

OUR VIEW

In a recent speech, the newly appointed Commissioner of Taxation, Michael D'Ascenzo, spoke about a new relationship between the Tax Office and the tax profession. He prefaced his speech by saying that tax agents have a symbiotic relationship with the Tax Office. I thought this was an interesting observation and looked up *symbiotic* in the Macquarie Dictionary. This is the adjective of the noun *symbiosis* meaning a union of two animals or plants advantageous or necessary to both. The example given is the case of the fungus and algae which together make up the lichen.

One wonders if the fungus represents the Tax Office and the algae the tax profession or vice versa? Seriously though, the speech does indicate a substantial improvement in the attitude of the Tax Office to people at the coalface endeavouring to cope with burdensome rules and regulations.

The Tax Office intends to continue working with the tax profession in forums such as the CEO Forum, the National Tax Liaison Group and the Tax Practitioner Forum, and will make these transparent by doing away with the use of confidentiality agreements which have stopped members from seeking broader views among taxpayers and tax agents.

The publication and circulation of agendas and minutes will no longer be restricted.

Through improvements to the tax agent portal, premium phone services and improved correspondence, the Tax Office aims to continue its change programme by making it *easier, cheaper and more personalised* to deal with the Tax Office.

The tax agent portal has become a valuable tool to tax agents in obtaining information about their clients' tax affairs. Planned improvements include enabling agents to access information for their clients concerning Centrelink payment summaries, child care rebate details and family tax benefit information.

In this issue, we publish details of proposed new effective lives and depreciation rates for some farming operations, plant nurseries and similar. These are due to commence from 1 July 2006 and are as yet only in draft form. A quick review of the effective life determinations will show that the Tax Office is by no means being generous. One wonders whether plant items on the list will actually last as long as the Tax Office thinks they will.

You have the right to depart from the rates determined by the Tax Office if you have good reason and evidence to show that the effective working life of plant in your business is shorter than the Tax Office's determination. You would be wise to have independent written evidence.

The Tax Office may be starting to relent on the hard line it has adopted about water rights for farmers. Since this asset has been separated from the land, the Tax Office considers that it can no longer be acquired from a farmer by his super fund. We report that the Tax Office agreed to consider further submissions on this important topic.

With the start of a new FBT year from 1 April, we publish new per kilometre rates for the provision of vehicles (not motor cars) to employees and also for 2005/06 per kilometre rates for claiming deductions for business kilometres in motor cars.

There is a limit on the amount of depreciation you can claim for luxury motor cars used for business purposes. In this issue, we publish details of a clarifying draft determination issued by the Tax Office about how the depreciation cost limit works vis-à-vis the input tax credit.

The end of another financial year is approaching. Now is the time to have a serious look at your accounting records. Prepare interim financial statements for your business, review these and estimate your profit for the full year. Discuss these with your accountant or financial adviser. In our next issue, we aim to provide end of year tax planning tips to help you ensure your tax affairs are in order and that you are not paying tax unnecessarily.

Tony Lovett

TRUE AND FAIR? A POLITICIAN'S PERSPECTIVE

Writing recently in the *Australian Financial Review*, Tony Harris, a former senior Commonwealth Officer and past NSW Auditor-General, trenchantly criticises both State and Federal Government Ministers who happily sign-off official Government financial statements which are not in accordance with accounting standards.

He instances the Commonwealth Minister for Finance and Administration, Nick Minchin, certifying the truth and fairness of Commonwealth financial statements which, contrary to accounting standards, omit accounting for GST.

Tony Harris says that Nick Minchin is putting politics above the law when he states that whilst GST and associated payments should be included, it is Government policy to exclude them. Harris makes the point that chief executives and directors in the private sector can suffer significant penalties, even gaol, for signing-off misleading statements.

He instances also the NSW Treasurer certifying the truth and fairness of that State's accounts when assets worth \$7 billion have been excluded "due to measurement problems" and \$2.4 billion of liabilities under the bankrupted WorkCover Scheme excluded because the Government does not wish to admit responsibility for the scheme it established and oversees.

In 2004/05 the ACT Treasurer departed from accounting standards which were adopted in prior accounts against the opinion of the Auditor-General. Had he kept to the standards he would have reported a deficit of \$188 million instead of a \$26 million surplus yet he still reported that the 2004/05 statements "fairly reflected the financial operations of the Territory."

SUPERANNUATION PENSIONS

In an article under this heading in *Tax IQ Monthly* March issue we noted that the current lump sum RBL as \$619,223. Unfortunately the gremlins crept in here – that amount was the RBL for 2004/05. The current (2005/06) lump sum RBL is \$648,946. The current pension RBL is \$1,297,886.

CASH ECONOMY TARGETED

Cash transactions between businesses and consumers result in substantial tax evasion. This problem was supposed to have been overcome with the introduction of GST but apparently it is still alive and kicking! The Australian Bureau of Statistics has conservatively estimated the cash economy at about 2% of GDP. This would make it over \$13 billion in 2001 – much higher today.

The Australian National Audit Office (ANAO) has released its audit report dealing with the Tax Office's strategies in relation to the cash economy. Whilst it gave the Tax Office a tick in relation to targeted elements and its preparedness to follow expert advice from the Cash Economy Task Force, it did make a number of recommendations:

- Tax Office to publish an explicit statement of its strategic approach and how it will work with particular industries.
- Tax Office should set down a charter for the Cash Economy Steering Committee, its role and responsibilities, membership and relationships with other key committees.

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- Tax Office should focus especially on compliance work directed at business-to-consumer transactions.
- Tax Office should quickly develop and implement a community education campaign.
- Tax Office should work with tax and accounting bodies to develop ideas on compliance measures.
- Tax Office should establish mechanisms allowing it to measure changes in tax revenue for particular industry sectors and changes of attitudes among business and consumers.

The Tax Office has agreed to all recommendations.

SUPER FUND ADMINISTRATION

In a recent speech to the Superannuation Professionals' Association, the newly appointed Tax Commissioner, Michael D'Ascenzo, talked about the Tax Office's approach to compliance requirements of Self-Managed Superannuation Funds (SMSF's). The Tax Office is concentrating on the prevention of compliance breaches and aims to support those seeking to do the right thing.

The Tax Office will however be firm with trustees failing to make a genuine effort to comply or deliberately avoiding obligations.

He said that 25% of Australians will be aged 65 or more by 2045 and stressed the importance of superannuation to the community.

Some statistics:

- Establishment of new super funds reached its peak of 3,000 per month during 2003 and 2004. This has slowed to 1,800 per month.
- There are currently 308,000 SMSFs holding a total of \$165 billion in assets.
- The average member balance has increased from \$84,000 in June 2000 to \$285,000 in June 2005.

The Tax Office expects to complete 3,600 audits (about one in a hundred) during 2005/06 and has a dedicated team of 35 officers who are contacting, either by phone or mail, trustees who are behind in lodging. There are 30,000 funds with outstanding income tax/regulatory returns or member contribution statements.

The main problem discovered by the Tax Office during audits are:

- In-house asset rules breached;
- Assets acquired from related parties;
- Fund assets have been used by members thereby breaching the sole purpose test;
- Fund assets held in trustees' own names instead of the name of the fund;
- Funds not meeting the definition, eg more than four members;
- Fund assets used to prop up ailing related business.

DEPRECIATION COST LIMIT - CARS

Under Section 40-230 of the 1997 Tax Act depreciation claims on "cars designed mainly for carrying passengers" is limited. The current limit is \$57,009. Depreciation can be claimed up to that limit only.

Is the principal occupant of a hearse a passenger? The Tax Office says no. It has issued draft Taxation Determination TD 2006/D10 indicating that a hearse is not a car designed mainly for carrying passengers and therefore not subject to the depreciation cost limit.

In draft Determination TD 2006/D11 the Tax Office importantly says that the amount of any applicable GST input tax credit is applied *before* the depreciation cost limit is applied. This means that you take the total cost of the car, then reduce it by the input tax credit, then apply the depreciation cost limit.

The ruling gives the following example:

A taxpayer, registered for GST, purchases a car for \$77,000. The depreciation cost limit is \$57,009. The cost price of the car (\$77,000) is first reduced by the input tax credit of \$5,182 (1/11th of \$57,009) to arrive at \$71,818. This amount exceeds the depreciation cost limit and, for depreciation purposes, the cost of the car is further reduced to \$57,009.

A second car is purchased for \$60,000. This is reduced by the input tax credit of \$5,182 and the adjusted cost is \$54,818. As this does not exceed the depreciation cost limit, there will be no further reduction under Section 40-230.

GST – PROPERTY SALE

A recent case before the NSW Supreme Court highlights difficulties involved in deciding whether or not a property sale is subject to GST.

In this case a house and land was purchased by two companies jointly and development consent was obtained to demolish the house and construct a 14 unit building on the land. The joint venturers ran into disagreements and trustees were appointed under the NSW Conveyancing Act. The house was divided into two self-contained residences. It had previously been used as a veterinary clinic and following purchase by the joint venturers it had been intermittently tenanted.

The trustees sought legal and accounting advice in relation to GST and were advised that the property was a development site and would therefore be subject to GST. The trustees therefore obtained GST registration and indicated that the property would be sold subject to GST. The property was then put up for auction and sold for \$2.76 million inclusive of GST. No election was made to apply the margin scheme.

Subsequently one of the joint venturers complained that GST was not applicable. The joint venturer obtained a private ruling from the Tax Office which confirmed that GST was not applicable on the basis that the supply was input taxed.

The joint venturer, Landmark Building Developments Pty Ltd (Landmark), then took the trustees to Court asking for compensation for breach of trust. Landmark argued that it had suffered a loss as the result of the trustees selling the property as a taxable supply. After hearing submissions and arguments as to whether or not the trustees were carrying on an enterprise and whether the property met the definition of residential premises the Court held that the trustees were carrying on an enterprise which included retaining real estate agents and other professionals, marketing the property, liaising with the owners, arranging for public auction and selling the site.

The Court considered that the Act required a prediction as to the future use of the premises at the time of supply and a decision cannot be made solely by reference to the physical construction of the premises.

In the case of a sale, circumstances can be ascertained from the physical condition of the premises, the zoning and restrictive covenants, location, development consents granted and the fact that the building was disused at time of sale. The Court found that the trustees had correctly treated the sale of the property for GST purposes.

TEMPORARY RESIDENTS

As announced in the May 2005 Budget, temporary residents in Australia will be taxed only on Australian income and capital gains from 1 July 2006. These amendments will apply to holders of temporary resident visas except those who are treated as residents for social security purposes and those with spouses who are Australian citizens or permanent residents.

New Zealanders will be eligible if they are not entitled to Australian social security or medicare benefits and have not applied for permanent residence. There is no time limit for the exemption which is to start from 1 July 2006.

Under the new rules the temporary residents:

- Will not be subject to tax on foreign income.
- Will be subject to Capital Gains Tax only in relation to Australian assets.
- Will not be caught under the CGT deemed disposal rules when leaving Australia.
- Will not be subject to the FIF rules, CFC and Transfer Trust attribution rules.
- Interest paid to non-residents will not be subject to interest withholding tax.

DEPRECIATION AND EFFECTIVE LIVES (FARMING)

The Tax Office has issued a list of proposed effective life determinations effective from 1 July 2006 for the following industries:

- Plant nurseries, cut flower, seed growing and turf production industries.
- Grain, cotton and rice farming.
- Sheep farming, sheep-beef cattle farming, grain-sheep or grain-beef cattle farming.

When these draft Determinations are finalised some items on existing lists for generic assets will be removed. The Tax Office proposes to treat items such as glasshouses, shade houses and igloos as single depreciation assets including framework, flooring and coverings. Items for conserving or conveying water are included but it should be remembered that in most cases deductions for such items are available over three years as water facilities.

The draft Determinations are as follows:

Asset	Effective Life (years)	Diminishing Value Rate (%)	Prime Cost Rate (%)
Planting Equipment:			
Benches and tables	10	10	15
Conveyers	15	6.67	10
Dibblers and Seeders	15	6.67	10
Hoppers	15	6.67	10
Pot, punnet and tray dispensers	12	8.33	12.5
Potting machines	10	10	15
Soil elevators	10	10	15
Soil mixers	10	10	15
Transplanters (plugs and seedlings)	8	12.5	18.75
Tray and punnet fillers	10	10	15
Tray washers	15	6.67	10
Vermiculite dispensers and coverers	15	6.67	10
Watering tunnels	12	8.33	12.5
Propagation Assets:			
Sell and punnet trays, reusable	3	33.33	50
Heated propagators	10	10	15
Other Assets:			
Bins and pallets	5	20	30
Fertiliser spreaders	10	10	15
Fumigation assets	5	20	30
Pasteurisation assets:			
Pasteurisation rooms	20	5	7.5
Steam boilers	15	6.67	10
Racks	15	6.67	10
Refrigeration assets:			
Insulation panels (cool rooms)	40	2.5	3.75
Refrigeration generally	10	10	15
Ride-on mowers	5	20	30
Spraying assets (chemicals)	10	10	15
Trailers	15	6.67	10
Trolleys	15	6.67	10
Weed mats	5	20	30
Turf Production Assets:			
Boom sprayers – linkage and trailed	10	10	15
Fertiliser spreaders	10	10	15
Field top makers	10	10	15
Irrigation system assets:			
Pipes and pipelines (above ground)	15	6.67	10
Travelling gun system irrigators	15	6.67	10
Land planes	25	4	6
Line planters	10	10	15
Mowers (including reel and rotary)	10	10	15
Net layers	10	10	15
Power harrows	10	10	15
Roll layers	10	10	15
Soil aerators	10	10	15
Turf harvesters (including pedestrian and tractor mounted)	10	10	15
Turf rollers	15	6.67	10
Turf seeders	15	6.67	10
Turf vacuum	10	10	15
Grain, Cotton and Rice Farming:			
Tillage:			
Generally	15	6.67	10
Harrows	5	20	30
Laser controlled scraping assets:			
Transmitters	7	14.29	21.43
Buckets	10	10	15
Rippers	10	10	15
Seeding and Fertilising Assets			
Fertiliser spreaders	10	10	15
Planters	15	6.67	10
Seed and fertiliser bins	15	6.67	10
Spraying Assets (Crop Protection):			
Broadacre booms	10	10	15
Self-propelled	8	12.5	18.75
Utility	10	10	15
Harvesting Assets:			
Boll buggies	15	6.67	10
Chaser bins	15	6.67	10
Field bins	20	5	7.5
Fuel trailers	15	6.67	10
Module builders	15	6.67	10
Module tarpaulins	5	20	30
Peanut diggers (including pullers)	10	10	15
Precision Farming Assets (excluding Hydraulic Automated Systems)	5	20	30
General Assets:			
Aeration			
Controllers	10	10	15
Kits	15	6.67	10
Augers	15	6.67	10
Conveyors	15	6.67	10
Dryers	20	5	7.5
Fuel Tanks	20	5	7.5
Moisture meters	5	20	30
Mulchers	10	10	15
Peanut pre-cleaners	10	10	15
Slashers	7	14.29	21.43

Asset	Effective Life (years)	Diminishing Value Rate (%)	Prime Cost Rate (%)
General Environmental Control Structures (Glasshouses and Greenhouses)	25	4	6
Protective Structures (Igloos, Netting, Shade Houses, Tunnel Houses)	20	5	7.5
Plant Nursery, Cut Flower and Seed Growing:			
Environmental Control Assets:	20	5	7.5
Boilers	10	10	15
Control systems	10	10	15
Evaporative coolers	10	10	15
Fogging and misting assets	10	10	15
Heating assets	10	10	15
Instruments	8	12.5	18.75
Retractable screens	5	20	30
Ventilation fans			
Fertigation System Assets (including control systems, pumps and tanks)	10	10	15
Harvesting Assets:			
Bed lifters and diggers	10	10	15
Tree spades	15	6.67	10
Irrigation System Assets:			
Control systems	10	10	15
Overhead boom irrigators (fixed track)	10	10	15
Pipes and pipelines:			
Above ground	10	10	15
Inground	30	3.33	5
Pumps	10	10	15
Tanks:			
Concrete	30	3.33	5
Metal	15	6.67	10
Polyethylene	20	5	7.5
Water Treatments Assets	10	10	15
Packaging Assets:			
Deleafers	15	6.67	10
Bunching and bundling machines	15	6.67	10
Grading machines	15	6.67	10

Sheep Farming, Sheep-Beef Cattle Farming, Grain-Sheep or Grain-Beef Cattle Farming:			
Sheep Farming Assets:			
Crutching machines (portable)	15	6.67	10
Dipping and spraying assets:			
Jet spray system assets	10	10	15
Mobile plunge dips	5	20	30
Drinkers, drinking troughs	25	4	6
Feeders	15	6.67	10
Footbaths	25	4	6
Instruments (measuring wool fibre – laser)	10	10	15
Instruments (ultrasound)	5	20	30
Sheep handling assets	15	6.67	10
Weigh bars, indicators and platforms	10	10	15
Yards, races, loading ramps			
Permanent type	40	2.5	3.75
Portable type	25	4	6
Wool shed assets:			
Grinding machines	30	3.33	5
Shearing machines	30	3.33	5
Shearing and crutching hand pieces	10	10	15
Wool bale movers	20	5	7.5
Wool presses	20	5	7.5
Wool shed/shearing sheds	50	2	3
Wool tables	20	5	7.5

This legislation catches trusts not involved in land tax minimisation. No other State has such draconian rules.

Recently the High Court held that owners of units in a unit trust were not "owners" of land for the purposes of the Land Tax Act. This varies from prior practice where unit holders of the unit trust owning land were treated for land tax purposes as owning the land in question in the proportion of the ownership of units.

The NSW Government seized on this judgement and issued a ruling to the effect that unit trusts in NSW would now be assessed as *special trusts* and thereby lose the land tax threshold exemption. Fortunately, this time, there have been protests with one NSW accounting firm describing the action "incredibly unfair".

This action was contrasted with the Victorian Government's approach which allowed individuals to declare an interest in the land and have the land tax assessed personally. As a result of the protests, the NSW Office of State Revenue has put the proposal to treat unit trusts as *special trusts* on hold pending further review.

Let's hope that common sense and fairness will take precedence.

FRANKING CREDITS – DECEASED ESTATES

Where income is derived by beneficiaries through a life interest in a deceased estate or as beneficiary of a testamentary trust, problems have arisen in relation to claiming of franking credits.

Under existing law these franking credits could only be claimed by beneficiaries if the estate or trust lodged a family trust election thereby restricting distributions to immediate family members of the named person. If distributions were made to others who are not immediate family members, family trust distribution tax would be payable.

The law is to be amended to overcome this anomaly and allow beneficiaries to claim franking credits without the necessity for a family trust election. The amendments are to be back-dated to 1 July 2002 and trustees who have made family trust elections in order to enable beneficiaries to obtain franking credits will be given an opportunity to revoke those elections.

TAXPACKEXPRESS TO GO

The Tax Office has announced that it intends to decommission its *TaxPackExpress* service from 1 July 2006. The Tax Office will be writing to all users of *TaxPackExpress* advising that this service will no longer be available and asking users to transfer to eTax, the telephone lodgement service (which will be released nationally on 1 July 2006) or a registered tax agent.

UK BUDGET 2006

Feeling the burden of high taxes? Here's something to make you feel really envious.

The 2006 UK Budget, which was handed down on 22 March, maintains the corporate tax rate at 30%. However small companies only pay 19% for taxable profits up to £300,000.

Marginal relief is available for incomes between £300,000 and £1,500,000 when the top rate of 30% is reached.

The top personal tax rate is 40% (compared with our 48.5%).

GENERAL INTEREST CHARGE

The General Interest Charge (GIC) rate for the April-June 2006 quarter is 12.61%. The rate for the March quarter was 12.63%.

SUPERANNUATION FUNDS AND WATER RIGHTS

It is permissible for self-managed super funds to acquire *business real property* from related parties. This enables a super fund to acquire an office, factory or farm used in a business operated by members and to lease that property back to the business entity.

Water rights attached to a farming property have been separated and are now regarded as separate assets to the land and capable of being traded separately. The Tax Office recently informed a liaison group sub-committee that it considers water rights are not *business real property* and, if acquired by a super fund, may cause the super fund to breach the in-house asset rules if they exceed 5% of the total value of super fund assets.

Following submissions by the National Tax and Accountants' Association, the Tax Office has agreed to further consider its position on this matter after receipt of a more detailed submission.

MANAGEMENT FEES

In the light of the Tax Office's current attack on service trusts (it is looking closely at the level of service fees paid by operating companies to associated entities), there was a very interesting win by the taxpayer in a recent case before the Administrative Appeals' Tribunal (AAT).

In this case the taxpayer company claimed a deduction for a management fee of over \$1 million paid to a related management company. The fee was based on the company's expenses plus a mark up of 15%.

In fact only \$59,093 of the total fee had been physically paid to the management company by the end of the relevant year and there was no written agreement in place at that time. The AAT however found that a deduction was available for the full amount because there was oral agreement in place before the end of the year and the amount of the fee payable had been calculated as at that date. The AAT concluded that the taxpayer company which was in the business of processing and disposing of organic pollutants had a need for asset protection and the arrangement was made for that purpose.

NSW LAND TAX

The NSW Government has had in place for many years a draconian rule concerning land held by discretionary family trusts. These trusts are classified as *special trusts* and are not eligible for the land tax free threshold of \$352,000.

Any land (except farms) held by discretionary family trusts in NSW is subject to land tax of 1.7% from the first dollar. This draconian legislation was brought in to overcome a land tax minimisation technique involving the establishment of multiple trusts holding separate parcels of land all benefiting one particular family.

CAR EXPENSES – PER KILOMETRE RATES

Specified per kilometre rates may be claimed in respect of car expenses where the claim is limited to no more than 5,000 business kilometres during the income year. The rates for 2005/06 have been announced. These, together with the 2004/05 rates, are:

Engine Capacity		Rate Per Kilometre	
Non-Rotary Engine	Rotary Engine	2004/05	2005/06
Up to 1,600cc	Up to 800cc	52c	55c
1,601 – 2600cc	801 – 1,300cc	62c	66c
Over 2,600cc	Over 1,300cc	63c	67c

AUSTRALIA'S HIGH TAXES

The Organisation for Economic Cooperation and Development (OECD) has reported that Australia has the second highest tax rate in the world for those taking on extra paid work.

A sole working parent with two children, who takes on extra work, stands to lose up to 70 cents in every extra dollar earned under the current system.

A married couple with two children on one income faced an effective marginal tax rate of 51.5 cents for earning more than their current level. This is made up of direct tax and reduction in family tax benefits.

This report showed the tax burden on Australian workers growing whilst overseas tax rates are falling.

Australia has the third highest reliance on personal income taxes and is lagging behind other countries in reducing top tax marginal rates.

The Treasurer has commissioned a report to compare Australia with overseas' tax regimes and has since received this report. While keeping the report confidential for the time being the Treasurer has announced that he will make it public prior to the May Budget.

GST – TAX OFFICE CRITICISED

Last year the Tax Office was criticised by the Inspector-General of Taxation for withholding \$20 billion in GST refunds for verification. Some repayments were systematically delayed without justification.

The Inspector-General found that delays affected about 90% of the total value of all GST refunds but that only \$275 million in additional taxes were collected as a result of Tax Office reviews.

The Australian National Audit Office (ANAO) recently reported that despite the Tax Office's effort to improve its performance in assessing and refunding GST, it was unable to demonstrate that it was operating more efficiently. The ANAO reported that while the Tax Office claims to have processed 92% of GST refunds within 14 days, its reporting was "flawed".

There was no evidence to show whether delays had been reduced or whether there had been an increase in the detection of incorrect refunds.

"Based on the data maintained by the Tax Office, it is difficult to determine the overall effectiveness of its compliance methods".

GETTING MONEY FROM THE TAX OFFICE

The *Tax IQ Monthly* November 2004 issue contained a lengthy article on how to obtain compensation from the Tax Office for any losses suffered through its negligence or through defective administration.

You can obtain details about how to do this by visiting www.ato.gov.au. Type in *Claiming compensation* in the search box. Then follow the links after selecting *Claiming compensation from the Tax Office*.

FBT – MOTOR VEHICLES

Special FBT rates are provided for the provision of motor cars to employees. Where an employee has private use of a vehicle other than a car, the benefit is known as a residual fringe benefit and is calculated according to engine capacity of the vehicle.

The per kilometre rate for the FBT year 2005/06 and 2006/07 are as follows:

Engine Capacity	2005/06	2006/07
0 – 2500cc	39c	40c
Over 2,500cc	47c	48c
Motor cycles	12c	12c

Taxation Determination TD 2006/13

FBT – RECORD KEEPING

An employer who provides fringe benefits to employees which total less than a threshold figure is not obliged to keep and maintain FBT records unless they are in relation to:

- Benefits provided to an associate
- Benefits provided by a Government body
- Benefits provided by an exempt taxpayer; or
- The Tax Office has provided a written notice requiring written records to be kept.

The threshold figure for the 2005/06 FBT year is \$6,223. This increases to \$6,391 for the 2006/07 year.

Taxation Determination TD 2006/15

NEW ELEMENT FOUND

A major research institution as recently announced the discovery of the heaviest element yet known to science. The new element has been named *Governmentium*. Governmentium (GV) has one neutron, 25 assistant neutrons, 88 deputy neutrons and 198 assistant deputy neutrons. These 312 particles are held together by forces called morons, which are surrounded by vast quantities of lepton-like particles called peons.

Since Governmentium has no electrons, it is inert. However, it can be detected because it impedes every reaction with which it comes into contact. A minute amount of Governmentium causes one reaction to take over four days to complete, when it would normally take less than a second. Governmentium has a normal half life of four years: it does not decay but instead undergoes a reorganisation in which a portion of assistant neutrons and deputy neutrons exchange places. In fact, Governmentium's mass will actually increase over time, since each reorganisation will cause more morons to become neutrons, forming isodopes. This characteristic of moron promotion leads some scientists to believe that Governmentium is formed whenever morons reach a certain quantity in concentration. This hypothetical quantity is referred to as a Critical Morass. When catalysed with money, Governmentium becomes Administratium – an element which radiates just as much energy as Governmentium since it has half as many peons but twice as many morons.

READER QUESTIONS:**CHILD BENEFICIARIES**

Question: Could you clarify Section 98 of the 1936 Tax Act? This states that a beneficiary who is presently entitled, but under a legal disability, must have his/her share of trust income assessed in the hands of the trustee.

In practice, if the beneficiary is paid \$772 and is a minor, no tax return is prepared by the beneficiary and no income is included in the trustee's tax return. Is this correct? What would be the case if the beneficiary's share of income is over \$772?

Answer: The first \$416 of trust income is exempt from tax whilst the balance is subject to tax however the low income rebate applies which enables the beneficiary to be paid up to \$772 without paying any tax. If this is the only income the beneficiary receives the distribution would be shown in the trust tax return and no tax would be payable.

If the beneficiary is in receipt of income from other sources, he or she is required to lodge a personal tax return. Persons under the age of 18 are required to lodge returns if they have non-personal exertion income of more than \$772 or have income from dividends and trust distributions plus imputation credits of more than \$416. If distribution of more than \$772 is paid to an infant beneficiary, the trustee should pay the tax thereon. The beneficiary should also lodge a personal tax return and claim a credit for the tax paid by the trustee.

If the trustee does not pay tax on the beneficiary's share of income the beneficiary should lodge the return without claiming any credit and pay the full tax.

CGT - COST BASE

Question: Would you please advise on the following:

- Townhouse purchased in 2003 for \$285,000
- Improvements carried out costing \$10,000
- Townhouse re-valued in 2004 for \$330,000
- Loan taken out for \$330,000
- Townhouse sold in 2006 for \$280,000

Is the CGT loss:

- a. \$330,000 minus \$280,000 equals \$50,000, or
- b. \$295,000 minus \$280,000 equals \$15,000?

Answer: \$15,000. It is the difference between the sale price and the cost base which determines the capital loss.

PARTNERSHIP LOSSES

Question: Three companies are in a partnership owning a commercial rental property. This operation incurred losses for the financial year. The turnover (not profit) of the rental property is more than \$20,000 per year. Can the losses be distributed to the partners?

Answer: Yes. Losses in a partnership are distributed to the partners in accordance with the partnership agreement. This is a negatively geared rental property and the non-commercial business loss rules would not be applicable. The losses could be distributed even though the turnover did not reach \$20,000 per year.

EMPLOYEE SHARE SCHEME (1)

Question: As part of his salary package a client was given options in his company which would be available to him to convert to shares (at his expense) at the expiry of two years employment. Two years later the share price was less than the cost to convert the options and so he let the options expire.

I understand that had the options been converted, my client would have been income taxed on the benefit of the options and then charged capital gains tax once the shares were sold. Is there any tax benefit for my client as he basically lost income, and if so, how is this

Answer: As the options were given to him as part of a salary package he has no doubt salary sacrificed the cost of the options. Hence he is not regarded as having paid anything for the options. Otherwise he would have received a higher salary, been taxed on that, and then paid for the options. Two years later he let the options expire without exercising them. He had no expense nor any gain and therefore no tax benefit is available.

EMPLOYEE SHARE SCHEME (2)

Question: A client runs a large building business through a company structure. He wants to pay annual bonuses to his employees in the form of shares in the company (like an employee share plan). What are the tax consequences of this and how can this be done tax effectively?

Answer: Unfortunately this is too complex a subject to be dealt with adequately in *Tax IQ Monthly*. We recommend that you obtain specialist advice.

If the shares are qualifying shares (made available to at least 75% of employees, none of whom will hold more than 5% of shares in the company) a deduction of up to \$1,000 per employee can be claimed by the employer and the employees will be eligible for a \$1,000 discount when including the value of the shares in their personal tax returns.

Provision of shares to employees do not come under the FBT legislation but instead are regulated under Division 13A of the 1936 Tax Act.

If the shares are non qualifying shares there are no statutory deductions or discounts available, however you can set up a trust and have the company make an irrevocable contribution to the trust to enable the trust to acquire shares in the company for the benefit of employees. You need specialist advice to proceed.

CGT – ROLLOVER

Question: I purchased two investment properties in partnership with my wife. The first in 2003 and the second in November 2005. If we sell now I will have a capital gain of \$110,000 on the first and \$23,000 on the second. I intend to purchase a block of land for \$300,000.

Is it possible to roll the gains on both properties into the purchase of the land so that I pay capital gains tax when I eventually sell the land?

Answer: Unfortunately no. CGT rollover provisions are not applicable to that transaction. You will be eligible for 50% CGT discount on the first property but not on the second because you have not held it for a minimum of twelve months.

EMPLOYEE BENEFITS

Question: In general, the FBT exempt employee benefit is not tax deductible to the employer. Is that correct?

Answer: No. Employee benefits are generally tax deductible to the employer. Where the benefit is provided to employees on an irregular and infrequent basis and has a value of less than \$100 it is FBT exempt. In-house food, drink, coffee and tea provided during a working day on working premises is FBT exempt but is tax deductible to the employer.

Christmas parties may come under the FBT exempt provisions if valued at less than \$100 per employee. The costs of Christmas parties are not deductible because they are classified as entertainment expenses.

CGT – SMALL BUSINESS CONCESSIONS

Question: I am a sole practitioner operating in western Victoria. I have been a subscriber since your publication started and still find it very useful.

I have a unit trust that holds dairy farm land. The land is leased to a partnership which owns the cattle and equipment. The unit trust and partnership each have the same unit holders and partners holding their interests in the same proportion. The 12 unit holders/partners are a combination of individuals and entities.

- Are the assets of both the partnership and the unit trust grouped together to determine whether the \$5 million net asset test is met?
- If a new dairy farm was purchased as a completely independent business by a new unit trust with the same unit holders, would the assets of each unit trust be treated independently when calculating the net asset test?
- Is the fact that the unit trust which owns the land, but leases it to the partnership to operate a dairy farm business, sufficient to allow the unit trust to qualify as an active asset?

Answers:

- Two of the conditions for obtaining small business CGT concessions are that:
 - the net value of assets of the taxpayer and *connected entities* must not exceed \$5 million; and
 - the asset is an active asset.

An entity is *connected* with another entity if either entity controls the other or both entities are controlled by the same third entity.

Control occurs when the entity and its *small business CGT affiliates* have rights to at least 40% of income or capital or 40% of the voting power. In the case of discretionary trusts you look at distributions made.

A *small business CGT affiliate* is a spouse or child of the taxpayer under 18 years or any person who acts or could reasonably be expected to act in accordance with the taxpayer's directions or wishes or in concert with the taxpayer.

In the absence of further information it does appear that the net assets of the unit trust and the partnership would be grouped for the purpose of the net asset test. Assets of the individual partners and unit holders may also be grouped.

- Without further information we would assume that the second unit trust would come within the definition of a *connected entity* because it is controlled by the same third entity (the same unit holders).
- An asset is an *active asset* if it is used in the course of carrying on a business by a *small business CGT affiliate* or another entity that is *connected* with the taxpayer. If the unit trust and the partnership are *connected* the dairy farm owned by the unit trust will qualify as an active asset.

BORROWINGS BY PARTNERS

Question: If two partners borrow money from their respective banks to set up a partnership in order to takeover an ongoing business can the partnership pay off those loans as if they were business loans? Can the partnership claim interest paid as a tax deduction?

Answer: To be strictly correct you should treat the borrowings as borrowings by individual partners which are on-lent to the partnership. When the partnership makes payments to the bank, you treat these transactions as payments of interest and repayments of loans to the partners who in turn make payments in respect of their personal respective loans.

The partnership then claims interest paid to the partners. The partners then disclose those amounts as income (interest received) and then claim offsetting deductions for the interest payable on their respective loans. In fact the partners have borrowed money from their respective banks, lent that money to the partnership which has used the funds to acquire the business.

The partnership is paying interest on and repaying loans from the partners who in turn are paying interest on and repaying loans from their respective banks.

ELIGIBLE TERMINATION PAYMENTS

Question: An associate who is aged 55 has applied for and is in the process of receiving his superannuation in a lump sum. Can you please tell me the implications of this (if any) if he continues to work? He is currently only casually employed but may find full-time employment.

Answer: If a person is aged over 55 but under 60 he must satisfy the trustee of the superannuation fund that he is fully and permanently retired before he can collect his superannuation. If the superannuation trustee is satisfied, the payment will be made as an eligible termination payment (ETP). Subsequently if he changes his mind and decides to go back to work there will be no adverse consequences.

Essentially the question is whether or not he can satisfy the superannuation fund that he is permanently retired.

Recent amendments now enable superannuation fund members to collect superannuation pension whilst still working. This does not apply to lump sum payments.

DEPRECIATION – LOW VALUE POOL

Question: Hi guys. Love the newsletter, just taken up my second subscription.

A few years ago our tax agents advised us to pool our assets costing less than \$1,000 into a low value pool for calculating depreciation. The benefits were that we wouldn't have to track individual asset movements. However it has caused us a lot more work and many adjustments at tax time. Our tax agents have now told us that we cannot remove the low value pool, or even stop adding new assets to the pool. Is there any way we can stop using (immediately or over time) the low value pool?

Answer: Unfortunately no. Whilst it was open for you to choose whether or not to use the low value pool at the beginning, once commenced Section 40-430 provides:

"Once you have made a choice to allocate a low cost asset to a low value pool for an income year, you must allocate all low cost assets you start to hold in that income year or a later one to the pool.

Once you allocate any depreciating asset to a low value pool, it must remain in the pool".

Your only way around this impasse would be to set up a separate entity to acquire the plant and lease or hire it to the operating entity.

DIRECTOR'S FEES

Question: Can you please advise how a monthly meeting fee of \$250 to cover expenses should be paid? Should it be processed in payroll as ordinary income or as an allowance? Should it be taxed?

Answer: If it is to cover expenses you can treat it as an allowance. However, unless you are provided with requisite details of expenses incurred you must deduct PAYG instalments.

CONVERTING DEBT TO EQUITY

Question: We are planning to convert (say) \$5 million liability to equity. Is there any tax liability involved?

Answer: Presumably you are a company limited by shares. Presumably also shareholders have advanced funds to the company.

If these assumptions are correct the company can issue shares to those shareholders who have advanced funds to the company and thereby extinguish the liability. You need to ensure that the shares are issued at their current market value (if necessary creating a share premium reserve) if the share issue results in a change in the proportionate ownership among shareholders.

CGT AND LOSSES

Question: We are going to sell a property which is expected to earn \$1 million capital gain. Can the capital gain be netted off against the company's losses?

Answer: Yes. Companies are not eligible for the 50% CGT discount however revenue losses can be applied against capital gains subject to the normal rules about carrying forward of tax losses.

SUPER FUNDS – BUSINESS REAL ESTATE

Question: Husband and wife have a self-managed super fund (SMSF). They own their business property which they use for manufacturing. Can the SMSF buy 30% of the property and then, maybe, the next year buy another 30% with the business paying commercial rent?

Answer: Yes. Business real property is exempt from the in-house asset rules and up to 100% of the SMSF's funds can be used to purchase business real estate. The SMSF can acquire the property jointly with another party but take care if there is any mortgage on the property. The SMSF must have unfettered title to its assets.

TRAVELLING EXPENSES

Question: *Tax IQ Monthly* August 2005 issue states "if you are an employee required to travel for work-related purposes and in receipt of a travel allowance from your employer you may claim deductions for expenses incurred".

Is the travel allowance paid to the employee taxed? If not, why would you then be able to claim a tax deduction as well?

Answer: Allowances are generally taxed. The only exception is a Living Away from Home Allowance which is specifically exempted from FBT and not subject to tax in the employee's hands.

If you receive a travel allowance from your employer the amount should be included in your tax return and you should then claim deductions for expenses incurred.

If the employer pays a travel allowance within the rates set out in the Taxation Determination the employer is not required to deduct tax. Accordingly there will be occasions when the travel allowance is not included in the payment summary and therefore the employee cannot include any amount in his/her tax return. In those circumstances the employee must not of course claim any deductions.

SPEC BUILDING

Question: In the real estate market, developers and individuals purchase blocks of land for future building. After completion they put the property on the market and sell as a spec investment. In these circumstances what is the taxation position, including CGT, on the sale given that they may have only owned the block for three to six months?

Answer: If an individual or a developer purchases a vacant block with the intention of building a house and selling it at a profit, this becomes a transaction of a revenue nature and CGT is not applicable. Full income tax is payable at marginal rates on profit made. GST is payable on sale of the completed building however the vendor may be able to utilise the margin scheme if agreed by the purchaser. Input tax credits can be claimed on the cost of materials and sub-contracts.

If the land was purchased with the intention of retaining ownership of the house and earning income from rental, it will be treated as a capital transaction. You cannot claim input tax credits as residential rental premises are input taxed.

If later, due to changed circumstances, you sell the property it remains a capital transaction and CGT is payable on any gain. GST would also be payable if the property is sold within 5 years. You could then claim input tax credits for cost of materials and sub-contracts.

The CGT discount of 50% would only be applicable if the land was owned for more than 12 months.

TRAVELLING ALLOWANCES

Question: Directors of a company provide their services completely free. They receive no wages, salary, or director's fees. They are required to make some business trips for the company or attend training sessions or directors' meetings. Can they be paid the daily reasonable travel allowance as per the Taxation Determination rather than be reimbursed for actual travel costs incurred?

Answer: Yes. As directors they are defined as employees even though they do not receive a wage.

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