

WORK RELATED EXPENSES

We're now into a new financial year and you will be thinking about completing your tax returns for the year just ended. At this time the Tax Office usually issues warnings about claiming work related deductions.

Last year more than 6 million taxpayers claimed deductions for work related expenses totalling about \$9 billion. Around 250,000 taxpayers were contacted about their work related claims.

If you are claiming high work related deductions there is a reasonable chance that you will be contacted and asked for explanations or evidence to support the claims.

The Tax Office has said that it will review claims for motor vehicle, self-education, home office and travel expenses.

The National Tax and Accountants Association (NTAA) warns that the Tax Office intends to closely review returns of:

- Accountant's and financial planners in relation to high home office claims;
- Truck drivers and couriers for possible over claiming meal expenses;
- Real estate agents on fixed salaries wrongly claiming deductions for referral expenses

DATA MATCHING PROJECTS

Centrelink

Watch out, Centrelink is chasing your tax refund!

Centrelink has completed a data matching process with the Tax Office. It is looking to identify those Centrelink recipients who have to repay overpaid benefits and are entitled to a tax refund.

When this occurs Centrelink can serve a notice on the Tax Office and thereby grab the tax refund.

Real Estate

The Tax Office will collect business names, addresses and details of property title transfers from the following State and Territory authorities:

- NSW Office of State Revenue;
- Queensland Office of State Revenue;
- Queensland Department of Natural Resources and Mines;
- Tasmanian State Revenue Office;
- Tasmanian Department of Treasury and Finance;
- South Australia Revenue Office;
- WA Office of State Revenue;
- WA Department of Land Information

The information will be matched with Tax Office data with a view to identifying non-compliance with CGT, income tax and GST obligations.

If you have sold property in recent years and have not accounted for any capital gain or GST requirements you should make arrangements to get your income tax return or BAS amended. If you do this quickly and voluntarily, you will still have to pay interest on any late payments of tax but should be able to avoid penalties.

Adult Services

The Tax Office also plans to collect names and addresses of the providers of adult services from all of the various State licensing authorities involved in gaming, liquor, prostitution and other adult services. Information will also be collected from the Yellow Pages and Telstra which will be matched with Tax Office data to identify non-compliance with registration, lodgement and payment obligations under taxation law.

Some 30,000 entities which are registered with State, Territory and Local Government authorities will be matched.

SUPERANNUATION – CHOICE OF FUND

The new regime has arrived. Eligible employees have the ability to choose which superannuation fund should receive their contributions. People eligible are those currently receiving superannuation benefits except:

- Those receiving superannuation benefits under a State award or State agreement;
- Those receiving superannuation benefits under an AWA or certified agreement;
- Those who are members of a defined benefit fund.

We discussed this subject at length in *Tax IQ Monthly* June 2005 (page 9). If you have any further questions you can contact the Super Choice Infoline on 13 28 64.

There are heavy penalties for failing to comply, however the *Australian Financial Review* reports that the Tax Office will allow a 12 month grace period. During this time it would monitor the implementation very closely. During the first 12 months it will provide an education approach to those employers who make a genuine effort to meet choice obligations.

From 1 July next year you can expect the full force of the law on you if you are not complying with requirements.

OUR VIEW

At the start of another year, we publish updated figures for Medicare levies, superannuation contributions, RBL's, redundancies etc.

As is usual at this time of the year, warnings are issued about the perils of overclaiming work related expenses and getting caught for failing to declare income from property sales.

Data matching projects conducted electronically are in full swing with three new projects announced since our last issue.

Don't forget to advise employees about their right to choose their Super Fund. As an employer, you should have received a booklet and the necessary forms from the Tax Office. If not, ring the Super Choice Hotline 13 28 64 soon.

Most State budgets were handed down in May. We publish brief details in this issue. All States, except NSW, have finally bowed to Federal demands to get rid of a number of business taxes. These will be progressively abolished during the next five years.

Read our article on *Debt or Equity?* carefully. This new regime came into force on 1 July 2005 and will apply to your business entities unless you come within the exemption thresholds.

Many large professional firms are undergoing scrutiny by the Tax Office. They have established service entities and pay service fees to help distribute income to family members, as well as to provide asset protection. These arrangements are being examined and, in some cases, service fees are being disallowed as excessive or not commercially based.

This month we answer a record number of reader queries. Unfortunately, space limitations meant that some had to be held over until next month. Do try to keep your questions short and to the point.

Tony Lovett

CONTENTS

Work Related Expenses	1
Data Matching Projects	1
Superannuation—Choice of Fund	1
Partners' Salaries	2
Medicare Levy	2
CGT—Improvements	2
NSW—2005/06 Budget	2
WA—2005/06 Budget	2
SA—2005/06 Budget	3
QLD—2005/06 Budget	3
Debt or Equity?	3
General Interest Charge	3
Director's Liabilities	3
Super Fund Audits	4
Superannuation Contributions	4
Superannuation—	
Reasonable Benefit Limits (RBL)	4
Bona Fide Redundancy Payments	4
Superannuation Surcharge	4
Superannuation Guarantee	4
Retiring Allowances	5
Benchmark Interest Rates	5
Super Fund Assets	5
GST Refunds—Tax Office Criticised	5
READER QUESTIONS	
Luxury Car—GST and Interest	5
Motor Vehicle Expenses	6
Super Co-Contribution	6
GST—Artworks	6
Mains Electricity Connection	6
Trading Stock—Practice Statements	6
Foreign Earnings	6
Foreign Investment Earnings	7
GST—Travel Reimbursements	7
GST—Margin Scheme	7
CGT—Business Sale	7
Salary Sacrifice	7
Travelling Expenses	7
Dental Treatments	7
Super Co-Contributions	8
Tax Related Expenses	8
FBT—Deemed Interest Rate	8
GST—Prize Money	8
CGT—Main Residence Exemption	8
Stock on Hand	8
CGT—Vacant Land	8
CGT—Sale of Business Interest	8
Disclaimer	8

It is important that you do not advise employees as to which superannuation fund they should join. This represents investment advice which can only be done by licensed financial advisors.

Employees making decisions for themselves may wish to investigate industry super funds which are currently running a promotional programme. They pay higher benefits because of their low fees and ability to return all profits to members every year. Industry super funds are those which were set up, usually in partnership between Unions and employer bodies. They have a good track record and do not pay commissions – hence their low fees.

PARTNERS' SALARIES

Quite frequently partnership arrangements include the payment of a salary to one or more partners.

An old Ruling (IT 2218) concerning taxation position of partners' salaries was withdrawn in May 2002 because of different interpretations of a particular paragraph of that Ruling. It has taken three years for a replacement Ruling to issue. Taxation Ruling TR 2005/7 was released on 25 May 2005. This Ruling defines *partnership salary* as any additional remuneration paid to a partner as agreed where this remuneration is paid before the remaining part is divided in appropriate proportions.

The Tax Office has ruled that a partnership salary is not a true salary but is an additional distribution of partnership profits. This is so whether or not it is for actual work done by the partner. Hence, the payment of a partnership salary cannot cause or increase a partnership loss.

If a partnership salary exceeds the net income of the partnership the excess is not taxable income to the partner in that year. It is carried forward and assessed in a later year when there are sufficient profits in the partnership to cover the excess. To be effective, an agreement to pay a partnership salary must be entered into before the end of the income year.

MEDICARE LEVY

The Medicare levy is charged at the rate of 1.5% of your taxable income. If your income is below the low income threshold you will be exempted from the levy. There is also a phasing in range and higher exemptions for families and for taxpayers with children. Whilst the threshold for individuals is based on individual taxable income, the higher family thresholds are based on family income.

The thresholds for 2004/05 are as follows:

Taxpayer	Threshold (no levy) \$	Phasing In Range \$	Full Levy \$
Individual	15,902	15,903-17,191	17,192
Pensioner under age pension age	19,252	19,253-20,812	20,813
Individual with spouse and no dependants	26,834	26,835-29,009	29,010
One dependant	29,298	29,299-31,673	31,674
Two dependants	31,762	31,763-34,337	34,338
Three dependants	34,226	34,227-37,001	37,002
Four dependants	36,690	36,691-39,664	39,665
Five dependants	39,154	39,155-42,328	42,329
Six dependants	41,618	41,619-44,992	44,993
Each additional child	+2,464		+2,663

CGT – IMPROVEMENTS

If you have an asset which was acquired before 19 September 1985 any gain on sale is exempt from CGT.

Any money spent on improvements to the asset will also be exempt provided it does not exceed the exemption threshold. Where the exemption threshold is exceeded the improvement will be regarded as a separate asset and, on a subsequent disposal, the proceeds will have to be apportioned between the exempt original cost and a non-exempt improvement.

The exemption threshold is indexed each year. For the 2004/05 year it amounted to \$106,882. This was increased to \$109,447 for 2005/06 (*Taxation Determination TD 2005/20*).

NSW – 2005/06 BUDGET

The NSW State Budget was handed down on 24 May 2005. Main changes are:

- The tax free threshold for land tax which was eliminated in the previous year is to be restored and will be set at \$330,000;
- The land tax rate will be \$100 plus plus 1.7% of the unimproved value of the land in excess of \$330,000;
- The controversial 2.25% vendor duty on land sales remains unchanged;
- General insurance stamp duty rate on certain policies will be increased from 5% to 9%;
- Mortgage duty exemption for re-financing will be restricted to amounts up to \$1 million.

WA – 2005/06 BUDGET

The 2006 WA Budget was handed down on 26 May 2005. Main changes are:

- Land tax thresholds for the various rates are increased as follows:
 - \$100,000 to \$130,000;
 - \$220,000 to \$290,000;
 - \$570,000 to \$750,000
- The top land tax rate will be decreased from 1.76% to 1.62%;
- There will be a 50% land tax concession for caravan parks as from 1 July 2005;
- From 1 January 2005 re-financing of mortgages by owner/occupiers and small businesses will be exempt;
- Bank account debits tax is abolished from 1 July 2005;
- The Stamp Act will be completely re-written during the 2005/06 year.

Please send your Reader Questions by fax, mail or email

Tax IQ is published by:

Media IQ Pty Limited

PO Box 9007 GCMC QLD 9726

T 07 55124100 F 07 55124101

E info@miq.com.au W www.miq.com.au

SA – 2005/06 BUDGET

The SA Budget was handed down on 26 May 2005. Main changes are:

- Tax free land tax threshold is to be increased to \$110,000 from the 2005/06 land tax year;
- Debits tax on withdrawals is to be abolished from 1 July 2005;
- Mortgage duty on loan re-financing, residential loans for owner/occupation and mortgage discharges and stamp duty on all other mortgages will be phased out between 1 July 2007 and 1 July 2009;
- The \$10 stamp duty on transactions such as deeds will be abolished from 1 July 2006;
- Rental duty will be phased out between 1 July 2007 and 1 July 2009;
- Stamp duty rates on non-realty property transfers and non-quoted marketable securities will be reduced by 50% from 1 July 2009 and abolished from 1 July 2010.

QLD – 2005/06 BUDGET

The 2005/06 Qld State Budget was handed down on 7 June 2005. The main changes are:

- The land tax free threshold for individual resident taxpayers is increased to \$450,000 whilst the threshold for companies, trustees and absentees is increased to \$300,000 from 1 July 2005.
- Land tax rates are reduced. The maximum rate payable by an individual on property valued at \$3 million or more is 1.25%. For companies, trustees and absentees on property valued at \$2 million or more, the maximum rate is 1.5%.
- Caravans or residential parks with more than 50% long term residents will be exempted from land tax.
- Land tax exemption will apply where work from home use is incidental to residential use and where there is limited letting of home.
- Debits tax is abolished from 1 July 2005.
- Stamp duty on leases and credit businesses is abolished from 1 January 2006.
- Stamp duty on hiring arrangements and non-quotable marketable securities abolished from 1 January 2007.
- Stamp duty on mortgages reduced by 50% in 2008 and abolished in 2009.
- Stamp duty on business conveyances other than real property reduced by 50% in 2010 and abolished in 2011.

DEBT OR EQUITY?

Many people lend money to their companies. These funds are used for business purposes and interest is usually not paid.

New debt/equity rules came into force from 1 July 2005. These rules define what is debt and what is equity. If funds are treated as equity, any withdrawal could be treated as a dividend and taxed unless strict procedures are followed.

Under the new provisions the essential difference between *debt* and *equity* is:

- Where a company makes payments on account of debt (other than repayments) these payments are not frankable but may be tax deductible as interest;
- Where a company makes payments in respect of equity (other than capital reductions) these payments are not tax deductible but may be frankable as dividends.

An *equity interest* is defined to include:

- Shares;
- An interest that carries a right to a variable or fixed return from the company which is dependent on profitability;
- An interest whose right to a variable or fixed return from the company is subject to the company's or associate's discretion; and
- An interest issued by the company which may convert to an equity interest or for which the holder may have a right to be issued with an equity interest.

A *debt interest* is defined as an interest in the company resulting from a financing arrangement where the company receives a financial benefit and has an effectively non-contingent obligation to the provider at least equal to the value of the financial benefit received.

A *debt interest* could include an interest free loan. However, if the loan is for more than 10 years, present value rules apply to calculate whether the repayment is "at least equal to the value of the financial benefit received."

Usually, loans by associates to companies are for an indefinite period. If the loans are for periods in excess of 10 years they may not satisfy the definition of debt interest.

An at call loan will become an *equity interest* if the right to a return, or the amount of the return is at the discretion of the company or its associate (and in most cases the associate will be the lender). It is essential therefore that, if you have made loans to your company, there should be a loan agreement in writing creating a non-contingent obligation on the company to repay the loan within 10 years and to indicate what interest rate (if any) is payable.

If you do not do this you run the risk of having the at call loan treated as equity. In this case the company must keep a *non-share capital account* which will show these amounts which are not shares but are treated as equity, under the debt/equity rules. Amounts received are credited to the account and repayments are debited. Any interest paid on such loans are not deductible but could be frankable if there are sufficient credits in the company's franking account.

There is a carve out from these onerous new rules for small businesses. Although the carve out has not yet hit the statute books, the Assistant Treasurer announced in May 2004 that where:

- The company and related entities have CGT assets with a net value that does not exceed \$5 million; and
- The deductible interest in the year in respect of the loan does not exceed \$100,000

the new debt equity rules will not apply.

Take care, if your company and all related entities have assets in excess of \$5 million or if the interest payable on the borrowings exceed \$100,000 in any year, the new rules apply and you must be sure to have documented loan agreements.

GENERAL INTEREST CHARGE

The General Interest Charge (GIC) rate for the July-September 2005 quarter is 12.68%. The rate for the June 2005 quarter was 12.63%.

DIRECTOR'S LIABILITY

This is not specifically a taxation matter but it is one which is of deep interest to all those using family trusts who operate businesses.

It is widely known that if you operate a business as a sole trader or are a member of a partnership you are personally liable for all debts incurred.

The same liability arises if you are personally a trustee of your family trust.

However, if you are a director of a company you are not liable for the company debts unless:

- you have personally guaranteed those debts, or
- are held to have been negligent in your director duties, or
- have allowed the company to carry on business whilst it is unable to pay its debts.

This understanding was thrown into some disarray by a decision of the South Australian Supreme Court in *Hanel v. O'Neill* when the court held that due to the wording in Section 197(1) of the *Corporations Act* a director of a corporate trustee company would be personally liable.

This extremely unfair and unexpected decision raised questions. Would it be followed by other courts?

This problem has been solved by the Government which will amend the *Corporations Act* to ensure that the generally accepted interpretation of the law is followed. Directors of corporate trustees will be treated in the same way as directors of trading companies.

SUPER FUND AUDITS

CPA Australia has warned that you need to be alert if you operate a self-managed super fund as you may be subject to an audit by the Tax Office.

There are currently some 300,000 self-managed super funds and these are increasing at the rate of 2,000 every month. They account for 20% of all funds under management.

CPA Australia says that the Tax Office will be looking closely at the following:

- **New Funds** – The Tax Office will aim to ensure that trustees are aware of their responsibilities and will check that the fund has been established for the sole purpose of providing retirement benefits.
- **Investments** – You should ensure that all of the rules relating to permitted investments by super funds are carefully followed.
- **Returns and Audits** – Ensure that the super fund tax returns are lodged on time and that they are properly audited.
- **Super Guarantee** – The Tax Office will be looking carefully at super guarantee obligations. Ensure your employee super contributions are paid at least quarterly and within time limits.
- **Super Surcharge** – Super fund and personal income tax returns must be lodged on time together with surcharge member contribution statements to enable the Tax Office to issue super surcharge assessments. The Tax Office will be looking at those failing to meet deadlines.

SUPERANNUATION CONTRIBUTIONS

Employees can claim tax deductions for contributions to complying superannuation funds for the benefit of employees. The contributions have specified age-based limits which are increased annually. The limits for 2004/05 and 2005/06 are:

Employee's Age	Maximum Contribution	
	2004/05	2005/06
Under 35	\$13,934	\$14,603
35-49	\$38,702	\$40,560
50-70	\$95,980	\$100,587

Self-employed persons may claim the first \$5,000 and 75% of the remaining contribution up to the age based limits.

If you are a self-employed person making contributions to a superannuation fund you must give the fund a written notice that you intend to claim a deduction.

SUPERANNUATION – REASONABLE BENEFIT LIMITS (RBL)

On retirement you can take your superannuation benefit either as a lump sum (known as an *Eligible Termination Payment (ETP)*) or as an income stream (pension or annuity). You can also take a combination of both.

The lump sum or pension will be taxed at concessional rates if it does not exceed your RBL. Any excess over your RBL is taxed at your full marginal rate. The higher pension RBL applies only if you take what is called a complying pension.

RBL's are indexed annually. The amounts are:

Year	Lump Sum	Pension
2004/05	\$619,223	\$1,238,440
2005/06	\$648,946	\$1,297,886

If you are aged 55 or over and receive a lump sum benefit from a superannuation fund which has already paid tax on its contributions and earnings, there is a threshold figure. Benefits up to that threshold will be free of further tax. The thresholds are:

2004/05	\$123,808
2005/06	\$129,751

Lump sum benefits above the threshold but below the RBL are taxed at 15%.

BONA FIDE REDUNDANCY PAYMENTS

If an employee is dismissed due to a bona fide redundancy or retires under an approved early retirement scheme, redundancy payments up to certain limits are exempt from tax.

The limits are indexed annually. For 2004/05 the limits were \$6,194 plus \$3,097 for each completed year of service.

For 2005/06 the limits have been increased to \$6,491 plus \$3,246 for each completed year of service.

SUPERANNUATION SURCHARGE

If you are a member of a superannuation fund and your adjusted taxable income exceeds the threshold figure, your fund has had to pay a further tax which is called superannuation surcharge. The threshold figure for 2004/05 was \$99,710. This has been increased to \$104,496 for 2005/06.

The Government had intended to charge a maximum of 10% on contributions for 2005/06 reducing to 7.5% in 2006/07.

However, the Government has introduced a Bill to abolish superannuation surcharge and termination payment surcharge as from 1 July 2005. Happily this will be the end of this inequitable tax.

SUPERANNUATION GUARANTEE

If you are an employer you must pay a minimum level of superannuation for your employees. The amount payable is calculated at 9% of your employee's ordinary time earnings up to the maximum contribution base. You do not have to pay superannuation guarantee on earnings above the maximum contribution base.

This was fixed at \$32,180 per quarter (\$128,720 per annum) for 2004/05 and has been increased to \$33,720 per quarter (\$134,880 per annum) for 2005/06.

RETIRING ALLOWANCES

John Day, writing in *ATP Weekly Tax Bulletin* reminds us of a tax planning opportunity arising following the abolition of super surcharge and pending retirement of an employee.

Under Section 25-50 of the 1997 Tax Act you can claim a deduction for amounts paid as a pension, gratuity or retiring allowance to an employee or dependant provided the payment does not create or increase a loss.

The recipient is taxed at concessional rates. If under 55 the rate, including Medicare levy, is 31.5% while if 55 or over the rate is 16.5% on the allowance received up to \$129,751. Above that the rate is 31.5%. Section 109 of the 1936 Tax Act requires the Commissioner to be satisfied that the amount is reasonable. In determining an appropriate to be paid as a retiring allowance, the following factors should be taken into account:

- Term of employment;
- Length of service;
- Level of remuneration;
- Other benefits;
- Commercial practice;
- Value of services provided.

If the recipient has a debit loan account balance causing Division 7A difficulties, the retiring allowance can be used to repay the loans.

BENCHMARK INTEREST RATES

Under Division 7A of the 1936 Tax Act most loans by companies to shareholders or associates must be made under a written loan agreement and be subject to interest and minimum principal repayments.

If these conditions are not met, the loan is assessed to the shareholder as a deemed dividend.

The benchmark interest rate for the 2005/06 income year is 7.3%. The rate for 2004/05 is 7.05%.

SUPER FUND ASSETS

Tax Commissioner, Michael Carmody, has warned that trustees of self managed super funds are obliged to ensure that the assets of the fund are held in a legally recognised ownership arrangement. This means that the assets must be held in the name of the trustees on behalf of the fund.

In some States this is not possible. For instance, in NSW real property must be registered in the name of the trustee.

In such cases the Tax Office considers that a caveat, instrument or declaration of trust must be executed over the asset.

The Tax Office has warned that there have been instances where super fund's assets have been seized in debt proceedings because they were not clearly identified as belonging to the fund.

The Tax Office considers that the holding of an asset in the name of the trustee (whether it be a company or individuals) is not sufficient. Ownership documents must clearly state that the trustee holds the asset as trustee for the relevant superannuation fund.

GST REFUNDS – TAX OFFICE CRITICISED

The Inspector General of Taxation has issued a report criticising the Tax Office for delays in providing GST refunds.

Many businesses, particularly those who pay GST on inputs and provide GST free supplies, are entitled to substantial refunds following lodgement of their BAS.

Abattoirs, for instance, have to pay GST on all livestock purchased. This represents a substantial cash outflow and can cause significant cash flow problems. However, supplies of meat are GST free and they therefore cannot collect the GST paid on purchases until they lodge their BAS to receive a refund.

The Tax Office is delaying issuing these refunds for checking purposes. According to the Inspector General these delays have been for up to three months or longer and, in some cases, for more than six months.

Industries facing repeated delays include property, exporters, food suppliers and health services.

The refunds stopped for manual checking involved a massive \$20 billion – some 90% of the total value of GST refunds claimed.

In some cases there were significant delays before taxpayers were notified. Around 20,000 taxpayers had four successive BAS's stopped before refunds were released.

Taxation Commissioner, Michael Carmody, responded to this critical report saying that the Tax Office "had implemented a range of different criteria to its refund checking procedures to ensure that refunds were stopped based on risk criteria rather than size loan."

He estimates that refunds stopped during 2004/05 would amount to \$11 billion compared with \$20 billion in 2003/04.

READER QUESTIONS:

LUXURY CAR – GST AND INTEREST

Question:

I am trying to work out the interest schedule on a luxury car purchased under hire purchase. I am claiming GST on each monthly payment being the luxury car limit divided by the number of payments. Is this correct?

To work out the interest schedule, do I deduct the monthly GST from the monthly payment?

Can I claim the full interest on the hire purchase or only up to the luxury car limit?

Answer:

It seems you are lodging your BAS on a cash basis. You can only claim an input tax credit on your monthly payments up to the appropriate portion of the luxury car limit. The limit is \$57,009 and the maximum input tax credit is one-eleventh of that figure or \$5,182.64.

Your quarterly claim for input tax credit should be calculated on an actuarial basis. If you don't have the necessary software available, perhaps the finance company can assist. Failing that, you could get a roughly correct figure by dividing the total input tax credit of \$5,182 by the number of payments.

Whilst your depreciation claim is based on the luxury car limit less the input tax credit, you can claim the full interest as set out in the hire purchaser agreement. This claim has to be apportioned over the term of the agreement and again should be calculated on an actuarial basis.

MOTOR VEHICLE EXPENSES

Question:

I am a sole trader with one vehicle for work and private use. I travel approximately 32,000 km per year of which 26,000 km is business. The vehicle is registered and insured as a business vehicle. Reading your article in *Tax IQ Monthly* May issue on company vehicles, would the statutory percentage apply in my case or do I still have to use the log book method?

Answer:

You cannot use the statutory method as this is only available to employers under the FBT legislation. As a sole trader you have to use the substantiation rules.

The only methods available to you are the log book method, or alternatively you claim 12% of the market value of the car. Finally, if you don't have records you could claim one-third of total car expenses. Clearly the log book method is best for you. You need only keep a log book for 12 weeks and this will do for a five year period unless your business usage changes significantly.

SUPER CO-CONTRIBUTION

Question:

My proposal is to employ my children (aged 9, 13, 14 and 16) in my own business on a once off basis, pay them \$400 each, get a TFN for each of them, complete a TFN declaration and provide them with PAYG payment summaries and submit tax returns. If they also put personal contributions of \$1,000 each into a super fund would they be eligible for the \$1,500 Government co-contribution?

Is there a work test or are they required to work a certain number of hours in the year?

Answer:

There is no work test but 10% or more of the person's total income must be attributable to eligible employment. However, super contributions made by children under 18 are not eligible for the Government co-contributions.

GST – ARTWORKS

Question:

We have sold several paintings through an art gallery and we are GST registered. A price is agreed on and the painting is then sold for 104% of that amount which represents 60% for us and 44% for the gallery, made up of 40% commission plus GST. The gallery insists that the 60% due to us cannot go through their books and they just merely send us the money for us to sort out the paperwork. This does not seem correct. Could you comment?

Answer:

You raise some interesting questions. First we have to be clear about whether you have made a taxable supply.

To make a taxable supply you have to meet five conditions:

- You make a supply for a consideration;
- The supply is made in the course or furtherance of an enterprise that you carry on;
- The supply is connected with Australia;
- The supplier is registered or required to be registered for GST;
- The supply is not GST free or input taxed.

You clearly meet all of the conditions except probably the second. Are you supplying the artworks as part of a business operation? Are these business assets which you are selling? If not, then so far as you're concerned you are not making a taxable supply and it is in order for you to receive the proceeds less 40% commission without having to account for GST.

However, if you are making a sale which is connected with your business then you must account for GST. If you don't collect it from the purchaser you must still include the sale in your BAS and account for one-eleventh of the full sale price to the customer. You can then claim an input tax credit for the GST on the commission paid to the art gallery.

MAINS ELECTRICITY CONNECTION

Question:

The power supply company condemned a private power pole supplying power to a rental property. To avoid disconnection the landlord replaced the power pole and had a portion of the power line installed underground. Some minor additions of weatherproof security light and power point were added at the same time.

- Which of the following is applicable?
- Claim in full as repairs and maintenance?
- Claim on the basis of the 10 year write off for mains electricity connection?
- Apply the STS depreciation rates – general or long life?
- Claim the capital works allowance of 2.5%?

Answer:

As the work involves an improvement on the original supply the expense cannot be claimed as a repair.

The 10 year write off for mains electricity connection is available in respect of electricity connected to land on which a business is carried on. If the rental premises are business premises you can claim under this heading.

In the event that the premises are not business premises, the items referred to come within the definition of plant and are therefore depreciable. As the effective life of the overhead and underground equipment is more than 25 years you would need to include the cost in the long life STS pool and claim depreciation at 2.5% in the first year and 5% thereafter.

TRADING STOCK – PRACTICE STATEMENTS

Question:

In *Tax IQ Monthly* December 2004 issue you stated that a tax barrister, Mr Terry Murphy, disagreed with the Tax Office's view on the valuation of trading stock on hand for wholesalers/retailers as outlined in PSLA 2003/13. Mr Murphy's view is that the cost of trading stock to a wholesaler or retailer is limited to those costs which relate to the acquisition of the stock. Is there going to be a challenge to PSLA 2003/13 based on Mr Murphy's view?

Answer:

Law Administration Practice Statements (PSLA's) are a rather clever move by the Tax Office. They are administrative documents, not binding on taxpayers. However, they are binding on tax officers who risk disciplinary action if they go against them.

As they are not binding on taxpayers they cannot be challenged. Of course, taxpayers well know that if they do not abide by Practice Statements they risk disallowance of claims and imposition of penalties.

Hopefully this problem will be thrashed out in discussions between the relevant professions and the Tax Office before the extended start date. Keep in mind the \$10 million threshold as the stringent requirements of PSLA 2003/13 are only meant to apply to very large businesses.

FOREIGN EARNINGS

Question:

If an entertainer performs overseas, for a period longer than three months, and all remuneration is paid under a contract with a foreign company, what is the tax effect of these payments? How best can taxation be kept to a minimum?

Answer:

Under Section 23AG of the 1936 Tax Act foreign earnings from at least 91 days continuous employment in a foreign country will generally be exempt, however this relates only to earnings as an employee. Independent personal services are not covered. Foreign earnings by an Australian resident taxpayer are fully taxable in Australia although a credit is granted for any foreign tax paid or deducted.

The entertainer should maintain full records and documentation in respect of all expenses including travel, accommodation, etc as these can be claimed. Australian tax on entertainers' foreign earnings is quite draconian and many high earning entertainers have elected to reside overseas in order to overcome this problem.

FOREIGN INVESTMENT EARNINGS

Question:

I am considering investing in an overseas scheme that returns interest only on an ongoing plan. There is no capital return as the capital invested is lost.

Answer:

More information is needed to respond adequately. Australian residents are fully taxable on foreign investment income earned. Perhaps the payments you receive may be partly applicable to a return of capital. If this is the case the proportion representing the capital return would not be taxable.

GST – TRAVEL REIMBURSEMENTS

Question:

I invoice clients for motor vehicle travel expenses on a cents per kilometre basis. I am GST registered, should I add GST to the standard rates?

Answer:

Yes.

GST – MARGIN SCHEME

Question:

A property developer purchased two properties adjacent to each other. One was purchased prior to 1 July 2000 and the other afterwards. The second property was purchased on a GST free basis as it was a residential home.

The developer has amalgamated the two properties and developed them into residential apartments. He wishes to use the margin scheme. Can he use the valuation method or must he use the consideration method due to the fact that one of the properties was purchased after 1 July 2000?

If the valuation method can be used, can this be used for the whole of the amalgamated lot?

Answer:

You cannot use the valuation method in respect of the land acquired after 1 July 2000.

You can use either the original cost price or the valuation method for the land acquired prior to 1 July 2000, add this figure to the purchase price of the land acquired after 1 July 2000. You then pro rata the total among all of the residential apartments in order to calculate the margin on which GST is payable.

CGT – BUSINESS SALE

Question:

We are two shareholders of a company which has a sole director. The company operates the business and owns the business premises. The company owes us a substantial amount arising from the time it acquired the business from our partnership.

We are considering closing the business and selling the premises in order to start another. What is the most tax efficient way to change businesses?

Answer:

This is a complex area and you should get advice based on your personal circumstances. There are a number of CGT concessions available to small business. You can read about these on page 72 of the *Australian Taxation Manual*.

Rollover relief is available where active assets of a small business are sold and proceeds re-invested in active assets of the same or another business. Your business assets and business premises would qualify as active assets provided your total assets have a net value not exceeding \$5 million.

Rollover relief will apply if you intend to re-invest the proceeds of the sale of the business premises in a new business.

In other circumstances you can deduct the cost base of the business premises from the sale price to arrive at the capital gain. You can then deduct the 50% CGT discount and a further 25% active asset exemption. The balance can be placed in a superannuation fund to take advantage of the retirement exemption resulting in there being no CGT payable at all.

But first you need to obtain professional advice relating to your own circumstances.

SALARY SACRIFICE

Question:

What is the total salary sacrifice we can claim in relation to gross wages for all staff?

Would salary sacrifice result in reduced requirement for child support?

Answer:

There is no limit on the amount of salary which can be sacrificed. The requirements are that the arrangement must be entered into before the wages are earned. However, keep in mind any award obligations. If you allow an employee to sacrifice his salary to the extent that the actual salary received falls below an award wage, you run the risk that that employee may later sue you for underpaid wages. Awards prescribe minimum wages and don't make allowances for salary sacrifices.

Child support payments are determined by reference to the parent's taxable income plus reportable fringe benefits plus any rental property losses. If a salary sacrifice results in the employee receiving a reportable fringe benefit there would be no effect on child support payments.

TRAVELLING EXPENSES

Question:

My company is sending me to London in August to attend a workshop. The company will be paying my airfare, accommodation and meals whilst attending the workshop. I would like to spend about 10 days whilst there on private travel and will pay for that travel.

Can the company claim the full airfare and workshop costs as a deduction?

Answer:

Where the main purpose of the trip is for gaining or producing income the related expenses are fully deductible notwithstanding the existence of an incidental private purpose. Keep complete documentary evidence of your business expenses and a travel diary.

DENTAL TREATMENTS

Question:

I am an occupational health and safety auditor/consultant and trainer. My work involves face to face contact with clients or participants on training courses. I had to have major dental treatment which involved the removal of all teeth. I used an upper plate for appearance but this caused some grief due to moving and falling out during training sessions. I decided to get implants to hold the dentures in. This took 12 months at a cost of \$38,800.

My medical benefit refund amounted to \$1,500. Can I claim the cost of the dental treatment as a full tax deduction? This enables me to perform my work. Are there any arguments to assist me in justifying this expense?

Answer:

We believe not. Section 8-1 of the 1997 Tax Act allows claims for expenses incurred in earning income but prohibits claims for expenses of a private or a capital nature. The Tax Office would consider this expense as being both private and capital (of a lasting benefit).

Your only course is to claim the medical expense rebate amounting to 20% of your net cost after deducting the medical benefit refund. This doesn't reduce your taxable income but directly reduces tax payable or increases your tax refund.

SUPER CO-CONTRIBUTIONS

A reader has drawn our attention to an error which occurred in *Tax IQ Monthly* June issue. At page 4 we said that the maximum co-contribution is available to employees if their taxable incomes are below \$28,000. This should have read assessable income plus reportable fringe benefits. If you have a low taxable income due to negative gearing losses, etc you may not be entitled to the co-contribution.

TAX RELATED EXPENSES

Question:

Would you clarify your comments in *Tax IQ Monthly* page 4 as I can't find the case you refer to on the ATO website.

Answer:

Section 25-5 of the 1997 Tax Act provides that you can deduct expenditure incurred in managing your tax affairs or in complying with an obligation imposed on you relating to the tax affairs of an entity. If you are the public officer of your company you are obliged to lodge income tax returns and prepare all necessary financial accounts. If you have incurred expenses to do this personally, you can claim them in your personal tax return.

FBT – DEEMED INTEREST RATE

Question:

Please advise the 2005/06 deemed interest rate on motor vehicles for FBT purposes.

Answer:

The rate is 7.3%.

GST – PRIZE MONEY

Question:

Our non-profit organisation recently won \$10,000 in prize money. Does it include GST or not?

Answer:

That depends on a number of factors.

Did you enter the competition as part of your enterprise (business operations)? If not, the prize cannot be taxable. Are you GST registered? If not, the prize is not taxable. Is the organisation which provided the prize registered for GST? If not, the prize is not taxable.

If your entry into the competition is trivial, e.g. entering into a free prize draw, participating in social competitions, etc the prize would not be taxable.

CGT – MAIN RESIDENCE EXEMPTION

Question:

Our client wants to sell his main residence to a property developer but wants reassurance that he will not be liable for GST or CGT on disposal. The property has not been income producing in the entire ownership period commencing November 1989. After subdivision, our client intends to purchase his existing home from the developer.

Is there a complication due to the land being just over the 2 hectares rule?

Answer:

Main residence exemption for CGT purposes is limited to 2 hectares. Hence the area of land in excess of 2 hectares will not be CGT exempt. You will need to apportion the cost base between the exempt 2 hectares and the taxable remainder and similarly apportion the sale price. We imagine that the resulting taxable figure will be quite small. Sale of the main residence will not be subject to GST.

STOCK ON HAND

Question:

Our client is a share trader. Can he adopt either cost or market value for his closing share trading stock on hand?

Answer:

Yes. It is treated in the same way as the stock on hand of a retailer.

CGT – VACANT LAND

Question:

We purchased vacant land intending to build our main residence on it but later purchased a house elsewhere, where we currently live. We are yet to decide whether we will build on this land and there is always the possibility that we will sell it. Can we claim the interest on the loan for the land as it is basically an investment property?

If we sell the land before building are we liable for CGT as it is not our main residence?

Answer:

Tax deductibility for the interest payments depends on your intention at the time of purchase. As this was to build your own home the interest is not tax deductible. However, you should keep a record of all interest, rates and other expenses you pay in respect of this land as these amounts can be added to your cost base for CGT purposes.

CGT will be payable on sale of the lot so it is important that you keep a record of all costs which will increase your cost base and reduce the eventual capital gain.

CGT – SALE OF BUSINESS INTEREST

Question:

Husband and wife are directors and shareholders of a company which has been operating for four years. During 2004/05 the wife sold her interest in the company to an outsider for \$60,000. She is no longer a director nor shareholder.

The wife used the proceeds for private home renovations. Is CGT applicable to her? Is she entitled to the small business exemption? The company assets are less than \$5 million and she is 45 years of age.

Answer:

It would seem that she would be entitled to the small business exemptions as she satisfies the controlling individual test (50% interest in the company) and she was a CGT concession stakeholder. Her capital gain is calculated by deducting from the sale proceeds the original cost of the shares (presumably only a nominal amount?). From the resulting capital gain you can deduct the 50% CGT discount and a further 25% CGT active asset exemption. The remaining 25% of the gain is taxable.

DISCLAIMER

The information contained in this publication is for guidance only and should not be relied upon without obtaining professional advice having regard to your direct circumstances.

No responsibility for loss occasioned directly or indirectly to any person acting or refraining from acting wholly or partially upon or as a result of the material in this publication or for any error in or omission from this publication can be accepted by the publisher or any author, editor, contributor or consultant or any company referred to herein.

Nothing in this publication is intended nor should it be interpreted as in any way sanctioning, advocating or condoning directly or indirectly the commission of any unlawful act or omission by any person or company in any jurisdiction for any illegal or fraudulent purpose.

This publication is made available on the understanding that the publisher is not engaged in rendering legal, accounting, tax or other professional advice or services.

©Copyright Tony Lovett

All rights reserved. No part of this publication may be reproduced in any form or by any means, electronic, photocopying, recording, or otherwise without prior written permission.

**Author: Tony Lovett, Lovetts
Accountants & Business Advisers**