

STATUTE BARRED LOANS

Division 7A of the Tax Act came into force on 4 December 1997. From that date any loans by companies to shareholders or associates ran the risk of being treated as taxable dividends unless they were subject to written loan agreements requiring interest and principal repayments.

The rules also apply to any loans which are increased or forgiven.

This meant that any loans existing at 4 December 1997 had to be separately identified and quarantined in financial statements.

Concerns were raised that these may become statute barred under the Statute of Limitations Acts of the various States if they remained unpaid and ignored. In a recently issued Practice Statement the Tax Office has recognised the complexity of the matter and accepts that the legislation did not intend an unfavourable outcome to the taxpayer simply because nothing was done in relation to existing loans.

The Practice Statements suggest that the writing down of loans in the financial statements may be evidence of the fact that the loan has become statute barred and states that such actions should not result in the company claiming a capital loss as the loan will generally not have arisen in the course of gaining or producing assessable income or carrying on a business.

As the loan for CGT purposes is likely to be a personal use asset then any loss is disregarded.

The Practice Statement states that *as a matter of practical compliance and sensible administration, the Commissioner has decided to take no active compliance action on private company and trustee loans made prior to the enactment of Division 7A.*

This is indeed great news to many taxpayers and accountants who have had to deal with these old loans for many years always with the worry that an over-zealous tax auditor might decide that an old loan had become statute barred and was therefore to be treated as a taxable deemed dividend.

GST – BUSKERS

Next time you are inclined to drop a coin into a street entertainer's hat, you will be interested to know that the taxman wants his share.

In a recent GST Ruling, the Tax Office has indicated that a busker who makes a living by providing street entertainment is subject to GST on income received because the money given to him is linked to his performance and there is a sufficient nexus between the money and the supply.

This Ruling has surprised tax experts who had been under the impression that voluntary payments are not subject to GST.

In 2000 the then Deputy Commissioner had stated: "A genuine tip paid on a purely voluntary basis by a customer is not subject to GST."

Of course only buskers who make more than \$50,000 annually have to register for GST.

SUPERANNUATION STRATEGIES (PART 2)

In *Tax IQ Monthly* December 2005 issue we reported a strategy which utilises the transition to retirement pension available for over 55s that can save tax and help you build your superannuation nest egg.

The strategy involves:

- Making a large salary sacrifice contribution into super;
- Arranging, at the same time, to receive a pre-retirement pension.

Employees are normally not entitled to make personal super contributions but can do so if their assessable income, tax exempt income, and reportable fringe benefits is less than 10% of their total assessable income and reportable fringe benefits (super is not a fringe benefit).

Hence, if you salary sacrifice sufficient employment income and have no reportable fringe benefits you can satisfy the 10% rule. You can then make a large personal superannuation contribution and be entitled to a tax deduction for that contribution.

By calculating the figures carefully and taking advantage of this strategy you can reduce your tax and build a substantial superannuation nest egg.

TAX OFFICE – DEBT COLLECTOR

Do you have a tax debt? Expect a phone call while having dinner or watching TV. Using aggressive debt collectors, the Tax Office is undertaking a new programme attempting to collect some of the \$6.5 billion owed to the Tax Office by nearly 800,000 taxpayers.

External agencies will be hired to track businesses owing less than \$7,500 and telephone calls will be made to the homes of taxpayers between 5pm and 8.30pm.

From next April, dialler technology will be introduced. A computer will automatically work its way through a list of phone numbers, repeatedly ringing the phone until someone responds, at which point the call is transferred to a staff member. The process is supposed to filter out wrong numbers, busy signals and fax lines and is expected to boost the number of people contacted.

OUR VIEW

The Federal Government came under pressure from the Business Council of Australia (BCA) due to inaccurate information provided by Treasury for budget purposes.

According to the BCA, significant deviations between projected and actual revenues are not acceptable in the private sector, nor should they be accepted in the public sector. Excessively conservative estimates of taxation receipts have resulted in failures to carry out needed tax reform. In the last three years, budget surpluses were underestimated by these amounts:

2002/03	\$5.4 billion
2003/04	\$5.8 billion
2004/05	\$11.2 billion

In an editorial, *The Australian Financial Review* took issue with the fact that the Treasury blithely admitted to its appalling record of undershooting on revenue forecasts and to its habit of ignoring second round effects when costing tax measures, except when it suits the Government.

David Russell, President of the National Party, said that it was the Treasurer who stood in the way of Coalition consensus on the need for tax reform. According to Russell, even high ranking Treasury officials were concerned about Australia's international tax competitiveness. These criticisms were dismissed by the Treasurer who said that the error factor should be related to revenue and expenditure totals, not to surpluses. (Apparently there are different rules for Government – private enterprise must forecast profits as well as total revenues. If their profit forecasts are out, directors have some explaining to do!)

Under pressure from a number of sources to provide tax cuts in the upcoming Budget, the Treasurer has appointed two people – Dick Warburton and Peter Hendy to compare and contrast the Australian tax system and its laws with those of the other 23 richest nations in the world. These two people have just 36 days to undertake this work and to provide a succinct report on overall level of taxes, tax mix, tax base and rates of each of 24 OECD countries.

Branded as an impossible task and political sham, this action has been severely criticised because of its far reaching nature and very short time factor.

Whilst serious tax reform is urgently needed, it appears that this will not be on the agenda for the forthcoming Budget and we can but hope that the demands of leading business groups, including the BCA, the Australian Chamber of Commerce and the Australian Industry Group for cuts in personal income tax rates and superannuation taxes will be favourably looked upon by the Treasurer.

Tony Lovett

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TAXPAYER ALERTS

Taxpayer Alerts have no legal standing. They represent a warning from the Tax Office that it has concerns about a particular scheme or transaction.

TA 2005/4 – Creation of GST Input Tax Credits by Barter Exchanges

This arrangement involves a Barter Exchange setting up a trading account for itself and acquiring goods or services from members at grossly inflated prices and using trade dollars to pay.

Due to the grossly inflated prices on its acquisitions, the Barter Exchange lodges its BAS and claims GST refunds as its acquisitions exceed its supplies.

These acquisitions create a GST liability for the supplying member. The member offsets these through additional acquisitions in trade dollars at grossly inflated prices.

The Tax Office considers that:

- The acquisitions may not be creditable acquisitions;
- The Barter Exchange may not be carrying on an enterprise as defined; and
- The anti-avoidance provisions of the GST Act may apply.

TA 2005/5 – Outbound Offshore Re-invoicing Arrangement

This Alert applies to small businesses that exhibit the following features:

- An offshore structure is created in a tax haven;
- The taxpayer claims to provide goods or services to a third party through a re-invoicing arrangement via the offshore structure;
- The goods or services are provided to the offshore structure then re-invoiced to the third party at market value;
- The offshore structure accumulates the profits on the price differential;
- The taxpayer may access these profits, often in a disguised form;
- The taxpayer does not disclose involvement with the offshore structure and does not pay Australian tax on its profits.

The Tax Office is looking at the following issues:

- Whether the arrangement is a sham;
- Whether the offshore structure is an Australian resident under the Tax Act;
- Whether the offshore structure, the promoter or someone else is acting as agent or trustee for the taxpayer;
- Whether the offshore structure's income can be attributed to the taxpayer under the Act;
- Whether Part IVA or any other provision of the Act applies.

TA 2005/6 – Use of an Inbound Offshore Re-invoicing Arrangement

This arrangement is also generally used by small businesses in a similar manner to that outlined in TA 2005/5. However, it applies to the import of goods or services from overseas and the offshore structure acquires the goods or services from the third party at market value but re-invoices the same goods or services to the taxpayer at a price substantially above their market value.

Again, the offshore structure accumulates the profits which may be accessed by the taxpayer, often in a disguised form.

The Tax Office has the same concerns about these arrangements as in TA 2005/5.

TA 2005/7 – Asset Transfer to an Offshore Structure at Below Market Value

Arrangements under this heading have the following features:

- An offshore structure is established in a tax haven;
- The taxpayer transfers an asset to the offshore structure at a price substantially below its market value;
- The asset may include shares, options over shares, intellectual property, other intangible assets or the creation of a new asset such as the assignment of rights to future income.
- The offshore structure subsequently disposes of the asset to a third party at market value, retaining the proceeds;
- The taxpayer may access these proceeds, often in a disguised form;
- The taxpayer does not disclose their involvement in the offshore structure and does not pay Australian tax on the offshore structure's profits.

The Tax Office is looking at the same issues that apply to TA 2005/5 and TA 2005/6.

TA 2005/8 – Asset Transfer to an Offshore Structure at Below Market Value Subsequently Used for Income Producing Purposes

Similar conditions apply as in TA 2005/7 however in this case the offshore structure does not sell the asset but uses it to generate passive income which is retained by the structure and accessed by the taxpayer, often in a disguised form.

Again, the taxpayer does not disclose involvement in the offshore structure and does not pay Australian tax on the income earned by the offshore structure from the use of the asset.

The Tax Office is looking at similar issues as in the previously mentioned Alerts.

FBT – LAPTOP COMPUTERS

Our views concerning the provision of laptop computers and accessories to employees were expressed in an answer to a Reader Question in *Tax IQ Monthly* January/February 2006 issue.

These can now be updated following the release of minutes of a recent FBT sub committee meeting of the National Tax Liaison Group.

At this meeting the Tax Office provided its views on whether certain accessories provided with laptop computers were subject to the FBT laptop exemption.

The Tax Office has advised that pre-loaded software forming part of the overall computer package (not charged separately nor clearly identified as an additional cost) would be exempt.

Separate or subsequent software would only be exempt if it is for use in the employee's employment. This software only needs to be for use in the employee's employment and does not have to satisfy a predominant or primary test.

The exemption also extends to items that are "bundled" by the retailer as part of a special offer. The items would need to be included in a single invoice.

Where a retailer offers a special deal which includes upgraded memory and an extended warranty as part of the cost of the computer and this forms one price on the invoice, the exemption will also apply.

However, where peripheral items such as cables, modems or cradle, or an upgrade to the memory or extension to warranty is provided at an additional cost, the exemption will not apply. Nor will it apply to any computer externals not necessary for the basic operation of the computer.

Built-in internals such as modem and fax cards form part of the computer and are exempt.

A protective carry bag is also exempt if it forms part of the cost price of the computer but not if it comes at an added cost or is separately invoiced.

The Tax Office has suggested that where a particular item does not come under the laptop exemption, it may be exempt under the "otherwise deductible" rule or under the "minor benefit exemption" (minor benefits of a value less than \$100.)

SUPERANNUATION FUNDS – SPECIAL INCOME

Under Section 273 of the 1936 Tax Act, certain types of income diverted to self managed super funds for the intention of getting the benefit of concessional tax rates are taxed at 47% as special income.

The Tax Office has recently issued a new draft Ruling on this subject. The initial draft Ruling was issued back in 2000. This has been withdrawn with effect from 25 January 2006 when the new draft Ruling takes effect.

Keep in mind that a draft Ruling is not legally binding until it is finalised.

Special income of a super fund includes:

- Direct or indirect dividends from a private company;
- Income from a transaction where the parties are not dealing at arm's length;
- Discretionary trust distributions;
- Fixed trust distributions paid on a non-arm's length basis.

Where an amount is paid to a super fund as special income (e.g. rental income is excessive) the amount cannot be apportioned between an arm's length amount and the excessive amount. The whole amount would be treated as special income.

Private company dividends are treated as special dividends unless the Tax Office believes it would be reasonable not to so treat the dividend. The Tax Office will form this opinion where the dividends are derived on an arm's length basis. To achieve this, the shares must have been purchased, investment made and dividends received on an arm's length basis. All transactions must be in accordance with normal commercial practice.

In forming a view as to whether or not these conditions are satisfied, the Tax Office will look at the following matters:

- Value of shares – has the super fund received favourable consideration compared with other shareholders in relation to amounts paid up on the shares?
- Cost of shares – were the shares acquired for less than market value?
- Dividend rate – is the rate of dividend a reasonable return on the investment? This question would take into account level of risk, dividends paid by comparable public companies in the same industry and differing rates of dividend on classes of shares;
- Dividends on other shares – is the rate of dividend paid to the super fund greater than the rate of dividend paid to other shareholders?
- Shares issued – have bonus shares been issued to the super fund? Depending on circumstances of the issue this could be an unfavourable factor.
- Other matters – relationship factors will also be looked into. Are the members at arm's length from the company? What is the relationship between the super fund and the company and those from whom the shares were purchased?

Note that if the super fund derives income from a discretionary trust or by way of the trustee or someone else exercising a discretion, that income will be special income.

Income arising from a fixed entitlement in a unit trust will be treated as special income if:

- The units were acquired or the income derived under an arrangement;
- The parties to the arrangement are not dealing at arm's length; and
- The distribution is more than it would have been had the parties been dealing at arm's length.

NSW – LAND TAX

The NSW Premier, Maurice Iemma, has announced the following changes to land tax thresholds commencing from the 2006 land tax year:

Tax free threshold to be increased from \$330,000 to \$352,000;

In future the tax free threshold will be indexed annually;

An averaging system to be introduced from 2007 to protect property owners against sharp annual changes in land tax assessments.

The land tax rate of 1.7% on the combined value of all taxable land in excess of the threshold remains unchanged. Non-concessional companies and special trusts pay the same rate of tax but do not have the benefit of the tax-free threshold.

VIC – LAND TAX

Effective from 1 January 2006 there are special rates of land tax payable by trusts holding land in Victoria. Trustees are required to notify the State Revenue Office by 31 March 2006.

The rates payable by trusts holding land compared with normal land tax rates are shown below:

Value of all Land Held	Special Rate for Trusts	Normal Rates
\$0-\$19,999	Nil	Nil
\$20,000-\$200,000	\$75 Plus 0.375% of value exceeding \$20,000	Nil
\$200,001-\$540,000	\$750 Plus 0.575% of value exceeding \$200,000	\$200 Plus 0.2% of value exceeding \$200,000
\$540,001-\$900,000	\$2,705 Plus 0.875% of value exceeding \$540,000	\$880 Plus 0.5% of value exceeding \$540,000
\$900,001-\$1,190,000	\$5,855 Plus 1.375% of value exceeding \$900,000	\$2,680 Plus 1% of value exceeding \$900,000
\$1,190,001-\$1,619,999	\$9,843 Plus 1.875% of value exceeding \$1,190,000	\$5,580 Plus 1.5% of value exceeding \$1,190,000
\$1,620,000-\$2,699,999	\$17,905 Plus 1.706% of value exceeding \$1,620,000	\$12,030 Plus 2.25% of value exceeding \$1,620,000
\$2,700,000 and over	\$36,360 Plus 3.5% of value exceeding \$2,700,000	\$36,330 Plus 3.5% of value exceeding \$2,700,000

Once land values reach \$2,700,000 the land tax rate payable by trusts is the same as that payable by other entities.

To overcome these punitive rates, trustees of discretionary trusts may nominate a beneficiary as the landowner for land tax purposes. If this occurs, the trust will be assessed for land tax on the land at normal rates but the land will be aggregated with any land the particular beneficiary may own personally. The individual could also be liable to pay "top up" land tax because it is now assessed at a higher rate.

Beneficiary nominations are subject to various conditions:

- The nomination must be made before 30 June 2006 for the 2006 land tax year, or within 3 months after the date land tax liability first arises;
- Nominations are only available in respect of land purchased before 1 January 2006;
- The nominated beneficiary must be over 18 or, if no beneficiary over 18 exists, be the trustee;
- The nominated beneficiary may be changed if the beneficiary dies or if the land tax commissioner considers it just and reasonable;

- The nominated beneficiary may revoke the nomination in which case the trustee will pay the punitive rate of land tax;
- Land held by the nominated beneficiary is "grouped" with the trust land for land tax purposes;
- Where land is held by a fixed or unit trust, the notification must outline all beneficiaries interests and, whilst the trustee will be assessed on land owned by the trust, it will also be grouped with lands held by the beneficiary, beneficiaries or unit holders who may be required to pay "top up" tax.

FBT – EXEMPTIONS FOR CHARITIES

The Tax Office has made a recent announcement to clarify the FBT exempt thresholds for public benevolent institutions (PBIs) and public and non-profit hospitals. These thresholds have been available for some years and the Tax Office says there is some confusion about them. The exemptions are as follows:

- PBIs (other than hospitals) - \$30,000 per employee;
- Health promotion charities - \$30,000 per employee;
- Public and non-profit hospitals - \$17,000 per employee;
- Public ambulance services - \$17,000 per employee.

PBIs and health promotion charities must be endorsed by the Tax Office to access these exemptions whilst endorsements for public and non-profit hospitals and public ambulance services is not necessary.

The thresholds are the amounts applicable after grossing up the value of the fringe benefit provided in accordance with normal FBT rules.

"BLACK HOLE" EXPENSES

In confirmation of a May 2005 Budget announcement, an amending Bill is currently before Parliament to provide tax deductions for capital expenditure which cannot form part of the cost base of an asset and which otherwise would have been non-deductible and hence disappeared into a "black hole".

Commencing from 1 July 2005, capital expenditure incurred in relation to a past, present or prospective business being or to be carried on for a taxable purpose will be deductible if not otherwise counted or specifically denied deductibility.

The measures will provide that:

- Business capital expenditure incurred in relation to existing businesses carried on for a taxable purpose, not otherwise deductible or specifically denied deductibility, can be written off in equal instalments over 5 years;
- Expenditure incurred in relation to past or prospective businesses can also be deducted in equal instalments over 5 years provided the expenditure is not otherwise deductible nor specifically denied deductibility;
- The definition of expenditures which can be included in the cost base of CGT assets and depreciating assets is to be widened to include marketing expenses, search fees, conveyancing kits and borrowing expenses. These rules will apply to taxpayers whether carrying on a business or not.
- Capital expenditure incurred in terminating a lease or licence will be deductible in equal instalments over 5 years provided the expense is incurred in the course of carrying on or in ceasing a business.

The amendments relating to the 5 year write-off and the widening of cost base rules for depreciating assets apply in respect of expenses incurred on or after 1 July 2005.

The amendments relating to cost base of CGT assets apply to CGT events happening on or after 1 July 2005. This means that for CGT assets, expenses which may have been incurred prior to 1 July 2005 can be taken into account if the asset is sold after that date.

TEMPORARY RESIDENTS

Also confirming a 2005 Budget announcement, legislation has been introduced to Parliament to provide exemption from foreign sourced income of people who have come to Australia on a temporary basis.

This exemption will apply to individuals in Australia on temporary visas. A previously announced 4 year time limit has been removed so that the measures apply to all visitors to Australia who will, from the time these provisions come into force, not have to:

- Pay Australian tax on foreign sourced income;
- Pay Australian capital gains tax on assets not connected with Australia; and
- Pay interest withholding tax in respect of any interest paid to foreign lenders;
- Comply with the foreign investment fund (FIF), controlled foreign company, (CFC) and transferor trust rules.

This measure removes a serious problem for expatriates coming to Australia for temporary periods. They have in the past experienced serious problems in getting caught up with Australian tax rules on assets and income which have no relation to, or source in, Australia.

These changes are not yet in force. They will apply to income years which commence following the date of Royal Assent. This means that the measures will commence from 1 July 2006 or 1 July 2007, depending on when the legislation goes through.

Changes relating to interest free holding tax exemption commence from date of Royal Assent.

BOOKKEEPERS AND TAX AGENTS

Section 251L of the 1936 Tax Act prohibits anyone apart from a registered tax agent or barrister or solicitor from preparing a tax document or providing tax advice. Due to expected excess demand, this section was amended on the introduction of the GST to enable BAS services to be provided by bookkeepers working under the direction of a registered tax agent.

The Tax Office has recently issued guidelines about what is required to ensure independent bookkeepers are actually "working under the direction of a registered tax agent" when they provide BAS services to clients.

In order for a bookkeeper to be "working under the direction of a registered tax agent", the tax agent must have a risk-based quality assurance process in place to review the BAS services provided by the bookkeeper for accuracy and completeness, and be satisfied with the standard of BAS services provided.

The Tax Office recommends that the parties should document and maintain copies of their agreement as to:

- The clients;
- The period covered; and
- The details of the agreed quality assurance process.

Privacy, liability and appropriate provisional indemnity insurance considerations should be documented.

Competence

The bookkeeper must have appropriate knowledge and skills, including:

- Knowledge of tax laws relating to BAS and Tax Office Rulings;
- Knowledge of Tax Office administrative policies and procedures concerning lodgement of BAS;
- Knowledge of procedures and practices to complete BAS from clients' source accounting records; and
- Knowledge of appropriate software packages.

This knowledge can be evidenced by:

- Appropriate industry qualification or membership of bookkeeper associations;
- Previous work experience or demonstrated competence;
- Check lists, reconciliations and procedures and documented procedures;
- Tax agent's support for specific issues; and
- Maintaining information about new developments and regular updating of procedures and documents.

Checking by Tax Agent

The tax agent must undertake sufficient review activities to be assured that the clients are protected from malpractice and incompetence.

When designing a quality assurance process, the following matters require consideration:

Inherent Risk and Materiality. Consider:

- Bookkeeper's experience and qualifications;
- Complexity of work;
- Size of client's transaction.

Control Risk. Consider:

- Demonstrated use of check lists;
- Maintenance of detailed working papers;
- Use of appropriate research processes;
- Demonstration – accuracy and completeness of work previously reviewed.

Detection Risk. This is the risk that mistakes will not be identified. Level of this risk will depend on the nature, timing and extent of the tax agent's checking procedures. Consider:

- Sampling. The sample should be representative of the whole of the work, and;
- Checking original client documentations to verify workings of the BAS.

The Tax Office considers that in all cases, some substantiation procedures must be undertaken as it is not appropriate to conclude that inherent and control risks are so low that checking is not necessary.

It is preferable that reviews be performed prior to lodgement of BAS, however, timing of the checking of a bookkeeper's work is up to the tax agent. An appropriate time for review of BAS may be the time when the income tax return is being prepared by the tax agent.

Corrective Action and Feedback

After review, the tax agent must ensure that the bookkeeper:

- Is made aware of the deficiency, and
- Is educated as to the correct treatment.

Where mistakes have been identified it will be the bookkeeper's responsibility to identify and correct all instances. The tax agent should review existing quality assurance processes to correct any identified deficiencies and to, if necessary, increase the sample size or a greater proportion of pre-lodgement reviews.

Where errors are identified, voluntary disclosures of tax shortfalls will generally result in significant reductions of penalties.

SUPER FUNDS AND ACCOUNTANTS

The number of self managed super funds (SMSFs) previously running at the rate of 3,000 per month, dropped to 2,000 per month during 2005 and is still declining.

CCH Tax Week considers that this may be a result of excessive complexity and the problem that accountants are unsure as to whether they are able to provide advice about super fund establishment.

Unless holding an Australian Financial Services Licence (AFSL), accountants are precluded from providing advice about investment strategies. They are, however, permitted to:

- Provide advice about the establishment, operation, structuring or valuation of an SMSF;
- Arranging for another person to deal in interests in an SMSF; and
- Provide advice on taxation issues, including taxation implications of SMSFs.

These exemptions are subject to some restrictions and accountants must be careful not to provide financial product advice.

Accountants without an AFSL cannot advise clients to establish an SMSF by transferring their interest in an industry fund. However, if the client had already decided to establish an SMSF, the accountant could provide advice about administrative matters concerning the setting up of the fund.

CCH Tax Week considers that current regulations may have placed accountants in an untenable position causing them to keep silent about super fund establishment, resulting in potential fund members being inadequately advised or unaware of possible benefits.

SUPERANNUATION PENSIONS

Commencing from 1 January 2006 the method by which term allocated (market linked) pensions and allocated pensions are calculated has been changed.

Term Allocated Pensions

Using a term allocated pension you are eligible for the pension RBL (currently \$1,238,440) and also for a 50% exemption from the Centrelink assets means test.

You can invest in a range of investments including growth assets. The actual pension increases or decreases in line with market movements. Previously you had to choose a term which covered you and your spouse's life expectancy at commencement, or that expectancy on the assumption that you were 5 years younger at commencement.

For pensions commencing from 1 January 2006, you can elect to have the pension payment continue until you and (for reversionary pensions) your spouse reach age 100. Additionally, each year you can vary the market linked pension payment by between plus or minus 10%.

If desired, your spouse can commute the pension following your death. These changes will enable you to receive a reduced pension which could lower your income tax if you have other income, or increase your entitlement to Centrelink pensions. The ability to vary annual pensions by plus or minus 10% enables you to reduce your pension still further or alternatively to receive a little more in years where the fund has a poor investment return.

Allocated Pensions

These are pensions where you still have some control over the capital sum. The applicable RBL is the smaller lump sum figure (currently \$619,223.) The amount of capital invested in an allocated pension is fully assessed for the Centrelink assets means test.

Pensions are determined using the pension valuation factors (PVFs) which reflect life expectancies and you have the choice of electing between an upper and lower figure. The PVFs have been updated with effect from 1 January 2006 to reflect current life expectancies.

These are the rules:

- For pensions which commenced prior to 1 January 2006 the old PVFs must be used and must continue to be used for the life of the pension;
- For pensions commencing between 1 January 2006 and 30 June 2006 you have a choice of using either the old PVFs or the new PVFs;
- For pensions commencing from 1 July 2006 the new PVFs must be used.

NIL TAX RETURNS

The Tax Office normally cannot amend income tax assessments after four years from issue. This measure provides a modicum of certainty for taxpayers but not for those who have submitted nil or loss returns. Because assessments have not issued, the Tax Office has had, in the past, unlimited time in which to revisit those returns, disallow expenses and issue assessments. With recent amendments this has changed.

Nil returns and loss returns for 2004/05 and later years, lodged after early January 2006 will receive a notice of assessment. Full self assessment taxpayers (companies and super funds) will be deemed to have been served with a notice of assessment.

Nil and loss returns for 2004/05 processed before January 2006 will be regarded as original assessments. This means that the period of review commences on the day of issue of the non-taxable advice or assessment for the 2004/05 return. The four year reviewable period commences from that day.

READER QUESTIONS:**FBT – MOBILE PHONES****Question:**

In *Tax IQ Monthly* January issue you mentioned that mobile phones are exempt from FBT – is this the case where the company owns the phone and pays the bill?

Answer:

Yes (but keep in mind that the phone must be primarily used in employment – that is for business purposes).

CGT – MAIN RESIDENCE EXEMPTION**Question:**

A vacant block of land was purchased by a couple for the purpose of building their main residence. This did not proceed because it was cheaper to buy an existing residence. The vacant block will be sold and the proceeds used to reduce the mortgage on the main residence. Will CGT apply?

Answer:

Yes. The main residence exemption applies only to the home in which you live. It cannot apply to a vacant block. Replacement asset rollovers are only available in very restricted circumstances and unfortunately this is not one of them.

WORK RELATED VEHICLE EXPENSES**Question:**

A client has the use of a motor vehicle under a novated lease as part of his salary sacrifice package. He provided a log book to calculate appropriate percentages for work and private use. His employer has told him that he believes that the work kilometres can be claimed in his own return as work related motor vehicle expenses. Is this correct?

Answer:

No. If the vehicle was provided by the employer, vehicle expenses can only be claimed by the employer. If the employee has paid any vehicle expenses that information should be passed on to the employer and will reduce FBT payable, thereby reducing any salary sacrifice contribution. No amount can be claimed in the employee's personal tax return.

JOINTLY OWNED PROPERTY**Question:**

A husband and wife have rental properties included in their personal tax returns. Are rentals from a commercial property treated similarly or do husband and wife have to lodge a partnership tax return?

Answer:

If the property is jointly owned as an investment, the Tax Office readily accepts the relevant shares of income and expenses being shown in the personal returns without the necessity of preparing a partnership return.

If the rental income from the commercial property exceeds \$50,000 it will be necessary to register the partnership for GST and to lodge a partnership BAS. In this event you should lodge a partnership tax return as well.

SUPERANNUATION GUARANTEE**Question:**

We run a factory where we pay our staff on hourly rates for ordinary time as well as overtime and periodic bonuses. Bonuses are not related to any specific performance criteria. According to page 42 of the 2006 *Australian Taxation Manual*, 9% superannuation only needs to be paid on the ordinary time earnings. Our present accountants claim it must be paid on the gross earnings amount, including overtime and bonuses.

Which is correct? (hopefully, the Manual is correct!)

Answer:

Required superannuation support is measured at 9% of an employee's notional earnings base. This is the employee's ordinary time earnings unless a different amount must be used under an industrial award.

Ordinary time earnings is defined in Section 6 of the Superannuation Guarantee Administration Act as the total of earnings for ordinary hours of work other than lump sum payments on termination, together with earnings from over award payments, shift loadings or commissions.

The definition does not include overtime payments or bonuses not related to specific performance criteria. The definition of ordinary time earnings is fully explained in Ruling SGR 94/4.

CGT – SMALL BUSINESS**Question:**

We have a small business which we run through our company. We wish to sell the business and retain the company for possible future ventures. The proceeds of the sale are obviously taxable – do you have any suggestion for minimising the tax payable? Are there any pitfalls we should be aware of?

Answer:

Yes there are lots of consequences which you should be careful about in disposing of a small business. We strongly recommend that you obtain competent legal and accounting advice based on your own particular circumstances.

The sale of a business may involve both income tax and CGT. If you have trading stock and plant which is worth considerably more than its depreciated value, you could have substantial income tax consequences.

Sale of the business with substantial good will may involve CGT. There are a number of concessions available for small businesses including the active asset exemption, the small business retirement exemption and the CGT discount. You can read about these on page 73 of the *Australian Taxation Manual* and about the sale of depreciated plant on page 23.

BUSINESS OR HOBBY?**Question:**

My sister, an aged pensioner, collects rare plants and over the years has amassed quite a large collection. When she is able, she propagates them and sells the extras on e-Bay to supplement the expense of her growing collection. Should she declare this income or is it classed as a non-taxable hobby?

Answer:

These are some of the characteristics of a business:

- Frequent acts/transactions;
- Conducted with a view to profit;
- Conducted over a lengthy period;
- Conducted continuously/systematically;
- Involves specialised knowledge;
- Significant capital investment;
- Business records kept;
- Market research done;
- Has business organisation/business name;
- Actively marketed.

It would seem that these characteristics do not apply to your sister who, we believe, is simply running a hobby. This could change if she earns substantial profits.

FBT – LONG SERVICE AWARDS**Question:**

We have granted employees gift vouchers for length of service awards. They vary from \$100 to \$500 depending on number of years' service (\$29 per annum). The employee selects the retail outlet and chooses the item and the employer pays for it. Please advise how these should be treated for tax purposes.

Answer:

Long service awards up to the value of \$1,000 for service in excess of 15 years and an additional \$100 for each additional year of service can be paid as exempt fringe benefits.

There are no exemptions for payment for service less than 15 years. If the gift voucher has a value of less than \$100 it could be exempt under the minor, infrequent and irregular exemption, otherwise the award will be subject to FBT and must be included in your FBT return.

HOME OFFICE EXPENSES**Question:**

The *Australian Taxation Manual* quotes the deduction for electricity, gas and depreciation of office furniture at 20 cents per hour but this has been raised to 26 cents per hour for 2004/05.

Answer:

Thank you for pointing out this oversight.

CGT – VACANT LAND**Question:**

My client purchased a block of land and built his principal residence. Due to better work prospects and opportunities, he moved to Queensland. He sold the block of land within 12 months and made a profit of \$50,000. He has been assessed for CGT. He intended to build his home on the land but changed his mind and moved interstate for better opportunities. He is currently running a successful business in Queensland so his move was justified.

Are there any case studies to support that he should not be liable for CGT?

Answer:

Unfortunately, no. Main residence exemption is only available if your client actually lived in the residence. The CGT discount is not available because the asset was owned for less than twelve months.

SUPERANNUATION GUARANTEE**Question:**

We have a casual employee who works on average 10 hours per month and receives wages of \$600 per month. Do we need to pay SGC super? What will happen if he works only a few hours a month?

Answer:

Superannuation guarantee support does not have to be provided for:

- Employees paid less than \$450 in a particular month;
- Employees aged 70 or more;
- Employees under 18 working not more than 30 hours per week;
- Employees paid for domestic or private work for not more than 30 hours per week;
- Partnerships, companies or trusts;
- Taxi drivers

If your casual employee's earnings drop to less than \$450 in any month you do not have to pay SGC for that month.

LUXURY CAR LEASING**Question:**

We have noticed in the commercial marketplace that some banks are offering "luxury car leasing" for vehicles over \$57,009 and are removing clauses in their standard lease documents relating to depreciation.

Have the rules been changed? We thought that no matter what the customer signs with the bank, they can only depreciate up to the luxury car ceiling plus interest. They cannot deduct the full monthly rental charge.

Answer:

You are correct. There has been no recent change in the law. Leases of luxury cars (other than genuine short term hiring arrangements) with a cost price over \$57,009 must be treated for tax purposes as if they were hire purchase agreements with a depreciation cost limit of \$57,009.

FBT – MEAL ENTERTAINMENT**Question:**

Can you please advise which method we should use for our entertainment expenses. We probably have only 20 items. If we choose not to use the 50/50 method, do we treat the expenditure as a property fringe benefit?

How do we account for each item under this category? For example, our managing director takes two clients out for lunch at a restaurant. If the total bill comes to \$75, do we record a property fringe benefit of \$25 for our MD's proportion and claim a tax deduction for that expense with the \$50 client portion being recorded as non-deductible entertainment expenses? Would the same position apply for a party held at our premises? It seems that this way we could minimise our FBT.

Answer:

There are three alternatives:

- Use the 50/50 method, treating 50% of the cost as deductible but subject to FBT and the balance as non-deductible entertaining;
- Use the 12 week register method, recording all entertaining costs in a register over a 12 week period indicating details of employees and clients who received meal entertainment. At the conclusion of the 12 week period you determine the percentage of total expenditure applicable to employees and subject to FBT with the balance being treated as non-deductible entertainment.
- Alternatively, you can keep records in respect of every transaction, noting details of employees and clients attending each function and apportioning the costs accordingly.

You can use whichever method you consider results in the least cost to your company.

SUPERANNUATION BENEFITS**Question:**

An associate who is 55 has applied for and is in the process of receiving his superannuation as a lump sum. Please advise the implication if he continues to work. He is currently only casually employed but may find full time employment.

Answer:

In order to receive his benefit as a lump sum he must satisfy the trustee that he has retired. The amount received is an eligible termination payment (ETP) and will be taxed at 15%. If he obtains alternative employment he will be taxed on this as well. If he does not need the lump sum benefit immediately he may wish to consider rolling his super benefits into another super fund but must do this prior to receipt of the funds.

SUPERANNUATION CONTRIBUTIONS**Question:**

I have to prepare a tax return for a member of a State Parliament. There are two payment summaries. One shows the member's salary with tax withheld and the second shows Parliamentary allowances which also has a component of tax withheld.

The Member Entitlements Handbook explains that "salary is paid fortnightly and is subject to PAYE income taxation. The Clerk of the Parliament deducts superannuation contributions on behalf of each member". This leads me to believe that the gross salary included in the payment summary includes an amount paid into superannuation. If this is included it should surely be claimed as a deduction.

Answer:

The amount deducted from gross salary is a personal contribution, not a salary sacrificed employer contribution. As the member enjoys superannuation support from his employer he is not entitled to claim a deduction for personal superannuation contributions.

An individual who has employment income can only deduct personal superannuation contributions if his assessable income and reportable fringe benefits from employment is less than 10% of his total assessable income and reportable fringe benefits for the year.

GST – PERSONAL DIGITAL ASSISTANTS (PDAS)**Question:**

Our company provides software to customers. It would like to purchase PDAs which are compatible with the software and provide these to customers. If invoices are made out to the customers and we pay these on their behalf, would we be able to claim the tax deduction and the GST input tax credit?

Answer:

It would seem, under these circumstances, that while you are acquiring the PDA for subsequent delivery to the customer under a marketing arrangement, you are arranging for the items to be acquired in the customers' names, acting as your agent.

You can claim an input tax credit when you hold a tax invoice (addressed to the agent) and make payment for the item. You can claim a tax deduction for the expenditure as having been necessarily incurred in order to earn income and hence deductible under Section 8-1 of the 1997 Tax Act.

FREQUENT FLYER POINTS**Question:**

My investment company has a large margin loan to purchase listed shares. The company pays 0.20% (or 20 basis points) extra so that it earns Qantas frequent flyer points. These points are awarded in my name. Due to the size of the margin loan and the pricing structure, I am earning well in excess of 250,000 points per year.

Would these points be treated as income or as a fringe benefit? How is the value determined? How is the tax payable computed? Does the Tax Office have a legal right to oblige Qantas and the margin lender to provide details of frequent flyer points earned?

Answer:

Fringe benefits tax is only applicable in relation to benefits provided to employees in their capacity as employees. The connection between the benefit and the employment must be material.

If the benefit is being provided to you in your capacity as a shareholder rather than as an employee, there will be no FBT problem. You then have to determine whether you are receiving a non-cash business benefit under Section 21A of the 1936 Tax Act. This is property or services provided to the taxpayer wholly or partly in respect of a business relationship or for or in relation directly or indirectly to a business relationship.

It would seem this doesn't apply either and the benefit is coming to you as a non-cash benefit provided to a shareholder of a company, not for an income producing or business purpose. On this view, the extra 20 basis points payable to the margin lender would not be tax deductible and the frequent flyer points would not be taxable.

In answer to your final question, yes the Tax Office does have a legal right to oblige both Qantas and your margin lender to provide all required information. The Tax Office's information gathering powers are very strong and no organisation can deny access.

TRAVELLING EXPENSES**Question:**

Our soccer players receive a weekly travel allowance to cover expenses for travelling to and from games and training. I have deducted PAYG instalments from these allowances. Is this correct? If so, is there any way I can avoid paying PAYG instalments?

We are a small club and with a small budget. If tax on travel allowances cannot be avoided we will have to increase the amount of travelling allowances paid.

Answer:

Your footballers should be entitled to a deduction for costs incurred in travelling to and from games. Accordingly, members should provide details of travel costs incurred and provide you with this information. If you are satisfied that your players have offsetting tax deductions against the allowances received, you will not need to deduct PAYG instalments.

GST – MEDICAL EXPENSES**Question:**

Regarding the item in *Tax IQ Monthly* January issue concerning non-deductibility of medical and dental procedures which are solely cosmetic, does this mean that these procedures are now subject to GST?

Answer:

Actually, most forms of cosmetic surgery have always been subject to GST. There is an exception which applies to cosmetic surgery undertaken for medical reasons, eg if the person has been in a fire, cosmetic surgery may be required to improve the skin graft that has been done.

LICENCE FEES AND ROYALTIES**Question:**

Our client has a "licence to use land" lease drawn up between himself as the licensor and his company as licensee to remove sand. The agreement states that the "licensee agrees to pay the licensor a licence fee of \$20,000 for the first hectare out of the licence area to be excavated and a licence fee of \$30,000 per hectare for any successive hectares to be excavated". Is this royalty income received assessable or non-assessable income?

Answer:

It is assessable income. Even though it can be argued that it is income of a capital nature, it falls for tax under Section 15-20 of the 1997 Tax Act which provides "your assessable income includes an amount that you receive as or by way of royalty within the ordinary meaning of "royalty".... if the amount is not assessable as ordinary income under Section 6-5. In other words, if Section 6-5 doesn't catch it, Section 15-20 will.

FBT – EMPLOYMENT RELATIONSHIP**Question:**

Is a director who received director's fees (but no salary) considered to be an employee?

Answer:

Yes, but remember that FBT is only applicable to benefits provided to employees in their *capacity as employees*.

SHAREHOLDER BENEFITS**Question:**

Can benefits be provided to a shareholder (who is not an employee) but whose spouse is an employee?

Answer:

This could get caught under the FBT provision relating to benefits to associates of employees. The company can, however, provide a benefit to a shareholder provided that benefit is specifically stated to be a provision of a benefit to a shareholder in his capacity as a shareholder. This makes the benefit a non-deductible capital item.

FBT SHAREHOLDER BENEFITS**Question:**

Could a company provide a house or a car for the benefit of the shareholder and his spouse?

Answer:

Yes, provided the benefits are provided to them in their capacity as shareholders and provided the company does not claim any tax deductions relating to these items.