

GST – SMALL FOOD RETAILERS

From 1 October 2005 food retailers who:

- are registered for GST throughout the tax period; and
- sell food or other domestic goods equivalent to those commonly sold at supermarkets or convenience stores; and
- are not petrol stations; and
- have less than 5% of total sales which are taxable supplies but were purchased GST free; and
- have annual turnover of less than \$2 million; and
- use adequate point-of-sale equipment.

can use a simplified accounting method which avoids the need to tally individual tax invoices to claim input tax credits. The method involves calculating the percentage of GST free sales and applying that percentage to total purchases in order to calculate the input tax credit entitlement.

The following goods must be excluded from calculations:

- those not held as part of retail operations;
- those not in the range of food and domestic goods commonly sold at supermarkets or convenience stores;
- those held in substantially greater quantity or variety than is common; and
- alcoholic beverages.

WA STAMP DUTY EXEMPTION

Western Australians who hold their family home in a company or trust structure have a one off opportunity for stamp duty exemption on transfer of the home into their personal names.

If you do so, your home will be eligible for land tax exemption from 2006/07.

The stamp duty exemption is available for property transfers between 1 November 2005 and 1 November 2006.

SERVICE TRUSTS

More than 25 years ago the Full Federal Court decided that the use of a service trust by a professional partnership was legitimate and payment of service fees fully deductible (*Phillips* case).

Since then, most legal, accounting and other professional partnerships have set up service entities which provide staffing, occupancy and administrative services to the partnership for commercially based fees. The service entity is then able to distribute profits to members of the families of the partners.

After all this time the Tax Office has decided to review these arrangements and, in many cases, regard them as "aggressive" tax planning arrangements. This is somewhat surprising in light of the Court decision and the length of time these entities have been operating without question.

The Tax Office issued Draft Tax Ruling TR 2005/D5 in May and subsequently issued a booklet setting out its preliminary view as to what should be taken into account to determine whether the service arrangements are commercially realistic and reasonably connected to the taxpayer's business.

The Tax Office is currently undertaking 40 audits and expects to add a further 40 new audits. It is looking at cases where service fees paid are over \$1 million and represent over 50% of gross fees earned by the professional firm.

The Tax Office considers that the service entity must provide commercial benefits relevant to the firm's income producing activities. These could include:

- Access to staff, skills or know how not accessible to the firm;
- Relieving the firm from responsibility for conducting and managing certain functions (eg recruitment, payroll services);
- Relieving the firm of certain risks (eg fixed or pre-determined cost structures);
- Relieving the firm of financial or legal obligations (eg workers' compensation, payroll tax, superannuation, statutory holidays, long service leave or unfair dismissal);

Unrealistically low mark-ups are suggested as reasonable.

Adequate documentation is required to satisfy the Tax Office that the arrangements are commercially realistic. Examples of necessary documentation include:

- Service agreement;
- Documentation re calculation and pricing structure;
- Tax invoices for service fees and evidence of payment;
- Statement showing how service fees were calculated and details of mark-ups;
- Minutes;
- Budgets, business plans, etc;
- Financial statements for the business and the service entity for current year and two prior years;
- Constituent documents (eg trust deed);
- Distribution minutes;
- Employee lists, duty statements, employment contracts, time sheets, etc;
- Insurance contracts;
- Lease and/or rental agreements.

OUR VIEW

The Treasurer recently announced a huge cash surplus for 2004/05. Originally budgeted at \$2.4 billion, this expectation increased to \$8.6 billion by the time of handing down of the 2005/06 budget in May 2005.

We now find that the budget surplus turned out to be \$13.6 billion!

It is indeed surprising, with all the resources available to the Commonwealth Government, that so late in the financial year, it made such a large error in its expectations.

Writing in the Brisbane *Courier Mail*, Economics Editor, Tim Hughes, makes the case that this money should be given back to taxpayers. He says that it is outrageous that the Commonwealth appears to think that this huge sum actually belongs to it.

He says that under the terms of our democracy the Commonwealth has a right to raise taxes, but it has gone way past that. This much was admitted by the Prime Minister during a radio broadcast last August when he said that he believed that the top tax rate is too high and that it cuts in too early. While not promising to cut the rate, he did say that it was something the Government would certainly consider.

Tim Hughes goes on to say that there is no doubt the surplus is large enough to finance absolutely ground shaking taxation reform. Will it happen? Will there be genuine tax reform? It seems we may have to wait for answers to such questions.

In this issue, we provide details of a new simplified GST calculation method for small food retailers, more details on service trusts used by professionals and details of Tax Office requirements concerning valuations required to adopt the GST Margin Scheme.

Are you operating a small business and taking goods from stock for your personal use? We provide updated details of Tax Office approved estimates covering various business types.

The results of a pilot study conducted by Monash University provide a solid indication that Australians are as tax averse as they always have been.

Tony Lovett

CONTENTS

GST-Small Food Retailers	1
WA Stamp Duty Exemption	1
Service Trusts	1
GST-Margin Scheme	2
Superannuation-Choice of Fund	2
Tax Evasion	2
Vale Super Surcharge But Is It?	2
Low Doc Loans-Caution	3
Debt or Equity?	3
Data Matching Project	3
Heads I Win (Taxman), Tails You Lose	3
Inspector General of Taxation	3
Trading Stock Used Privately	4
HECS Needs HELP	4
PAYG Instalments	5
General Interest Charge	5
Trusts-Interest Deductibility	5
The Ant and the Grasshopper	5
Reader Questions:	6
Depreciation and Capital Works	6
Travelling Expenses-Travel Agents	6
Taming the Lion	6
GST-Going Concern Exemptions	6
Accounting Fees	7
Super Funds-Business Assets	7
Travelling Expenses/Superannuation	7
Debt or Equity	7
GST-Agency Arrangements	8
GST-Credit Card Charges	8
Franking Account	8

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**

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

GST – MARGIN SCHEME

Under the margin scheme, GST payable on the sale of land or a strata unit is calculated at the rate of 1/11th of the margin rather than on the sale price. The margin represents the difference between the cost price or value at 30 June 2000.

The valuation must comply with Tax Office requirements.

The three valuation methods acceptable to the Tax Office are:

1. By an approved professional valuer who must provide a signed certificate specifying:
 - full description of the property;
 - applicable valuation date;
 - date valuation made;
 - market value of the property at valuation date;
 - valuation approach and calculation; and
 - qualifications of the valuer
2. Purchase price of the property provided it was acquired on an arm's length basis;
3. Most recent Government valuation prior to acquisition.

When valued by a professional valuer, the land must be valued on the basis of its value at the valuation date. If improvements are constructed on the property subsequently these must be ignored for valuation purposes.

For contracts entered into before 29 June 2005 the decision to adopt the margin scheme must have been made by the vendor by not later than the contract date.

If you did not make such a decision at the time, you can write to the Tax Office at GPO Box 9935 in your capital city and show that:

- Your failure to choose to apply the margin scheme was a genuine mistake;
- You satisfy all other requirements
- The purchaser cannot get a GST credit or decreasing adjustment;
- You and the purchaser did not agree on a GST inclusive price; and
- The transaction is not part of a GST scheme.

If you do this, hopefully, you will get Tax Office approval to use the margin scheme.

For contracts signed after 29 June 2005 there must be an agreement between vendor and purchaser for the margin scheme to apply. This is usually done by an appropriate clause in the contract of sale.

If you obtain a professional valuation, such valuation must be obtained by not later than the due date of your BAS covering the period in which you sold the property.

SUPERANNUATION – CHOICE OF FUND

From 1 July 2005 employers are required to allow certain employees to choose which superannuation fund should receive their contributions. These requirements have been discussed in *Tax IQ Monthly* June and July issues.

The penalty for non-compliance in respect of each quarterly contribution is 25% of the contribution up to a maximum of \$500 per employee. This penalty must be paid by way of a superannuation guarantee shortfall.

The Tax Office has advised that during the first year of operation (2005/06) it will not apply the shortfall where employers have demonstrated that they have made a genuine attempt to comply.

Guidelines have been released as to appropriate levels of reductions of the shortfall which will operate until 30 June 2006. These are as follows:

- **Intentional disregard** – the employer knowingly decided not to comply – no reduction of penalty;
- **Recklessness** – the employer was indifferent to the requirements – 25% reduction of penalty;
- **Failure to take reasonable care** – the employer did not exercise the level of care reasonably expected – 75% reduction of penalty;
- **Reasonable care taken** – the employer made a genuine effort to meet choice of fund requirements – 100% reduction of penalty.

Further reductions of penalties are available if the employer makes a full and voluntary disclosure and otherwise has a good compliance history.

TAX EVASION

It would appear that the sustained campaigns and even "terror tactics" adopted by the Tax Office in its attempts to ensure everyone pays their "fair share" of tax is having little effect on ordinary people.

In a pilot study undertaken by Monash University, respondents were asked for their opinions of a hypothetical scenario in which a business owner negotiated discounts for customers in return for being paid cash.

An overwhelming 70% of males and 82% of higher income earners were willing to ignore the penalty and risk tax evasion.

It was noteworthy that 64% of males said that they would feel "victorious" if they succeeded. Australian-born respondents were more likely to resent the Tax Office controlling them.

The university is currently negotiating with the Tax Office to extend this research to a larger sample of taxpayers. It seems to us that this proposal may not eventuate as the Tax Office is unlikely to want it publicly known that its education programmes have failed. Such failure is not surprising when regard is had to the huge budget surpluses and the Government's reluctance to reduce tax rates.

VALE SUPER SURCHARGE BUT IS IT?

The Government announced the ending of this iniquitous tax as from 1 July 2005. Writing in the *The Weekend Australian*, Alan Wood refers to the super surcharge period as "one of the most bizarre and disgusting episodes in the Byzantine history of Australian taxation legislation."

In outlining the story of deceit and political shenanigans he says:

- Lie number 1 was to call it a surcharge when it was actually a tax because the Howard Government had promised in its election campaign that there would be no new taxes;
- Lie number 2 was that it was to reduce advantages to high-income earners and thereby enhance the Government's commitment to an equitable tax system. Now the Treasurer tells us that the surcharge was to reduce the huge inherited deficit and was always going to be temporary;
- The Leader of the Opposition opposed the surcharge in 1996 but now opposes its abolition.

It is clear that the surcharge has significantly discouraged superannuation contributions and will cost retirees dearly because it slashes their retirement benefits. Alan Wood says that the capital sum which is invested in superannuation has been reduced which reduces earnings and will make a big difference over the life of the super investment.

Due to inefficient management and operation of the super surcharge scheme assessments going back many years are still being received by some super funds. One taxpayer's self-managed super fund has just received a charge for super surcharge going back over the last four years.

Tax practitioners and super fund administrators will be very glad to see the end of this iniquitous tax which is currently dying a lingering and tortuous death.

LOWDOC LOANS - CAUTION

These are loans made available by many financial institutions to borrowers who can provide good security but don't wish to, or are unable to, provide evidence of income.

Some time ago the Tax Office announced that it was looking closely at individuals who had taken out these loans because many had understated their income or had failed to lodge income tax returns.

By using its powers to obtain information from financial institutions, the Tax Office was able to pinpoint individuals for further checking.

It selected 350 taxpayers who had borrowed from eight different lenders and found that about 50% of these had not lodged income tax returns.

The Tax Office took enforcement action and has secured eight Court convictions. More than \$1.3 million in additional tax has been raised.

It also found that there was a significant concealment of income by LowDoc borrowers who had lodged returns. The Tax Office focused particularly on clients of certain mortgage brokers and selected 400 cases for further checking. Of these, 140 were subjected to full tax audits.

These audits raised over \$23 million in tax and penalties.

The Tax Office intends to undertake systematic checks of future LowDoc borrowers and will attain details from financial institutions and also from mortgage insurance companies. If you have or intend to utilise LowDoc finance, be aware that your tax return is likely to be carefully scrutinised by the Tax Office.

DEBT OR EQUITY?

In *Tax IQ Monthly* July 2005 issue, we provided details of new rules which determined whether money provided to companies is to be treated as *debt* (payments on account are treated as tax deductible interest) or *equity* (payments on account are treated as non tax deductible dividends).

These new rules particularly affect loans by associates to companies for indefinite periods. If these loans do not have a loan agreement providing for repayment within 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).

There is a carve out from these onerous rules for small businesses. We reported the original Government announcement concerning this to be:

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

The Government has changed these carve out provisions and has announced that, instead the rules will not apply to companies with an annual turnover of less than \$20 million.

Accordingly you now have one simple condition. If your company has a turnover of less than \$20 million you do not have to worry about these debt/equity tax rules.

If your company has \$20 million or more in annual turnover you have a further opportunity to reduce compliance costs. Your company can elect to have at call loans treated as debt interests from 1 July 2005 or from the start of any later year of income in which it fails the turnover test, provided:

- The terms of the loan are changed to ensure that it will be treated as a debt for tax purposes; and
- The changes are made during the time between the start of the relevant year and the due date or lodgement date of the company's tax return (whichever is the earlier).

DATA MATCHING PROJECT

WorkCover Corporation SA

The Tax Office will conduct a data matching project using information obtained from the South Australian WorkCover Corporation.

The Tax Office will collect business names and addresses and electronically match these in order to identify businesses which have WorkCover but have not complied with registration, lodgement and payment obligations under taxation law.

Information relating to approximately 70,000 entities will be matched with taxable records.

HEADS I (THE TAXMAN) WIN, TAILS YOU LOSE

Since amendment to the CGT Rules as from 20 August 1991 *non-capital costs of ownership* of assets can be included in their cost base if you have not been able to claim the tax deduction. These include:

- Interest on monies borrowed to acquire the asset;
- Costs of maintaining, repairing or insuring the asset;
- Rates or land tax;
- Interest on a refinanced loan;
- Interest on monies borrowed for capital expenditure on the assets.

In a recent case known as *Harts Case*, the Court decided on a split loan arrangement where monies were borrowed for a private home as well as a rental property. Repayments were made only on the private home loan, causing interest on the rental property loan to increase on a compounding basis. This was struck down under Part IVA. The additional interest caused by the compounding effect was held to be non tax deductible.

The Tax Office has issued Taxation Determination TD 20005/33 to say that this disallowed interest cannot be added to the cost base of the rental property.

The rather convoluted reasoning used by the Tax Office is that the interest on the compounding loan is deductible until such time as the Tax Office strikes it down under Part IVA. Accordingly because it was deductible you cannot add it to your cost base!

If the Tax Office later comes along and declares it to be non tax deductible under Part IVA you cannot turn around and then add the amount to the cost base.

Weekly Tax Bulletin refers to this as "strained" reasoning. We would be inclined to use a harsher adjective and doubt that it would stand up in Court.

INSPECTOR GENERAL OF TAXATION

The Inspector General of Taxation is an independent official appointed by the Government to strengthen the advice given to Government on tax matters and to identify systemic problems in tax administration.

Each year the Inspector General announces his work programme for the year.

The Inspector General met with representatives from industry, business, accounting, law and tax organisations and then announced the issues which he aimed to review during 2005/06.

One of these issues is the Tax Office's response to large numbers of tax returns lodged late by tax agents.

Approximately 500,000 returns for 2002/03 were not lodged until after 30 June 2004. The Tax Office expressed concern that the same pattern was emerging this year. The tax profession was told that this would be monitored closely and there would be increased compliance action, including refusal to extend lodgement deadlines and automatic penalties.

Coincidentally, within a few weeks after this announcement, after hearing of the Inspector General's proposals to investigate this matter, Deputy Commissioner Shane Reardon said that there was significant improvement in lodgement patterns in the 2004/05 year with 95% of all returns being lodged by 30 June 2005.

Mr Reardon thanked tax agents for their efforts to improve the timely lodgement of returns, activity statements and other documents.

Other issues to be included in the Inspector General's work programme for 2005/06 are:

- Whether the Tax Office can quickly identify and deal with major, complex issues;
- Whether the private binding ruling system is biased towards increasing tax revenue;
- How the Tax Office is managing its small business debts;
- Management of remission of late lodgement penalties and/or interest charges for late PAYG Summary Statements, nil BAS and nil tax returns;
- Whether the Tax Office is inappropriately using general anti-avoidance provisions and penalty remissions to settle audit adjustments.

TRADING STOCK USED PRIVATELY

The Tax Office has issued Taxation Determination TD 2005/36 which updates amounts that it will accept as estimates of the value of goods taken from trading stock for private use. The updated figures are set out in the **table 4.1 below**. These should be used as a guide only. If your own records or evidence show different private use, you should use your figures rather than those in the determination.

These rates should be used for the year ended 30 June 2006. It is interesting that some of the figures are lower than those adopted for the year ended 30 June 2005 (refer *Tax IQ Monthly* November 2004 issue).

Table 4.2

2004/05		2005/06	
Income \$	Repayment Rate %	Income \$	Repayment Rate %
Below 35,001	Nil	Below 36,185	Nil
35,001-38,987	4	36,184-40,306	4
38,988-42,972	4.5	40,307-44,427	4.5
42,973-45,232	5	44,428-46,762	5
45,233-48,621	5.5	46,763-50,266	5.5
48,622-52,657	6	50,267-54,439	6
52,658-55,429	6.5	54,440-57,304	6.5
55,430-60,971	7	57,305-63,062	7
60,972-64,999	7.5	63,063-67,199	7.5
65,000 and above	8	67,200 and above	8

Table 4.1

Business	Adult/Child Over 16	Child 4--16 years
Bakery	\$940	\$470
Butcher	\$630	\$315
Restaurant/Café (licensed)	\$3,230	\$1,280
Restaurant/Café (unlicensed)	\$2,560	\$1,280
Caterer	\$2,810	\$1,405
Delicatessen	\$2,560	\$1,280
Fruiterer/Green Grocer	\$680	\$340
Take-Away Food Shop	\$2,430	\$1,215
Mixed Business (includes milk bar, general store and convenience store)	\$3,080	\$1,540

HECS NEEDS HELP

Various schemes including the Higher Education Contribution Scheme (HECS) available to assist students pay for higher education fees are being reconstituted into a new suite of loans called the Higher Education Loan Programme (HELP). Loans are available for eligible students enrolled in Commonwealth supported educational institutions, for eligible fee paying students enrolled at an eligible higher education provider or an open university and for eligible Commonwealth supported students studying overseas.

From 1 June 2006 accumulated HECS debts will become HELP debts and, as before, repayments may be effected in the following ways:

- Compulsory repayments through the tax system;
- Additional amounts through the PAYG system;
- Voluntary repayments;
- Voluntary repayment bonuses; and
- Indexation applied to debts on 1 June each year.

Information statements are sent out in June of each year. No interest is charged but the debt is indexed by the appropriate pension on 1 June each year.

Compulsory repayments are calculated as a percentage of income. The relevant rates for 2004/05 and 2005/06 are as follows in the **table 4.2 below**:

You should advise your employer that you have a HELP debt and answer the relevant question on the relevant withholding declaration form. This will result in an additional amount being deducted from your salary for your HELP debt and consequently reduce the amount you have to pay in tax at the end of the year.

PAYG INSTALMENTS

This is the means by which the Tax Office collects income tax on a pay as you go basis. It is the successor to provisional tax which was included in income tax assessments.

Most taxpayers have the option of paying an instalment amount determined by the Tax Office or calculating the amount payable in accordance with an instalment rate.

Option 1 – Instalment Amount

The amount is calculated by the Tax Office based on your most recently assessed tax return. Those eligible for this option are:

- All individuals;
- Companies and super funds with business or investment income of \$1 million or less; and
- Companies and super funds eligible to pay quarterly PAYG instalments.

If you use this option you will not, in future, need to lodge the Instalment Activity Statement (IAS) which will be forwarded to you. All you need to do is pay the instalment amount by the due date.

You can choose to vary the instalment amount but if you do so and end up paying less than 85% of the actual tax that you should have paid you could be subjected to an interest charge. If you vary the amount you need to lodge your IAS by the due date.

Option 2 – Instalment Rate

The amount payable is calculated by taking your actual income for the quarter and multiplying it by the rate provided to you by the Tax Office. All taxpayers can use this option if they wish.

You can choose to vary the instalment rate if your business circumstances have changed since lodging your last income tax return. However, if you end up paying less than 85% of the actual tax that you should have paid you could be subject to an interest charge.

If you use this option you need to lodge your IAS and pay your PAYG instalment by the due date.

GENERAL INTEREST CHARGE

The General Interest Charge (GIC) rate for the October/December 2005 quarter is 12.62%. The rate for the September 2005 quarter was 12.68%.

TRUSTS – INTEREST DEDUCTIBILITY

In *Tax IQ Monthly* April 2005 issue we discussed the new Draft Ruling which has since been finalised as TR 2005/12. This relates to interest deductibility for monies borrowed to repay advances from beneficiaries (of capital or settlement sums or advances from entitlements accrued from income distributions).

The Ruling defined a new term *returnable amount*. This is the money previously advanced to the trust or a beneficiary entitlement from a distribution.

Where a distribution is made by way of trustee resolution and shortly thereafter the trust borrows money to pay that distribution to beneficiaries, the Ruling considers that the amount could not be classified as a *returnable amount*. It would ordinarily be concluded that the purpose of the borrowing was to pay the distribution.

In the April 2005 issue, we suggested that the distribution resolution must occur well before actual payments 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 the gaining or producing of assessable income". If that can be shown, interest on a subsequent borrowing to pay the present entitlement would be tax deductible.

This is further discussed in a recent article in *CCH Tax Week*. The view is expressed that tax deductibility for interest on money borrowed to pay trust distributions would be subject to the following requirements:

- The trustee must have resolved to make a distribution to the beneficiary; and
- The beneficiary must have agreed for that income to be retained by the trust;
- Subsequently the income must have been used for income producing purposes;
- After the above steps the trustee borrows money in order to pay out the present entitlement.

In practice, income would have been earned then immediately re-invested in the business of the trust. Because of this it would appear that before the trustee can borrow to pay out a present entitlement, some time must elapse after the distribution resolution. The funds must have been employed in the business or income producing activities of the trust.

THE ANT AND THE GRASSHOPPER

The Original Story

The ant works hard in the withering heat all summer long, building his house and laying up supplies for the winter.

The grasshopper thinks he is a fool and laughs and dances and plays the summer away.

Come winter, the ant is warm and well fed. The shivering grasshopper has no food or shelter, so he dies out in the cold.

The Modern Australian Version

The ant works hard in the withering heat all summer long, building his house and laying up supplies for the winter. The grasshopper thinks he is a fool and laughs and dances and plays the summer away.

Come winter, the ant is warm and well fed. The shivering grasshopper calls a press conference and demands to know why the ant should be allowed to be warm and well fed while others less fortunate like him are cold and starving.

The ABC and Channel 9 show up to provide live coverage of the shivering grasshopper with cuts to a video of the ant in his comfortable warm home with a table filled with food.

Australians are stunned that in a country of such wealth, this poor grasshopper is allowed to suffer while others have plenty. The Democrats, the Greens and the Coalition Against Poverty demonstrate in front of the ant's house.

The ABC, interrupting an Aboriginal cultural festival special from North Queensland with breaking news, broadcasts them singing "We Shall Overcome".

Bob Brown rants in an interview with Ray Martin that the ant has gotten rich off the backs of grasshoppers and calls for an immediate tax hike on the ant to pay his "fair share".

In response to polls, the Liberal Government drafts the Economic Equity and Grasshopper Antidiscrimination Act, retrospective to the beginning of the summer.

It is quickly passed through the Senate. The ant's taxes are re-assessed and he is also fined for failing to hire grasshoppers as helpers. Without enough money to pay both the fine and his duly imposed retrospective taxes, his home is confiscated by the Government.

The ant moves to Asia and starts a successful agribiz company. The TV stations later show the now fat grasshopper finishing up the last of the ant's food though spring is still months away, while the Government-owned house he is in, which just happens to be the ant's old house, crumbles around him because he hasn't maintained it.

Inadequate Government funding is blamed. Kim Beazley is appointed to head a Commission of Enquiry that will cost \$10 million. The grasshopper is soon dead of a drug overdose, the Sydney Morning Herald blames it on obvious failure of Government to address the root causes of despair arising from social inequity.

The abandoned house is taken over by a gang of immigrant spiders, praised by the Government for enriching Australia's multi-cultural diversity, who promptly terrorise the community.

Reader Questions:

DEPRECIATION AND CAPITAL WORKS

Question:

What is the difference between leasehold improvements and capital works? Is the correct tax depreciation rate dependent on the length of the lease? For instance, if a company spends \$10,000 on leasehold improvements and the life of the lease is for five years, should the depreciation rate be 20% or does the capital works rate of 2.5% apply?

Are there any Tax Rulings or ATO Interpretative Decisions that could assist?

Answer:

The lease of land gives you a *quasi-ownership right* and the construction of an improvement on that property entitles you to claim depreciation in the same way as if you were the owner of the property.

Quasi-ownership right is defined in Section 995(1) of the Income Tax Assessment 1997 and there are a number of interpretative decisions relating to depreciation claims. These include ID 2003/228 and ID 2003/592 relating to ownership of common property. ID 2004/564 relates to assets attached to land by the licensee.

If you erect improvements on leased property which cannot be described as plant or articles you can claim the capital works allowance of 2.5% during the period of the lease. If you receive no compensation for the improvements at the conclusion of the lease you can claim a capital loss for the undepreciated balance of expenditure.

Instead of paying for the fittings outright, you might like to consider approaching a financier with a view to leasing the fitout. In *Eastern Nitrogen Limited v. FCT* and *Metal Manufacturers Limited v. FCT* the Full Federal Court held that sales and lease backs of fixtures were effective for tax purposes. The High Court declined to hear an appeal by the Tax Office.

If you lease an office or shop fitout you could argue the case for a low residual after five years and obtain a full deduction for lease payments. At the end of the term of the lease you are required to acquire the fitout for its residual value.

TRAVELLING EXPENSES – TRAVEL AGENTS

Question:

Can a travel agent claim his travel costs when escorting customers on a trip? If so, what percentage?

What deductions can travel agents claim in relation to conferences?

Answer:

A travel agent escorting a trip is carrying out his work related duties. His expenses are fully deductible under Section 8-1 because he is incurring expenditure in the course of producing assessable income. It is only if he extends the trip in order to have a private holiday would he need to apportion the travel costs between business and private.

If the travel agent took his wife or partner with him, who was not participating in escort duties, the accompanying person's expenses would not be deductible.

All expenses, including travel, accommodation, meals and incidentals, of travelling to attend conferences are fully deductible if the conferences are specifically designed to assist travel agents in their work. Costs of any side pleasure trips are not deductible. Expenses of an accompanying person who is not involved in the travel agency business are not deductible.

TAMING THE LION

Question:

I am a contented subscriber to *Tax IQ Monthly* and find the reading informative, interesting and often frustrating. You're doing a great job!!!

I am not normally one to write to periodicals or newspapers (being one of the quiet majority) however I am becoming increasingly alarmed at the constant eroding of cash flow by the onerous obligations imposed by GST on businesses.

My business is directed towards assisting small business with their day to day operations (bookkeeping, administration, management, etc). I deal with the financial and administration operations of each of my client's businesses, either directly or as a sub-contracted remote operation.

I can disclose that nearly all of my clients owe money to the Tax Office for outstanding GST and PAYG Instalments. These debts are significant and are increasing, not reducing. It's disturbing to witness these businesses slowly self destruct in trying to meet the unwavering demands of the Tax Office.

The stress and strain of these Tax Office debts is leading to nervous breakdowns, break-up of marriages and, in one case, death from the strain.

I cannot accept that such a large percentage of business collapses is a result of poor management practices. Many of these businesses operated before the introduction of GST without the stresses and strains they are currently enduring.

If such a large percentage of my clients are in this position, there must be a significant number of small businesses in the same position.

My objective (some say "tilting at windmills") is to increase the GST registration annual turnover from \$50,000 to \$1 million.

Would you be prepared to participate in the struggle? I am writing to other organisations – Chambers of Commerce, small business organisations and individual operators to see if there is a level of support.

Answer:

We are indeed sympathetic with your aims. With such a massive cash surplus the Government is well equipped to ease the burden on small business. As you say, the never ending burden of accounting for GST and PAYG is creating severe stress and hardship for many thousands of small businesses throughout Australia.

Our task, as a tax publisher, is to bring these problems out into the open, to write about them as well as to provide information to assist people cope with the almost impossible burdens placed on them by our politicians and the bureaucratic juggernaut which is the Tax Office.

It is for others to get involved in protests, demonstrations, lobbying and whatever else is needed to make the Government understand the plight of small business.

GST – GOING CONCERN EXEMPTIONS

Question:

A husband and wife partnership (FM) built a factory to specially suit the agricultural implement business operated by a partnership of their son and daughter-in-law (SD). FM then leased the factory to SD. Both partnerships are registered for GST.

An unrelated buyer wants to purchase both the business and the factory and wants to claim GST exemption as a going concern.

The officer at the Tax Office business tax line is not sure whether the sale of the factory will be GST free if it is purchased at the same time as the business.

Can you advise how to proceed so that both sales are GST free?

Answer:

It is indeed concerning, but unfortunately commonplace, that the Tax Office itself cannot advise you in relation to its own Rulings.

GST ruling GSTR2002/5 provides the answer to your question. There are two entities, each running separate enterprises. FM is in the business of leasing, whilst SD is in the business of agricultural implements. Each of those entities can apply the going concern exemption if they carry on their respective businesses to the day of supply, the purchaser is registered for GST and agrees.

Both of the entities must supply all things necessary for the continued operation of the respective businesses and must carry on the business until the day of supply.

The two contracts should be inter-dependent and settlement of both contracts should occur simultaneously.

The ruling provides an example which is as follows (with wording changed to suit your circumstances):

FM owns a commercial property which it leases to SD. SD operates an agricultural implement business from the commercial property. The purchaser will acquire both enterprises. The successful completion of each contract is subject to the completion of the other contract. Both settlements will take place at the same time.

FM is carrying on an enterprise of leasing and can supply this enterprise to the purchaser as a GST-free supply of a going concern, provided that the property is supplied with the lease intact. SD will sell all the plant, equipment and goodwill, together with orders for future supplies. Provided SD also assigns the lease of the premises to the purchaser, it will be making a GST-free supply of a going concern.

ACCOUNTING FEES

Question:

Could you please help with some ideas about what accountants should be charging for the work they carry out. I have talked with various people about this and it seems some ridiculous fees are being charged.

My business is a small business with turnover of \$400,000 annually. All my financials are completed and balanced on MYOB v15 and presented on disc. My business work is presented along with my wife's full time position details.

Answer:

Accounting fees have increased steadily over the past several years, particularly since the introduction of GST. Accountants find it necessary to spend a considerable time trying to keep up to date with increasingly complex legislation and have to spend a considerable amount of time dealing with issues emanating from the Tax Office.

Your accounting fees will depend on a number of factors including the quality of the information that you can provide to the accountant to enable him to prepare necessary tax returns. You should check whether your MYOB reports are properly balanced and whether they accurately record the transactions which have taken place during the year. Is the bank account fully reconciled? Are all transactions processed into MYOB and have you provided all the necessary information to your accountants?

If you are looking for a budget price, the best way is to shop around. Call a few accounting firms in your area and explain what records you maintain and their quality and ask for a quote for your work. However keep in mind that most successful business people put a greater priority on the quality of the advice and support provided by their accountants.

SUPER FUNDS – BUSINESS ASSETS

Question:

In the August newsletter an article on self managed super funds (SMSF's) stated that:

- An SMSF cannot borrow money to purchase property;
- That instalment warrants can be used to achieve the result.

Could you please supply further detail on how we can use this approach to buy the property we currently lease. We wish to purchase the property in the name of our SMSF.

Answer:

Instalment warrants are in relation to the acquisition of shares in listed public companies. They cannot be used to acquire real estate.

Do you have enough funds in the SMSF to acquire the property? If you do the SMSF can purchase the property provided it is not borrowing and is operated in accordance with the powers it is given in the trust deed. The funds investment strategy, which should be adopted at a meeting of trustees, should show what the assets and liabilities will be after acquisition of the property. The property must be used in your business.

TRAVELLING EXPENSES/SUPERANNUATION

Question:

My son was offered a job in building. His new employer required him to become a contractor and pays him an hourly rate of approximately \$25.

He resides with us but his job requires him to move from one town to another. For example, he may be in Sydney for a month, then Tamworth for three weeks, then on to Armidale for two weeks and so on. Is he entitled to claim an allowance for his rental and food? Should he or his employer pay his superannuation?

I would greatly appreciate your help. I have been on the NSW Industrial Relations site but cannot find anything.

Answer:

If your son is employed as a contractor he should have obtained an ABN and if his total income exceeds \$50,000 in 12 months, he should register for GST. He should be submitting accounts to his employer for his work and quoting his ABN. If registered for GST he should be adding GST to the charges and submitting quarterly BAS.

Where his work requires him to travel away from home and he has to sleep away from home he can claim travelling expenses. He should keep a travel diary (obtainable from a stationer or newsagent) and keep all receipts for meals, accommodation and incidentals.

The Superannuation Guarantee (Administration) Act defines an employee to include a person who works under a contract that is wholly or principally for the labour of the person. This means that your son's employer is obligated to contribute to your son's superannuation fund at the rate of 9% of ordinary time earnings.

DEBT OR EQUITY

Question:

During the last financial year my husband and I loaned our business \$40,000. Also during that year we have taken drawings for the sum of \$32,000. How is this approached for tax purposes? The money we loaned the business had to be borrowed and I do not want to claim the \$32,000 as wages as it was our money to start with.

We have also just paid out our silent partners, leaving my husband and I sole directors of the business. The payout was \$30,000 and came from personal money. Please advise us what we have to do in relation to legal or accounting/tax situations.

Answer:

You haven't advised how your business is structured. You have, however, mentioned wages and being sole directors. We therefore assume that your business is structured as a company. This means that your ownership interest is represented by the holding of shares.

As you have loaned the company \$40,000 and then drawn \$32,000 you can treat the drawings as loan repayments and do not have to treat those drawings as wages. In fact, if they were wages drawn from a company you should have attended to your PAYG Withholding obligations and issued payment summaries.

The \$30,000 payout to the silent partners would either be for the purchase of their shares in the company or partly for that and partly to repay loans they made to the company.

If for purchase of shares, this is a personal transaction between yourselves and the silent partners and there should be a share transfer drawn up, signed by the parties, approved by a director's resolution and the transfer recorded in the company's register of members. If there was a loan to the company by the silent partners paid out by yourselves, you have effectively loaned this money to the company thereby enabling the company to repay the loan to the silent partners. Appropriate entries should be made in the company's books to record this transaction.

If your business is not structured as a company, please write back to us as the answers would be different if you are structured as a partnership or discretionary trust.

GST – AGENCY ARRANGEMENTS

Question: (from a Local Government Entity)

Our Civic Centre has offered to act as a ticketing agent for a local fundraising dinner. The aim is to pass the proceeds back to the fundraising committee who are not registered for GST and do not have an ABN.

Our question relates to the treatment of GST as we will not receive a tax invoice. Are we able to receive the proceeds of the ticket sales without having to remit GST given that we are collecting on behalf of a non-registered entity?

Answer:

Yes. You are not making a taxable supply. You are merely acting as agent for a third party principal. You should receive the proceeds and remit those proceeds without deduction to the fundraising committee. You should not report the amounts in your BAS as they are not supplies made by you.

If you make a charge to the fundraising committee for your services you would be required to account for GST on your charges.

GST – CREDIT CARD CHARGES

Question:

We have chosen to pass on a 3% charge for clients paying by credit card. Most clients are businesses and are able to claim the costs as tax deductions. We have a desk sign stating the surcharge. As the invoice for the goods is payable on pick-up, we are unsure as to clients' method of payment until then.

If we add 3% to the invoice total, would we then have to add 10% GST to the 3% surcharge? Alternatively, is the surcharge viewed as a financial charge and therefore GST free?

Answer:

The merchant fee which you have to pay to the credit card supplier is subject to GST and likewise if you elect to pass on that charge to customers it will be subject to GST as well. It is not regarded as a financial charge and is not GST free.

FRANKING ACCOUNT

Question:

If space allows, could you show a correct treatment for the following items as in **the table 8.1** in a franking account return?

Table 8.1

Date	Details	Amount
1/7/02	Opening Class C franking account balance	\$2,875
1/7/04	Fully franked dividend received	\$200
1/7/04	Dividend franked to 50% received	\$50
28/10/04	Paid tax instalment	\$1,000
31/10/04	Paid fully franked dividend	\$200
15/12/04	Paid 2004 income tax	\$3,250
28/1/05	Paid tax instalment	\$1,000
28/2/05	Received tax refund	\$1,200

Answer:

The various items you mention are either debited or credited to the company's franking account. In the following table, amounts shown in brackets are debits. All other items are credits:

Table 8.2

Date	Details	Amount
1/7/02	Opening balance	\$2,875
1/7/04	Received dividend \$200 x 30/70	\$86
1/7/04	Received dividend franked to 50% - $\$50/2 = \$25 \times 30/70$	\$11
28/10/04	Paid tax instalment	\$1,000
31/10/04	Paid fully franked dividend \$200 x 30/70	(\$86)
15/12/04	Paid 2004 income tax	\$3,250
28/1/05	Paid tax instalment	\$1,000
28/2/05	Received tax refund	(\$1,200)
	Closing Balance	\$6,936