

DATA MATCHING PROJECTS – REAL ESTATE

In *Tax IQ Monthly* July 2005 issue we advised the Tax Office's intention to collect business names, addresses and details of property title transfers from various State and Territory authorities. There has since been some amendments to the list of authorities from which information will be sought. An updated list is as follows:

- NSW Office of State Revenue
- NSW Department of Land Property Information
- Victorian State Revenue Office
- ACT Revenue Office
- ACT Planning Authority
- ACT Registrar General – Land Titles Office
- Northern Territory Treasury
- Queensland Office of State Revenue
- Queensland Department of Natural Resources and Mines
- Tasmanian Department of Treasury and Finance
- Tasmanian Department of Primary Industries, Water and Environment
- South Australia Revenue Office
- South Australia Land Services Group
- Western Australia Office of State Revenue

The Tax Office intends to match all this information with its own data in order to identify taxpayers who have not declared property sales for CGT purposes or have not accounted for GST which should have been charged on commercial or investment property sales.

DROUGHT RELIEF MEASURES

The Government has announced an additional Government assistance package for farmers costing more than \$250 million. Key features are:

- The interest rate subsidy for farmers in exceptional circumstances (EC) drought areas to be increased from 50% to 80% when in the second and third year of drought;
- The off farm asset threshold for EC business support assistance to be doubled from \$217,500 to \$435,000 and to be subsequently adjusted with the CPI;
- The taxable EC relief payment to farmers to have the benefit of a \$10,000 annual offset against the income test.

MUTUALITY PRINCIPLE

This is a long established principle which recognises that your income consists only of money or other benefits derived from external sources. Hence when a number of people get together and form a mutual association for a common purpose, any surplus derived from their contributions is not income.

This means that subscriptions and payments from members for particular services provided by a club or association (including poker machines and bar and dining room services) are not assessable income of that club or association. The Tax Office's official guidelines state that the mutuality principle would apply in the following circumstances:

- The rules of the club prohibits distribution of surplus funds to members;
- Upon dissolution surplus funds must be donated to another club with similar interests and activities;
- Club operations fall within State/Federal laws governing clubs;
- The club is a member of a recognised club association.

A recent decision by the Full Federal Court convincingly demolished these guidelines. In *Coleambally Irrigation Mutual Co-operative Limited v. FCT* (2004) 57ATR104, the Court held that the mutuality principle could not apply where members are prevented from obtaining the value of the assets on its winding up.

The High Court refused special leave to appeal so this decision stands.

Within three days after the High Court's refusal to grant special leave, the Government announced that it would amend the income tax law to restore the mutuality principle to not-for-profit organisations.

Weekly Tax Bulletin reports that somewhere between 200,000 and 300,000 organisations (largely RSL and social clubs) would have become subject to tax under the new Court ruling. The amended legislation will exempt these organisations from paying tax on income earned from their own members.

VIC – 2005/06 BUDGET

The 2005/06 Victorian Budget was handed down on 3 May 2005. Main changes are:

- Land tax threshold increased to \$200,000 from 1 July 2005;
- The current top land tax rate is reduced from 4% to 3.5% from 2005/06 and to 3% in 2007/08;
- Other land tax rates reduced by between 0.5% and 1.25%;
- Lands valued between \$750,000 and \$2.7 million will receive a partial rebate;
- Land tax exemption for aged care facilities, supported residential services and rooming houses. However, a special land tax rate of 5% will be applied where previously exempt land is no longer so used;

OUR VIEW

The *Australian Financial Review* reports that the corporate tax burden in Australia is more than 5% of gross domestic product. This is the highest of OECD countries and compares with 1.5% in the US.

Individual tax rates are also much higher than those levied in other comparable countries. New Zealand, for instance, has its top tax rate at 39% compared with 47% in Australia.

These high rates are on top of extreme difficulty in understanding an impossibly complex legislation and a penchant by the Tax Office for making ambit claims – to disallow deductions and make accusations of aggressive or even fraudulent behaviour without fully investigating relevant transactions.

All this is having its effect. The Tax Office has reported that its compliance activities have resulted in the issue of extra tax assessments totalling some \$8.7 billion. Whilst much of this is under dispute, it does seem that compliance enforcement is raking in a tidy sum of money.

This is not surprising when one considers the complexity and very high tax rates.

This issue of *Tax IQ Monthly* reports on new travel allowance rates for domestic and overseas travel for 2005/06, data matching projects, drought relief measures, family trust elections, carparking and the luxury car depreciation limit.

On the good news front, we report the abolition of the NSW vendor duty, some more State budgets eliminating some miscellaneous duties and taxes and reducing land tax and a decision by the Government to amend the law following a Court decision which would have resulted in thousands of RSL and other social clubs paying tax on earnings from their own members.

Tony Lovett

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- Land tax increases will be capped at a maximum of 50%;
- A special rate will be assessed for land held by discretionary trusts;
- The first home bonus scheme to be extended to 30 June 2007. This is in addition to the \$7,000 first home owner grant and will be at \$5,000 for first homes acquired to 31 December 2005 and \$3,000 for homes acquired to 30 June 2007;
- WorkCover premiums to be decreased by an average of 10% from 1 July 2005;
- Bank account debits tax to be abolished from 1 July 2005;
- Rental business duty to be abolished from 1 January 2007.

TAS – 2005/06 BUDGET

The 2005/06 Budget for Tasmania was handed down on 19 May 2005. Main changes are:

- There will be a new land tax scale from 1 July 2005 and the tax free threshold will be increased to \$25,000;
- Business conveyance duty for all property except real property will be abolished from 1 July 2008;
- Mortgage duty will be reduced by 50% and abolished from 1 July 2007;
- Debits duty was abolished from 1 July 2005;
- The first homeowner duty concession and a stamp duty refund will be available in respect of land purchased upon which a first home is built.

FAMILY TRUST ELECTIONS

How's this for absolutely unnecessary complications?

In *Tax IQ Monthly* May 2004 issue we reported on a breakthrough in relation to Family Trust Elections. Taxpayers were being caught for millions of dollars in back taxes through a mere failure to lodge a piece of paper. Family trusts could not claim prior losses or franking credits exceeding \$5,000 unless they lodged *Family Trust Elections* and any company or trust beneficiary lodged an *Interposed Entity Election*.

Additionally, companies owned by family trusts could not claim prior losses unless that family trust lodged a *Family Trust Election*.

These highly complex requirements were introduced during a period of intense tax reform. Because of this and the varying requirements in relation to lodgement of the objections, they were occasionally missed. This resulted in a serious disadvantage to taxpayers.

To relieve this unnecessary tax impost the Tax Office issued a Practice Statement enabling the lodgement of *Family Trust Elections* and *Interposed Entity Elections* on a backdated basis provided these elections were lodged not later than the lodgement date of the trust's 2003/04 tax return.

The Government has now amended the law to allow trustees to make *Family Trust Elections* and *Interposed Entity Elections* at any time in relation to earlier years.

This ability is subject to a couple of provisos which must have been in place throughout the period from the specified date to the end of the last income year before the actual making of the election:

- The entity must pass the family control test; and
- All distributions must have been made to members of the specified individual's family.

The "Alice in Wonderland" touch is that these amendments only apply from the 2004/05 income year. At any time after that you can make a backdated *Family Trust Election* or *Interposed Entity Election* but you can only backdate it to 2004/05.

If you want to backdate your election to an earlier year you should have done this with your 2003/04 tax return!

BAS RATIOS

The Tax Office is publishing ratios which have been calculated from income tax returns and has produced a suite of activity statement ratios for most industries.

These indicate the following:

- Percentage of total expenses to sales;
- Percentage of wages to sales;
- Percentage of net GST to sales.

These ratios will undoubtedly be used by the Tax Office to identify taxpayers for selection for audit or further investigation.

It would be wise to compare these ratios with those developed from your own BAS so that you can compare your business with industry averages and possibly rectify any anomalies.

You can access these ratios by visiting the Tax Office website www.ato.gov.au. Then search for *Activity Statement Ratios*. This will lead you to the ratios.

FBT – CAR PARKING

In certain circumstances FBT is payable in respect of car parking provided to employees where the premises are within 1km of a commercial car parking station which charges more than a threshold figure for all day parking.

The threshold figure stood at \$6.28 for the 2004/05 FBT year and has been increased to \$6.43 for the 2005/06 year.

DONATIONS – TSUNAMI APPEAL

The Tax Office has issued a Practice Statement (PS LA 2005/12) concerning small cash donations made to the 2004 Boxing Day Tsunami Appeal.

Provided the donation does not exceed \$10, the Tax Office will accept that taxpayers have donated amounts of \$2 or more even though they have not obtained receipts or other evidence.

LUXURY CARS

The indexed depreciation cost limit for cars and the luxury car tax threshold for 2005/06 has been fixed at \$57,009. This figure remains unchanged from the previous three years.

If you purchase a car for more than the threshold figure you cannot claim depreciation on the excess. If you lease a luxury car you cannot claim lease rentals. Instead the transaction will be deemed to be a hire purchase and you can claim the interest. Your depreciation claim is calculated on a cost limit of \$57,009.

NSW VENDOR DUTY - GOOD NEWS!

Tax IQ Monthly August 2004 issue reported on a new tax introduced by the NSW Government from 1 June 2004.

Please send your Reader Questions by fax, mail or email

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Known as Vendor Duty, this is a tax at the rate of 2.25% payable by vendors on the sale of real property. Following its introduction, property investors shied away from NSW and invested in other States. It has caused great harm to the NSW property industry. Following the recent resignation of both the NSW Premier and Treasurer, the newly appointed Premier has announced its immediate abolition.

TRAVELLING EXPENSES

Substantiation is usually required for travel expenses. Travel expenses are deductible if incurred for work related purposes and you are away from home for at least one night. If away from home for more than five nights, you must keep a travel diary as well.

If you are an employee required to travel for work related purposes and in receipt of a travel allowance from your employer, you may claim deductions for expenses incurred.

If your claims are not more than the amounts prescribed as reasonable travel and meal allowances you will not be required to provide substantiation. Notwithstanding this, the Tax Office says that you must have incurred the expense and will not look kindly at a high claim for travelling expenses when you obtain free accommodation at your conveniently situated relative's house!

Taxation Determination TD 2005/32 sets out the rates for reasonable allowances for 2005/06 whilst Taxation Determination TD 2004/19 sets out the rates applicable for 2004/05. The rates are in three levels depending on your salary range. We show the details below:

Salaries below \$78,750 (2004/05) and \$81,400 (2005/06):

Place	2004/05	2005/06
Sydney	\$245.55	\$248.00
Melbourne	\$238.55	\$241.00
Brisbane	\$214.55	\$226.00
Canberra	\$191.55	\$199.00
Adelaide	\$219.55	\$222.00
Darwin	\$210.55	\$219.00
Hobart	\$192.55	\$195.00
Perth	\$205.55	\$209.00
High Cost Country Centres	\$178.55-\$258.55	\$182.00-\$373.00
Tier Two Country Centres	\$166.75	\$170.00
Other Country Centres	\$151.75	\$158.00

Salaries below \$140,000 (2004/05) and \$144,691 (2005/06)

Place	2004/05	2005/06
Sydney	\$300.00	\$303.00
Melbourne	\$277.00	\$280.00
Brisbane	\$255.00	\$263.00
Canberra	\$237.00	\$245.00
Adelaide	\$260.00	\$263.00
Darwin	\$248.00	\$251.00
Hobart	\$228.00	\$232.00
Perth	\$248.00	\$256.00
High Cost Country Centres	\$198.00-\$278.00	\$202.00-\$393.00
Tier Two Country Centres	\$195.90	\$199.50
Other Country Centres	\$177.90	\$185.50

The high cost country centres and tier two country centres are individually named in the determination. These are towns which have higher than usual accommodation costs.

Salaries above \$140,000 (2004/05) and \$144,690 (2005/06)

Place	2004/05	2005/06
Sydney and Melbourne	\$394.20	\$401.75
All Other Capital Cities	\$324.20	\$331.75
Non-Capital Centres	\$210.20	\$282.75

TRAVELLING ALLOWANCES – TRUCK DRIVERS

If you are an employed truck driver receiving a travel allowance from your employer you can claim a deduction for the cost of food and drink while you have to sleep away from home. If you receive an allowance from your employer and your claim does not exceed the reasonable amount set out in the determination you are not required to substantiate. The reasonable daily allowances for 2004/05 are:

Salary Range	Allowance
\$78,750 and below	\$67.55
Above \$78,750	\$73.70

Daily allowances for 2005/06 are:

Salary Range	Allowance
\$81,400 and below	\$69.45
Above \$81,400	\$75.75

If you are an owner/driver you do not receive a travel allowance and must substantiate all your accommodation, meal and other travel expenses.

OVERSEAS TRAVEL ALLOWANCES

Taxation Determinations TD 2004/19 and TD 2005/32 also provide details of allowances for food, drink and incidentals which may be incurred and claimed by employees travelling overseas on work related duties. Amounts for accommodation are not provided as claims for accommodation when travelling overseas must always be fully substantiated.

Countries are classified into six groups depending on relative costs. Countries such as Malaysia, Bangladesh and the Philippines are in the lowest cost group. Bermuda, Norway and the Bahamas are in the highest cost group. There are further classes depending on the employee's salary.

Countries are allocated to cost groups as follows:

Group 1:

Argentina, Bangladesh, Bolivia, Brunei, Cape Verde, Chile, Costa Rica, Eritrea, Ethiopia, Fiji, Georgia, Guinea, Guyana, Iran, Kenya, Laos, Macedonia, Malawi, Malaysia, Mozambique, Nepal, Nicaragua, Pakistan, Paraguay, Philippines, Romania, Rwanda, Slovakia, Solomon Islands, South Africa, Sri Lanka, Surinam, Tanzania, Thailand, Uganda, Uruguay, Venezuela, Vietnam, Zambia, Zimbabwe.

Group 2:

Ascension, Azerbaijan, Bosnia, Brazil, Bulgaria, Burkina Faso, Colombia, Czech Republic, East Timor, Egypt, El Salvador, Gambia, Ghana, Guatemala, India, Mali, Mauritius, Mexico, Namibia, Peru, Samoa, Saudi Arabia, Serbia, Slovenia, St Vincents, Syria, Tunisia, Uzbekistan.

Group 3:

Algeria, Bahrain, Cambodia, Cook Islands, Croatia, Cyprus, Dominican Republic, Ecuador, Estonia, Gibraltar, Hungary, Indonesia, Jamaica, Jerusalem, Jordan, Kazakhstan, Latvia, Libya, Lithuania, Morocco, Myanmar, Netherlands, New Zealand, Niue, Panama, Papua New Guinea, Poland, Portugal, Qatar, Singapore, Taiwan, Tonga, Turkey.

Group 4:

Austria, Belgium, Benin, Cameroon, China (including Hong Kong and Macau), Côte d'Ivoire, Cuba, Falkland Islands, Germany, Greece, Israel, Italy, Korea Republic, Kuwait, Lebanon, Luxembourg, Malta, Nigeria, Oman, Puerto Rico, Reunion, Senegal, Sierra Leone, Spain, Sudan, Sweden, Ukraine, United Arab Emirates, Vanuatu.

Group 5:

Antigua and Barbuda, Barbados, Congo Democratic Republic, Denmark, Finland, France, Gabon, Irish Republic, Martinique, Monaco, New Caledonia, Russia, St Lucia, Switzerland, Trinidad and Tobago, United Kingdom, United States.

Group 6:

Angola, Bahamas, Bermuda, Iceland, Norway.

The rates for 2005/06 remain the same as those applicable to the previous two years, however the salary levels for each category have increased. The rates are as follows:

Salary Level \$78,750 (2004/05) or \$81,400 (2005/06) and below:

Group	Meals	Incidentals	Total
1	\$65	\$25	\$90
2	\$80	\$30	\$110
3	\$105	\$35	\$140
4	\$130	\$35	\$165
5	\$170	\$40	\$210
6	\$205	\$45	\$250

Salaries Below \$140,000 (2004/05) and \$144,690 (2005/06):

Group	Meals	Incidentals	Total
1	\$90	\$25	\$115
2	\$110	\$35	\$145
3	\$130	\$40	\$170
4	\$160	\$45	\$205
5	\$210	\$50	\$260
6	\$260	\$50	\$310

Salaries Above \$140,000 (2004/05) or \$144,690 (2005/06):

Group	Meals	Incidentals	Total
1	\$115	\$30	\$145
2	\$140	\$40	\$180
3	\$160	\$45	\$205
4	\$190	\$50	\$240
5	\$250	\$60	\$310
6	\$300	\$60	\$360

EMPLOYEE REIMBURSEMENTS

If you are an employee and incur a tax deductible expense which is reimbursed by your employer you cannot claim a deduction for that expense. In the employer's hands the reimbursement would not be a taxable fringe benefit because it is exempt under the *Otherwise Deductible* rule.

A Taxation Determination issued more than 10 years ago (TD 93/145) states that where an employee is reimbursed for the cost of a depreciable asset by the employer, this does not prevent the employee from claiming depreciation on the asset.

In other words, reimbursement stops you from claiming a tax deduction for an expense but does not stop you from claiming depreciation on an item of plant (such as a computer) which you purchased.

This Ruling has been withdrawn and a new draft Determination issued (TD 2005/D17).

The new draft Determination says much the same thing and notes that the *Otherwise Deductible Rule* applies only where the expense would have been fully deductible (not depreciable to the employee).

Not said in the Ruling is the fact that reimbursement of the cost of a depreciable item represents a fringe benefit. The employer will be subject to FBT on that reimbursement unless it is for an exempt item such as a laptop, briefcase or PDA.

GOVERNMENT REBATES – RENTAL PROPERTY

Draft Taxation Determination TD 2005/D18 seems rather at odds with the Determination discussed in the previous paragraph.

This deals with cases where investment property owners receive Government rebates for purchasing energy saving appliances such as solar hot water systems.

If you are operating a business and receive a Government rebate, that rebate is normally assessable under Section 20-20 however in this case it is not income under ordinary concepts or derived from a business or income from renting a property to a tenant.

Instead, under Section 20-40 you apply the rebate against the depreciation claimed in each year.

This means that if in the 2004/05 year you acquired a solar hot water system for \$3,450 and received a Government rebate of \$600 you can claim \$230 for depreciation in 2004/05 and \$513 depreciation in 2005/06. While making those claims you have to show as assessable income \$230 of the rebate in 2004/05 and the balance of \$370 in 2005/06.

NEW ZEALAND TAX INFORMATION

Thinking of doing business in New Zealand? The Australian Tax Office and the NZ Inland Revenue have jointly released a range of web-based information to assist Australia and New Zealand businesses.

This information compares the New Zealand and Australian tax systems and provides information for New Zealanders doing business in Australia and Australians doing business in New Zealand. One interesting comparison is the fact that the top rate of personal tax in New Zealand is 39% which compares with the high rate of 47% in Australia.

You can access this information by visiting the Tax Office website at www.ato.gov.au and entering *Australia and New Zealand Tax Information for Business* in the search label.

TRUSTS – INTEREST DEDUCTIBILITY

In *Tax IQ Monthly* April 2005 issue we reported on the issue of draft Taxation Ruling TR 2005/D4 regarding deductibility of interest paid on monies borrowed to pay distributions to beneficiaries.

The draft Ruling has now been released in final form as Taxation Ruling TR 2005/12.

A new term *Returnable Amount* has been introduced. This is used to refer to money or property forming part of the trust estate that:

- Is employed by the trustee in gaining or producing the assessable income of the trust, or in carrying on business for that purpose; and that
- A beneficiary of the trust is entitled to require to be returned to that beneficiary; and that
- Is or represents money or property that was either previously transferred by or on behalf of the beneficiary to the trust or was previously retained by the trust out of funds to which the beneficiary was presently entitled.

Where money is borrowed to repay a *Returnable Amount* interest on that borrowing will be tax deductible. Examples of *Returnable Amounts* include:

- An individual subscribes money for units in a unit trust with a right of redemption, and the money is used to purchase income producing assets;
- A beneficiary has an unpaid present entitlement to some of the capital of the trust or some of the net income and the amount has been retained by the trust and used in gaining or producing assessable income; and
- A beneficiary lends an amount to the trust which uses the money for income producing purposes.

Interest expenses will not be deductible if the objective purpose of the borrowing is merely to discharge an obligation to make a distribution. Where the borrowing and distribution are contemporaneous (or nearly so) the amount paid may not be a *Returnable Amount* as it would ordinarily be concluded that the purpose of the borrowing was only to make the distribution.

It seems the distribution resolution must occur well before actual payment to beneficiaries so that it can be shown that "The amount to which the beneficiary is entitled has been retained by the trustee and used in gaining or producing assessable income." If that can be shown, then interest on a subsequent borrowing to pay the present entitlement would be tax deductible.

GST PROPERTY DEVELOPERS

Margin Scheme

Tax IQ Monthly May issue reported that an amending Bill was before Parliament to change the method of calculating GST under the margin scheme in respect of land purchased under the going concern exemption or GST free farmland.

Effective from 17 March 2005 the margin would no longer be the sale price less acquisition cost. Instead, it will be the sale price less the value of the land at 1 July 2000.

Additionally, the developer was required to obtain an approved valuation of the land as at 1 July 2000.

Following representations, the Government has announced that it will remove these new rules from the amending legislation. Instead it will undertake further consultation with industry "to ensure the margin scheme applies appropriately to supplies of real property."

Service Fees

One of the very early Rulings issued by the Tax Office way back in 1978 was IT 276 which related to professional firms who set up service entities separate from the professional firms. These entities provided administration services and staff to the professional firm. The resulting profit was able to be distributed to family members.

This Ruling followed a decision in *Phillips v. FCT 78 ATC 4361* which held that these arrangements were effective provided the charges for the services provided to the firm were commercially based.

The Tax Office has recently undertaken a series of audits in large professional firms and, in some cases, has disallowed service fees on the grounds that they were excessive.

The Tax Office has issued a new draft Ruling TR 2005/D5 which places emphasis not just on the level of service fees, but also on the commerciality of establishing the service arrangement. Some examples of unacceptable arrangements are:

- Service fees disproportionate or excessive in relation to benefits conferred;
- Service fees and charges calculated using arbitrary or fixed mark-ups;
- No clear separation between the service entity and the firm's business activities.

The Tax Office has acknowledged the legitimacy of setting up a separate entity for asset protection purposes but does not consider that separating business profits from the entity is a legitimate form of asset protection. The Ruling has retrospective effect. If you are using a service entity you should urgently review the arrangements to ensure that they can be commercially justified and that you have full and complete documentation.

LODGING 2004/05 RETURNS

Now it's time to think about preparing and lodging your income tax return for the 2004/05 financial year. The Tax Office has published a Gazette notice which sets out who must lodge returns.

You are required to lodge a tax return for 2004/05 if:

- You had PAYG Withholding amounts deducted;
 - You incurred a loss or are entitled to a deduction for a prior year loss;
 - If a company or trust, you had unapplied tax losses or capital losses exceeding \$1,000;
 - You were liable to pay child support;
 - You carried on a business;
 - You were a beneficiary of a primary production business trust;
 - You were a partner of a primary production business partnership;
 - You were under 18 and had non-personal exertion income of more than \$772 or had income from dividends and trust distributions plus imputation credits of more than \$416;
 - You received overseas income under Section 23AF or 23AG, together with other income;
 - You paid a PAYG instalment amount which has not been later credited or refunded;
 - You are an author, inventor, performing artist, production associate or sportsperson under Section 405 of the 1997 Tax Act;
 - You are eligible to claim a private health insurance tax offset;
 - You have had a reportable fringe benefits amount shown in your PAYG payment summary;
 - You received a distribution on which family trust distribution tax was paid;
 - You received a distribution from a trust which was liable for ultimate beneficiary non-disclosure tax;
 - You received assessable income from dividends or distributions and imputation credits that exceeded \$6,000;
 - You are eligible to receive super co-contribution on personal super contributions;
 - You received a notification from the Tax Office that you are required to lodge a detailed form of return;
 - You were a resident of Australia for the whole or part of the year and your taxable income exceeds \$500 multiplied by the number of full or part months you were a resident;
 - You were a non-resident but derived income (including capital gains) subject to Australian tax other than income subject to withholding payments;
 - You are a company which derived income taxable in Australia other than income subject to withholding payments;
 - You are a super fund which derived income taxable in Australia other than income subject to withholding payments;
 - You are a head company of a consolidated group;
 - You are an agent for non-resident insurers, ship masters, owners or charterers or in control of a non-resident's money;
- You are a trust which derived income (including capital gains) during 2004/05

The following are exempted and do not have to lodge returns:

- Persons qualified for the Senior Australian's Tax Offset (SATO) or pensioners who did not qualify for SATO but whose taxable income was below SATO thresholds;
- A resident non-profit company whose taxable income in Australia does not exceed \$416;
- A non-profit association, organisation, institution, society or club whose income is exempt from tax;
- A subsidiary of a consolidated group.

Unless lodging through a tax agent who has been granted extended time to lodge, all 2004/05 returns must be lodged by 31 October 2005.

TAX OFFICE INCONSISTENT BEHAVIOUR

Writing recently in the *Australian Financial Review* Mr Geoff Taylor of *Australians for Tax Justice Inc* had some trenchant comments about the behaviour of the Tax Office in connection with a recent case heard before the Federal Court.

The case involved an investment by Capt. Michael Calder in Mayne Camp Tree Growing. Investments in Main Camp Tree Growing projects had been approved by five different Deputy Commissioners during the period from December 1992 to March 1996.

Yet, in spite of these approvals, the Tax Office disallowed the claim by Capt Calder and the Federal Court eventually held that Part IVA applied to disallow claims for deductions.

Geoff Taylor wonders why this case ended up in Court when five Deputy Commissioners had approved deductions for these investments.

It seems that dealing with taxation matters these days is truly a gamble.

READER QUESTIONS:

DEPRECIATION – PRIMARY PRODUCERS

Question:

Section 40-555 prohibits the claiming of the three year deduction for water facilities if the previous owner has already claimed this expenditure. If we cannot find out if the claim was made by the previous owner can we now claim the write off?

Answer:

No. Section 40-555 prohibits a deduction if the previous owner has or could have claimed the deduction. Interpretative Decision ID 2004/15 confirms this and states that the onus is on the taxpayer to prove that no claim was made or could have been made by the previous owner. In addition, you cannot claim normal depreciation on this item.

Question:

If the water tanks were constructed prior to 1 July 1997 can you confirm that the deduction would not have been claimed as legislation was introduced at that date?

Answer:

Similar rules applied prior to 1 July 1997 so earlier expenditure will not assist. The Tax Office has issued that Taxation Determination TD 96/40 which denies a deduction for expenditure on water facilities when there is an allocation in a contract for purchase of a farm property. The expenditure must be actually incurred by the taxpayer on the construction, acquisition or installation of plant or a structural improvement for the purpose of conserving or conveying water.

Question:

Can dams, sheds and concrete slabs (and other items built by previous owners which cannot be moved) which have been valued by a quantity surveyor be written off under normal depreciation rates?

Answer:

As explained above, you cannot claim depreciation on dams or any other water facilities. However, you can claim depreciation under the normal effective life provisions on other improvements.

SUPER CO-CONTRIBUTIONS

Question:

Would you please check the answer to the question about super co-contributions in *Tax IQ Monthly* July 2005 issue at page 6.

I did not think there were age restrictions to the co-contribution super scheme for the young ones.

Thank you for your very informative articles.

Answer:

Oops! Our mistake. Contributions by parents for children under 18 are not eligible, but contributions made by the children themselves are eligible.

CGT – RETIREMENT EXEMPTION

Question:

I am a public accountant aged 75, my wife is 60. My practice, owned by our company, will be sold with a view to my retirement. My wife will continue to work. My wife and I live in a townhouse owned by our company. My wife and I are the only shareholders and directors of the company.

Although I am over 75, can the proceeds of the sale of the practice be paid into my superannuation fund and used to offset capital gain?

We would like to transfer ownership of the townhouse to our joint names. We both have loan accounts owing to us and have been employed by our company for 13 years. As the company will cease trading we will both be redundant. If our loan accounts and our redundancy total near the value of the townhouse, is there any difficulty in offsetting one against the other?

Answer:

Provided your total net assets do not exceed \$5 million, a CGT retirement exemption up to a maximum of \$500,000 for each of you is available. You are both over 55 and the company will terminate the employment of both of you when the practice is sold. Presumably your wife will then go to work for the purchaser.

The amount of the capital gain must be paid to both of you as an eligible termination payment. It does not have to be paid into a superannuation fund. You can receive it directly.

By paying the capital gain to you both as an ETP it will be exempt from CGT.

The retirement exemption applies only to active assets. Certainly your practice is an active asset and the gain on sale of the practice will be exempt as a retirement exemption. The question arises as to whether the townhouse (in the event of a sale by the company to yourselves) will also be exempt.

Section 152-40 of the 1997 Tax Act defines *active assets*. These are assets used in the course of carrying on a business. An asset whose main use is to derive rent is excluded. If the townhouse was acquired by the company in order to provide accommodation for employees rather than to provide income from receipt of rent it is arguable that the townhouse will be included in the definition of *active assets*. If this is the case, any capital gain on transfer of the townhouse to yourselves could be included in the retirement exemption (so long as the total does not exceed \$500,000 each).

However it may be considered that the main use of the townhouse is the derivation of rent. In that case, we suggest that the company retain the townhouse after it ceases operating the accounting practice and simply allow you both to reside in it, subject to payment of outgoings.

As you are both directors of your company and are involved in the making of a decision to dispose of the practice the Tax Office's view is that you are not entitled to a tax free bona fide redundancy payment.

SUPERANNUATION GUARANTEE

Question:

Could you please advise whether the 9% employer superannuation contribution is calculated on that portion of an employee's wage which is salary sacrificed into a complying superannuation fund?

Thank you for a great service.

Answer:

The requirement is that the 9% superannuation contribution is based on the *notional earnings base* which, to all intents and purposes, is equivalent to *ordinary time earnings*. This includes allowances and bonuses but not overtime payments nor lump sum payments on termination of employment. It is based on actual earnings.

If these have been reduced by way of an effective salary sacrifice arrangement then the contribution is based on the actual earnings (after such reduction).

Interestingly the superannuation contribution paid as a result of an effective salary sacrifice actually counts for the required superannuation guarantee. This, of course, would not be fair to the employee, but the legal position is that under the superannuation guarantee legislation your obligation is to pay a minimum of 9% of ordinary time earnings by way of an employer superannuation contribution.

CGT – MAIN RESIDENCE EXEMPTION

Question:

My parents lived in the family home since 1959. This was transferred to my mother after my father's death in 2001. My mother is 72 and the home is in bad repair. As she does not have funds to re-build it is proposed to build three homes on the land, of which two would be sold to finance a new home for my mother. Would you please advise on the following matters:

- GST – should my mother be registered for GST?
- Is the sale of the two homes taxable supplies?
- Is the margin scheme appropriate?
- What proportion of GST credits would be claimable?
- CGT – would the sale of the two homes be subject to income tax or CGT if sold immediately upon completion?
- If only one home was sold immediately (to reduce debts) and the second continued to be held (after re-financing), how would each of them be treated?
- I understand the home she retains would become her main residence. How should the land and building costs be allocated?
- ATO Rulings – would you please direct me to appropriate tax Rulings (I don't know how the Commissioner can expect anyone to find which Rulings apply!)

Answer:

This is quite a complex matter and it is important that you obtain advice based on your mother's own individual circumstances, which are not entirely set out in your question. We will answer as best we can but have had to make some assumptions.

Presumably the existing home will be demolished and the land subdivided into three lots. Three homes will be built and your mother will retain ownership of one of the homes, selling the other two (or alternatively selling one and keeping the other for income producing purposes).

GST – If your mother intends to sell both houses she should definitely register for GST as she is conducting an enterprise with expected income exceeding \$50,000. She can claim input tax credits in respect of all expenses relating to the two homes to be sold but not in relation to the home proposed to be retained. Costs relating to the overall project will need to be appropriately apportioned.

The two homes could be sold subject to the margin scheme. You will need to obtain a valuation of the two subdivided lots as at 30 June 2000.

If one of the homes is intended to be retained for rental purposes your mother will not be able to claim input tax credits in relation to the construction of that home as it will be a residential rental property and accordingly input taxed. If that particular home is sold within five years it would still be subject to GST on sale.

Income tax or CGT? If the houses are being built with the intention of selling them at a profit it is the income tax provisions which would be applicable rather than CGT.

If one of the houses is intended to be held to produce income from rental, that house would become subject to CGT on a subsequent sale.

In either case the value of the land prior to development represents a private asset committed to a development project. Under income tax rules its value can be applied as a cost against the project. Under CGT rules the main residence exemption applied until the subdivision and subsequent development.

Main Residence – the old home is your mother's main residence until demolition. Provided the new home is built within four years after demolition it will also be fully CGT exempt as her new main residence.

Apportionment is required to be done on a reasonable basis and, in relation to the land costs, is usually most appropriately done on a land area basis unless there are some considerations putting a higher value on a particular area. Building costs should be applied to each building where possible. Overall project costs must be apportioned on a reasonable basis which may be determined by relevant areas or some other appropriate benchmark.

ATO Rulings – these are far too numerous to mention in this newsletter. You can obtain a listing by visiting www.ato.gov.au and click *Rulings and Law*, go to *Legal Database Home Page* then type *Main Residence* in the search box.

HYBRID TRUSTS

Question:

I am very interested in getting more information on types of trusts. Can the purchase of rental properties and other investments through (say) a hybrid trust assist taxpayers in reducing income tax? Will this avoid penalisation in the calculation of super surcharge (now defunct), family tax benefits, child care rebates and Centrelink payments? What are the positives and the negatives?

Can other investments be purchased through the family trust? How does this affect a single parent family? Should there be two trustees or is a corporate trustee a better way to go?

Answer:

As a single parent, child support payments and family tax benefits are calculated on the basis of your taxable income but that is increased by the amount of any rental property losses, exempt foreign income and reportable fringe benefits.

Centrelink payments are usually based on your actual income.

The purchase of a negatively geared rental property might reduce your income tax but you will suffer a double whammy in relation to child support and family tax benefits because the losses you incur on the rental property will be added back to calculate these items.

Instead, you can set up a hybrid trust and borrow money to invest in units in the trust. The trust then uses the cash to purchase a rental property. You can claim a deduction for your interest expense because it has been incurred in order to earn income by way of trust distributions. These losses will not be added back when calculating child support or family tax benefit. The losses would also be taken into account in relation to Centrelink payments. As a sole parent it would be best for you to establish a company to act as trustee of the trust. You can be the sole director and secretary.

ASSET PROTECTION

Question:

Could you please explain in detail what asset protection is and what is involved in setting it up and operating? I am a sole trader. I run cattle and sheep on my farm and am conscious of the risk of stock straying onto the road, etc.

Answer:

In our current litigious society it is important for business owners to learn about and engage in asset protection. Asset protection is only effective if it is carried out before a possible risk or liability actually eventuates. The way it is done is to have at least two entities – one entity is the risk taking entity. You ensure that this entity does not have any appreciable assets. The second entity is the wealth accumulation entity which avoids any business risk and accumulates assets.

The best way is to set up discretionary trusts. One trust operates the business and incurs business type risks. In your case, a horrendous accident might result in a damages claim which, for some technical reason might be avoided by your insurance company.

The owner or lessee of the livestock should not own any other assets. This means that those assets owned by a different entity such as your farm and your farm plant are protected. You should obtain advice based on your own particular circumstances. Transfer of the farm to a discretionary trust may be too expensive both from a stamp duty and CGT point of view but it may be possible for you to set up a discretionary trust to operate the farm and simply transfer your livestock to that trust.

You will need to obtain legal advice as to possible liability of the farm operator and the farm owner.

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.

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Important Reminder

Getting the most out of your Tax IQ

Since its inception in November 2002, Tax IQ has received considerable demand and support from our subscribers around Australia and across a variety of industry platforms. There are many reasons why Tax IQ has become one of the fastest growing business newsletter services: our highly recognised and respected author, Tony Lovett; our dedication to servicing our clients; and our pursuit of maintaining Tax IQ as one of the best investments a business owner can make.

More importantly is our effort to ensure all Tax IQ subscribers know how to use (and abuse) their subscription. My staff are sick of me using the analogy that Tax IQ is like a gym membership. "Just because you join a gym, doesn't mean you'll get fit and look great—likewise, just because you subscribe to Tax IQ, doesn't mean you save money on tax—you've got to use it, develop a routine, and stick to it!"

So, here's an important reminder from some of our long term subscribers on just how to get the most out of your Tax IQ subscription:

- Keep the Australian Taxation Manual handy so you can use it as a quick and easy reference guide when you have any tax or accounts related questions or issues;
- Scan the Tax Savings Special and Tax Returns Special for hundreds of tips and deductions that do apply to you. Even if you only find five right now and each one only saves you \$300, that's deductible savings of \$1,500 straight away;
- Spend just 10 minutes a month with your newsletter, a cup of coffee and a highlighter, and you're up to date with any critical changes that may effect your business and potential liabilities;
- And, don't forget our advisory service whereby if you have any questions or queries throughout the year, simply write, fax or email them to us and we'll answer them in the up-coming newsletter.

Tax IQ has been developed to create an effective and efficient decision making foundation for you in your business. We aim to provide you with an up to date information source which is easily accessible, reliable and value added to your business related activities.

Thank you again for your continued support and custom and all the very best for the next financial year.

Dwade Sheehan MBA (Laws)

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