and associated entities) must not exceed \$5 million.

The Tax Office has issued draft Taxation Determination TD 2005/D1 which provides an interesting slant on the ownership question. According to the Determination if there is a change in the majority underlying interest in an asset owned by an entity, the ownership period commences when the asset was originally acquired, not when there was a change in the majority underlying interest.

For example, a company may have acquired an asset more than 15 years ago but during that term there was a change in majority ownership of shares in that company. At all times the entity must have had a controlling individual (not necessarily the same person). The Determination states that the entity's ownership period starts when the asset was acquired (and does not restart when the shareholders change).

RECORD KEEPING

All taxpayers who carry on a business are required to keep records that record and explain all transactions which are relevant for tax purposes. These records must be kept in such a way as to enable a person's tax liability to be readily ascertained. The Tax Office has issued *Practice Statement PS LA 2005/2* in order to provide guidelines on taxpayers' record keeping obligations.

The Tax Office states that its approach to record keeping is to influence a positive change in the compliance behaviour by educating and assisting taxpayers. Main features are:

- Tax Offices will normally provide help and education as a first step to improve record keeping practices;
- Taxpayers will usually be given the opportunity to improve record keeping before any penalty is considered;
- Revisits will occur in high risk cases to ensure that the Tax Office's education approach has had a positive influence in changing record keeping behaviour;
- Where the Tax Office is satisfied that correct tax liabilities are being reported, any record keeping penalty will usually be remitted in full;
- If the records do not enable the Tax Office to verify correct reporting of tax related liabilities any record keeping penalties will not usually be remitted in full but there may be a partial remission;
- Where inadequate record keeping results in a tax shortfall a shortfall penalty will apply;
- There will be no penalty remission if the taxpayer makes no attempt to keep records or deliberately destroys its records;
- If records have been destroyed in circumstances outside the taxpayer's control this will not be regarded as a failure to comply with the record keeping provisions (however, the taxpayer must re-construct records to the best of their ability);
- Where electronic records are maintained, back-up copies must be kept or there must be some other method to enable ready re-construction;
- Only one penalty will apply if there is a failure to keep records for income tax purposes as well as for superannuation guarantee purposes.

Proposed penalties and possible remissions are set out below:

Record Keeping Behaviour	Remission Level	Penalty Amount
Genuine attempt made to improve record keeping practices	100%	Nil
Some effort made but tax liability still not readily ascertainable	75%	\$550
Very little effort made to improve record keeping practices	50%	\$1,100
No effort made to improve record keeping practices	Nil	\$2,200

NON-COMMERCIAL LOANS

Loans from Private Companies

In *Tax IQ Monthly* January-February 2005 we reported a relaxation of the rules concerning Division 7A. The changes allow a loan from a private company to a shareholder (or associate) to be repaid or put on a commercial footing before the earlier of the due date or lodgement date of the company's tax return for the year in which the loan is made in order to avoid the loan being treated as a deemed dividend.

We reported that this change will apply to loans made in the year of income commencing after the amending Bill received Royal Assent.

Following representations to the Government, the operation date has been amended and the new rules will apply to loans entered into in the 2004/05 and subsequent years.

BOUQUETS AND BRICK BATS

In his judgement in *Dean-Willcocks v. FCT* (57ATR570) Mr Justice Young of the Supreme Court of NSW had this to say:

"I should just add this. The ATO is to be commended for the humane and practical way in which the evidence in this case shows its officers deal with persons who are in difficulties. That attitude indeed probably produces more actual cash into the Treasury than any other approach. It will occur from time to time that some taxpayer will abuse that approach. It may also be that the laws respecting preferences nowadays operate unfairly against the ATO. I hope that neither of these last two points will operate to change the general attitude."

Such a comment will raise the eyebrows of many accountants and tax agents. Yes, there are some compassionate and understanding people working in the Tax Office and I guess we should not expect too much of people who have to administer such impossibly complex legislation. But are they carrying out their task in a way that supports and assists taxpayers or is the plethora of Rulings, Determinations, Interpretative Decisions, Practice Statements, Bulletins and Taxpayer Alerts making things that much more difficult? Here is a story doing the rounds:

It is a little known fact that at one time Santa considered basing himself in Australia. He was tired of the cold and snow at the North Pole and he knew from his once a year travels that Australia was one place generally devoid of both.

Upon setting up his operations he became aware that he was required to fulfil a number of taxation obligations. Being a good corporate citizen, he contacted the Tax Office. The Tax Office asked whether he was carrying on a business. When you look at his operation, all the signs indicated "yes", apart from the fact that Santa did not actually derive a profit nor receive any income.

Santa was instructed to request a "non-profit organisation" Determination. This involved the submission of a constitution outlining whether his functions were benevolent.

Santa, as a manufacturer and employer, was also required to register for a Tax File Number, an ABN, PAYG Withholding, FBT, Payroll Tax (in every State and Territory), Workers' Compensation and Superannuation Guarantee.

As Santa provided his employees (the elves) meals, accommodation and transport, he was liable for FBT. This affected his turnover under the GST Act and therefore he was required to register for GST and hence complete a BAS.

He also had to register the uniforms of the little elves in the Register of Approved Occupational Clothing and make sure he kept all of his employment records in place.

As the Tax Office doesn't provide a per kilometre rate for reindeer, Santa had to maintain records of his travel cost but as his Christmas eve journey only takes one day, a travel diary was not needed.

After working through all these issues, Santa eventually lodged his first return.

Like all taxpayers, he was subject to self assessment, but due to Santa's generosity in his dealings with the children of the world, his business return showed a loss and so he was audited under the Tax Office's compliance programme for individuals making business losses.

The first question asked was "Did the non-commercial loss provisions apply?" The answer was an emphatic Yes! Therefore, in spite of the fact that there was no net effect to the Tax Office in terms of lost revenue, Santa was failing in his reporting obligations under the self assessment provisions and risked penalties for fraudulent disclosure.

Another issue raised by the Tax Office was the milk, beer, cakes and biscuits Santa received when delivering presents. The Tax Office felt there was a barter arrangement in place requiring Santa to quantify what and how much he received and then attach a value to it that should be returned as income. His defence was that there was no barter in place, that this was purely a social or domestic arrangement he had with the children of the world.

The Tax Office decided that such a defence was clearly unsustainable. Its view was that the practice had all the hallmarks of a mass marketed tax avoidance scheme that could lead to the growth of similar unacceptable activities and a possible erosion of the national revenue system.

Santa was in a pickle. He sought professional advice and was quickly advised that it wasn't viable for him to operate his business in Australia. He had no option but to use the ultimate piece of tax planning and go "offshore". That is, return to the North Pole. There, even the Tax Office is frozen out.

So Santa's address is once again "The North Pole".

Back at the Tax Office meanwhile, the Large Business & International Audit Branch remains ever vigilant and keeps the Santa-gate file open. They are still trying to issue a draft Ruling to cover the Santa scam and the matter has been referred to Treasury with suggestions to the Treasurer that a series of potential loopholes used by such predatory non-profit institutions be closed and that further scrutiny at the time of registration be applied.

An unofficial Tax Office source commented that this case has placed an increased burden on non-profit organisations and characterised Santa as an offshore scam artist trying to make good of the Tax Office's favourable treatment of benevolent groups.

SALARY PACKAGING

As the taxation "bracket creep" inexorably creeps higher and higher, people receiving little more than average salaries are paying very high marginal tax rates.

It is helpful therefore to receive part of your salary in benefits which may not be subject to tax. This is known as salary packaging. As an employee, you sacrifice some salary in order to receive benefits such as superannuation, company car and so forth.

Some benefits provided in lieu of salary are exempt from FBT, others subject to FBT but at a concessional rate. Benefits which are exempt include:

- Taxi travel to and from work;
- Laptop computers and portable printers;
- Mobile phones used mainly for work;
- Briefcases;
- Electronic notebooks;
- PDA's
- Superannuation

(see the earlier article in this issue for more details of FBT exemptions)

Benefits which fall within the *otherwise deductible* rule will also be exempt. This rule applies where the employee receiving the benefit would have been able to claim a tax deduction for the

expense if he or she had personally paid for it. Benefits which are exempt under this rule include:

- Work related clothing;
- Work related membership fees and subscriptions;
- Home office expenses;
- Investment related expenses such as interest on a loan taken out to acquire an investment property.

There are prescribed ways of calculating FBT on provision of cars to employees. The employer has the option of calculating the FBT on the *log book method* or the *statutory method*. The private use of a motor car calculated under the *log book method* involves apportioning the cost between business and private use based on the motor vehicle usage as recorded in a log book over a 12 week period. The *statutory method* involves determining private use as a percentage of the original cost of the vehicle which will vary depending on the total number of kilometres the vehicle has been driven over a 12 month period. As the kilometres increase the percentage reduces. A vehicle which is used extensively throughout the year is subject only to a low private use calculation which results in a low FBT cost.

The employer is free to determine which method produces the lowest FBT cost.

In Taxation Ruling TR 2001/10 a *salary sacrifice arrangement* is defined as an arrangement under which an employee agrees to forego part of his or her total remuneration in return for the employer or associate providing benefits of a similar value. The main assumption made by the parties is that the employee is then taxed only on the reduced salary or wages and that the employer is liable to pay FBT, if any, on the benefits provided.

The Ruling makes the point that to be effective the arrangement must have been entered into between the employer and employee before the employee has actually earned the amount to be sacrificed. It is only in relation to future earnings that the parties can agree to a salary sacrifice arrangement.

There are two ways to negotiate and structure a salary package:

- Decide on a gross salary plus benefits. For example you might agree on a gross salary of \$50,000 plus 9% compulsory superannuation plus provision of a company car; or
- A total salary package expressed as the total cost to the employer. For instance, an employer may agree on a total package of \$100,000 and the employee can select preferred benefits and cash salary. Any FBT costs to the employer are factored into the package. An example might be that there is an agreement to a package of \$80,000 and the employee elects to take this as:

Cash Salary before tax	\$61,100
Superannuation @ 9%	\$5,500
Company car lease payments	\$7,000
Company car running expenses	\$3,000
Company car FBT cost	\$3,400
Total Package	\$80,000

Limitations

What percentage of salary can be sacrificed? There are no provisions in the Income Tax Act or the FBT legislation restricting the amount of salary which can be sacrificed. It is therefore possible for an employee to have a salary package which involves sacrificing the entire salary and receiving benefits such as superannuation, motor cars, etc in lieu.

However, care should be taken in relation to employees covered by Awards.

If the relevant Industrial Award for an employee provided that he should receive a salary of \$30,000 and entered into a salary sacrifice agreement which involved a reduction of the cash salary to

\$25,000 this would be effective for tax purposes. However, the employee is receiving a below Award cash salary and the employer could be called upon to increase the cash salary to the Award minimum.

Novated Leases

Where a company car is provided to an employee there are a number of possible dissatisfactions:

- The employee may not be happy with the type of car provided;
- When the employee leaves he will lose the car;
- If the employee is not replaced the company will have to dispose of the now unwanted car.

These dissatisfactions can be overcome by using a novated lease. This is an agreement between three parties – the employee, the employer and the leasing company.

Features are:

- The employee chooses a car and leases it through a finance company.
- The employee, the employer and the finance company enter into a novation agreement at the same time. This agreement transfers the rights and obligations under the lease to the employer, but only whilst the employee continues working for the employer.
- On termination of employment all rights and obligations under the lease revert to the employee.
- The employee must meet the residual value obligations on termination of the lease. This means that the lease does not have to be disclosed in the employer's balance sheet.
- The employee salary packages the leasing and running costs and associated FBT;
- On termination the employee simply takes the car and takes over responsibility for meeting future lease payments and residual.

Living Away From Home Allowance

FBT concessions are available where an employee must live away from his or her usual home for work purposes.

An allowance can be paid to cover both accommodation and amounts necessary to compensate the employee for increased expenditure on food. To work out the amount of additional food costs, an amount of \$42 per week for each adult in the family and \$21 per week for each child under 12 is called the *statutory food amount* which is the amount provided for the cost of food had the employee been living at home. For expatriate employees living in Australia the Tax Office has determined the following amounts as being reasonable food components for the FBT year commencing 1 April 2004:

Family Size	Per Week
1 Adult	\$176
2 Adults	\$282
3 Adults	\$318
2 Adults and 1 Child	\$318
2 Adults and 2 Children	\$318
2 Adults and 3 Children	\$370
3 Adults and 1 Child	\$423
3 Adults and 2 Children	\$423
4 Adults	\$423

If the reasonable food component amount is paid to the employee as an allowance the employer would be required to pay FBT on the *statutory food amounts* described above.

Additionally, the employer can pay accommodation costs which would not be subject to FBT.

The employer must obtain a living away from home allowance declaration in the approved form from the employee. This sets out the usual place of residence, the nature of that residence and where the employee actually lived during the relevant period.

SELF ASSESSMENT REVIEW

A reader comments on our article in *Tax IQ Monthly* January--February 2004.

I read the Tax IQ Monthly with interest.

Something that has irked me since its release is the self assessment review. Not the review or the recommendations, but its implementation. Why should taxpayers who acted on long standing Tax Office practice or interpretation in the past be penalised when the Tax Office changes its mind but those that act in the future (ie after Royal Assent or 1 July 2005) will not? Surely if it is unfair, immoral, etc, in the future it was the same in the past and there is no doubt that it is unfair and immoral!

The only answer to the prospective application is money: immorally and unfairly gained. As stated by Don Randall in Parliament on 10 February:

"The legislation gives effect to the Treasury's recommendations and will exclude the very people whose plight precipitated the dispute in the first place. What are we telling these taxpayers? 'Yes, you're right; you shouldn't be treated that way. Yes, we're going to prohibit' – not request 'the Tax Office from doing it again, but we are not going to stop them from abusing and penalising you, so bad luck!'"

It is worth reading his full speech. He hits the nail on the head. The recommendations, etc should be applied retrospectively!

Further, more as a comment, it beats me why you need a review like this to tell the Tax Office it has acted dishonestly, immorally and unfairly; any normal person would have recognised this fact in the first place and not acted so.

READER QUESTIONS:

INCOME PROTECTION INSURANCE

Question:

Are you able to tell me when it is applicable for income protection insurance to be a tax deduction? Is it available if you are on PAYG?

Answer:

Both self employed persons and employees can claim deductions for insurance premiums paid for benefits arising from sickness or accident provided the benefits are payable in the nature of income – that is by regular amounts and not by capital sum. If you make a claim on the policy, the benefits are fully taxable.

LAND TAX

Question:

A client of mine has, for many years, held a property that has always been used as a personal holiday house. The property has been subject to land tax which has been capitalised into the cost base of the property for CGT purposes. From 1 April the client intends to rent this property to a third party tenant at commercial rates.

Land tax is determined at midnight on 31 December for the ensuing 12 months, with an assessment usually sent in April/May.

In the current financial year, what proportion of land tax would be income tax deductible to the client?

Answer:

Where an expense is paid partly for private purposes and partly for business purposes the amount must be apportioned. Accordingly, as the land tax assessment which will be received in April/May will be for the 12 months' period from 1 January, it will be necessary to limit the claim to 8/12ths of the total, ie to cover the period from

1 April to 31 December. The amount of land tax which cannot be claimed can be added to the cost base for CGT purposes.

CGT ASSET ROLLOVERS

Question:

Does CGT apply when selling a residential investment property (a house) and purchasing a replacement commercial factory unit?

Would this be classed as selling a business to buy another business?

The property in question is in a unit trust, the sole beneficiary of which is a self managed super fund. The family qualifies as a small business operator.

We are subscribers and have not found an answer to this one to date. We would appreciate your comments.

Answer:

The small business rollover you are enquiring about is limited to active assets. An active asset is an asset used in carrying on a business which could include land and buildings. However, under Section 152-40 an asset is not considered to be an asset if it is used mainly to derive interest, rent, royalties, etc.

The capital gain on the sale of the rented house cannot therefore be rolled over because it is not an active asset.

The unit trust will distribute the gain to its beneficiary, the self managed super fund. If the unit trust has held the property for at least 12 months, the super fund can claim the CGT discount of one-third. This will effectively reduce the tax rate on the capital gain to 10%.

CHILD CARE REBATE

Question:

Hello – I just received the January/February issue of *Tax IQ Monthly* and I wanted some confirmation regarding the child care rebate issue. It states that it has been backdated to July 2004 but that the first return is 2005/06. If it has been backdated to July 2004 shouldn't we be able to claim the rebate in the 2004/05 year?

It also states that a refund cheque will not be issued. Does this mean that I should reduce the amount of tax I am paying between now and 30 June to ensure that in fact I receive the refund?

Answer:

Details are rather sketchy at the moment. In December the Commonwealth Treasurer issued a press release and announced that during early 2005 the Tax Office, Centrelink and the Department of Family & Community Services would work together with approved child care providers to develop a package of information to help families claim the rebate.

The rebate will be 30% of fees paid for approved care less the child care benefit (CCB).

Centrelink calculates the correct entitlement to CCB annually after receipt of child care usage data and taxable income details when relevant returns have been lodged. This occurs usually by November.

Hence for the 2004/05 year the correct claim can only be calculated when the CCB reconciliation is completed. The 2004/05 rebate is then claimed in the following year's return.

The Treasurer said that because of the year's delay, the start date for eligibility was brought forward from 1 January 2005 to 1 July 2004.

The Government will encourage child care providers to provide an annual statement of child care expenses paid but in the meantime you should ensure that you retain all receipts for payments so that you can make the claim in your 2005/06 tax return.

A typical example of Government sleight of hand – while giving itself kudos for backdating the rebate by six months it has effectively delayed any tax credits by twelve months!

BOAT CHARTERS

Question:

I have a question regarding boat charter. We are considering purchasing a boat and would like to know the tax advantages of owning a charter boat and the best options for purchasing. We will also use it for private use occasionally. We would like to reduce our CGT which will be very high this year and future years. We live in the Whitsundays and a boat would be perfect.

Answer:

Some years ago in what was the virtual death knell to the Australian boat manufacturing and charter industry, the Tax Office issued a draft Ruling denying tax deductions for most boat owners who placed their boats on charter.

Eight months later, after considerable damage had been done to the industry, the Tax Office backtracked and issued a final Ruling allowing tax deductions to boat owners and providing guidelines to enable them to show that they are, in a practical sense, operating businesses.

The Ruling is *Taxation Ruling TR 2003/04* and you can obtain a copy of this Ruling by visiting the Tax Office legal database website at www.law.ato.gov.au/atolaw/index.htm click Public Rulings, Determinations and Bulletins, then go to Public Rulings, then Taxation, then 2003, then click TR 2003/04-Income Tax: Boat Hire Arrangements.

Essentially you have to show that you are operating a business, not just passively leasing the boat.

Where you receive money from hiring out your boat directly, or under a management agreement with a charter operator, you must still show that the activity amounts to the carrying on of a business.

The arrangement between yourself and the charter operator should be a management agreement showing that:

- The charter operator is acting as your agent;
- You are personally deriving the income and incurring the expenses relating to the chartering;
- You must maintain sufficient control of the operation of the boat.

Indicators which determine whether you are carrying on a business are:

- There is a significant commercial purpose or character in the activity;
- There is prospect of making a profit;
- The activities are of a kind carried on in a similar manner to those ordinary carrying on this operation;
- The activities are carried on in an organised, systematic and businesslike manner;
- There is repetition and regularity in the activity; and
- There is reasonable size and scale of the activities.

For occasional private use you will be required to apportion the expenses on the following basis:

- Expenses directly attributable to your private use cannot be claimed, eg fuel and catering;
- Variable expenses such as general maintenance should be apportioned according to the private use percentage compared with business use;
- Fixed expenses such as leasing costs, interest and depreciation should be apportioned based on period of time used privately as opposed to business use.

It will be important for you to register for GST so that you can claim an input tax credit for GST included in the purchase cost or leasing costs for the boat and all other expenses. You will, of course, have to account for GST on income earned.

PRE-PAYMENTS

Question:

Due to a CGT liability we wish to pre-pay some interest to increase the loss on our farm.

We have a \$400,000 fixed interest only loan with interest taken out of a savings account. The bank tells me we cannot pre-pay interest on this type of account. If we start a new account and put the exact dollar amount of the three months' interest in this new account before 30 June 2005 (for July, August and September 2005) and the payment for these three months are taken from this new account, does this constitute pre-paid interest?

Can loss making entities make pre-payments?

Answer:

Loss making entities can certainly make pre-payments provided they have elected to be STS taxpayers.

The opening of a separate account and pre-paying the interest into that separate account will not constitute a pre-payment for tax purposes. You are simply transferring the money from one account to another. To be deductible the interest must be actually paid to the bank.

Perhaps you should look at other types of pre-payments or purchase of consumables prior to the end of the financial year.

Tax IQ Monthly June 2004 issue provides a number of year end tax planning tips which might assist you in your tax planning efforts. Our upcoming *Tax IQ Monthly* for May or June this year will provide more information.

INTEREST DEDUCTIONS

Question:

We have a \$200,000 variable loan in joint names for an investment property. This loan was in place first. We have a joint offset account against this loan. We paid \$110,000 into this offset account in June 2004. We then took the \$110,000 back out and purchased shares in wife's name. For purposes of completing tax returns is the interest on this \$110,000 deductible against the rental property or against the dividends in my wife's name or do we have a choice of what we claim it against. If it's deductible against the dividends, does it matter that the loan is in joint names and the dividend and receipts are in wife's name only.

Answer:

Your borrowing in the first place was for an investment property in your joint names.

You temporarily placed \$110,000 in the offset account and gained the benefit of reduced interest for a period then you took it out again.

Your original \$200,000 loan therefore remains in place and the full interest on that loan can be claimed jointly against the income from the investment property.

The shares in your wife's name have been purchased with the \$110,000 which you temporarily placed in the offset account. You do not have a loan against those shares and should not therefore claim any part of the interest in your wife's name.

CGT—SMALL BUSINESS ROLLOVER

Question:

My wife and I are joint owners of a property bought six years ago which we have been renting to a business run by a partnership consisting of myself and my wife and my daughter and son-in-law.

The business partnership has now purchased a larger warehouse and my wife and I intend to sell the old property.

As joint part owners of the new property are we entitled to rollover relief for CGT purposes as we will be investing all the proceeds of the sale in our new building.

Answer:

An *active asset* is an asset that is used either by the taxpayer, their small business CGT affiliate or an entity connected with the taxpayer in carrying on a business. This includes land and buildings. Your existing building is therefore an *active asset*. The four way partnership intends to purchase the new building to be used in the business. You and your wife will be acquiring a one-half share in the new building.

This means that you and your wife are selling an active asset and purchasing a 50% interest in a new active asset. Small business rollover relief will be available in respect of the 50% share in the new building provided you qualify as small business operators. That is, the assets of the entire family less liabilities relating to those assets must be less than \$5 million.

The effect of this is that the capital gain on the sale of the existing building can be applied against the purchase cost of your 50% share in the new building. If the 50% share is greater than the capital gain on the sale of the old building, no CGT will be payable and your cost base will be reduced by the amount of the capital gain.

If the purchase costs of the 50% share is less than the capital gain on the sale of the old building, you will pay CGT on the difference (less the 50% discount).

GST – SALE OF BUSINESS PROPERTY

Question:

Referring to the proposed sale of a business property by husband and wife and purchase of a new business property by a four-way partnership (see above), my wife and I are not GST registered but the four-way partnership running the business is registered for GST.

What are the GST implications for my wife and I on sale of the old property?

Answer:

None. Entities are not grouped together for GST purposes unless you so elect. Presuming the rent you receive from the four-way partnership does not exceed \$50,000 per annum you are not required to register for GST.

The sale of the property will not cause you to be required to register and (provided your rental income did not exceed \$50,000 per annum) you can safely dispose of the property without being concerned about GST.

You should look carefully at the GST implications of the property being purchased by the four-way partnership. Is the vendor intending to charge GST? If so, make sure you obtain a tax invoice so that you can claim an input tax credit.

Perhaps the vendor is intending to apply the margin scheme? This would mean that a lower amount of GST may be payable by the vendor but this would be a disadvantage to you as you cannot claim an input tax credit if the vendor has applied the margin scheme.

TAX CALCULATIONS

Question:

My husband took a redundancy package last September making his gross earnings from that employer \$76,000. Tax has been deducted from that amount. He also has \$14,000 in bank interest earnings.

Since then he has been working for another company and has salary sacrificed all of his earnings so far.

How much tax is payable on the \$14,000 interest? What tax would be payable if he earned \$10,000 in wages (not salary sacrificed) before 30 June 2005.

Answer:

It is somewhat difficult to give you a complete answer without knowing more information about the redundancy package and other earnings making up the total of \$76,000.

Assuming no part of that amount was a bona fide redundancy payment (which is exempt from tax) we would suggest that because of those earnings the bank interest earnings plus any additional income will be taxed at the maximum rate of 48.5% (including Medicare levy).

Hence the \$14,000 interest earnings will cost \$6,790 in tax whilst an additional \$10,000 salary will cost another \$4,850.

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