

Tax News, Views and Clues

Tax Compliance 2003/04

The Tax Office has outlined initiatives for the 2003/04 tax compliance program.

For individuals, there will be an increased focus on:

- work-related expense claims;
- rental income and rental expense deductions;
- interest and dividend income and expenses;
- capital gains income; and
- tax avoidance schemes.

High wealth individuals will continue to be under scrutiny.

Contact us for further information.

Interest Deduction Disallowed

The Federal Court has denied interest deductions claimed by a company on the basis that the interest deduction was grossly disproportionate to dividend income received, and that the true motive for the arrangement was to allow the company to transfer losses to related companies.

The taxpayer was a member of a group of companies. It borrowed

funds from a related company at interest and invested those funds by purchasing shares in a subsidiary. The subsidiary, which had an intermediary role, in turn used the funds to obtain shares in an 'investing subsidiary' which made underlying investments in public companies.

Dividends were ultimately passed upstream to the parent company by the investing subsidiary, however, dividends bypassed the taxpayer most of the time. This could be achieved as different class shares were held in the intermediary subsidiary by the parent company and the taxpayer.

The taxpayer incurred substantial losses as a result of the disproportionate interest incurred on the borrowings and the relatively small amount of dividend income it received.

The Commissioner of Taxation asserted that the taxpayer had a motive other than the generating of assessable income. Rather, it was formed to become the dedicated loss centre of the group, which could then distribute losses to other group members for the benefit of the group as a whole. The Commissioner also argued that because of the taxpayer's significant losses, the payment of dividends was unlikely to flow to

the taxpayer as it would not be able to utilise the franking credit rebate available to companies that do not have losses.

The Court agreed that no deduction was available to the taxpayer. It was not satisfied that the interest expense had been incurred by the taxpayer with a sufficient expectation of receiving dividend income. Specifically, the Court noted that while the interest deductions grossly exceeded the taxpayer's dividend income or the taxpayer had carry forward losses, there was no expectation that the taxpayer would receive dividends from its subsidiary. Accordingly, the interest deductions claimed by the taxpayer were denied.

The taxpayer has appealed against the decision to the Full Federal Court. We will keep you informed of any progress.

Small Business: Beware Schemes to Eliminate CGT

The Tax Office has issued a warning to small businesses to beware of scheme promoters who claim that they can use a special type of trust arrangement to eliminate future capital gains tax liabilities.

The arrangements are characterised by complex business restructures that involve special purpose companies and trusts associated with the promoter.

Based on available information, the Tax Office doubts the claims made in respect of these arrangements.

- **TIP:** Before entering into a business restructure or arrangement of any type, independent, professional advice should always be obtained.

Division 7A: Questions and Answers

The Tax Office has released a booklet outlining its views in relation to 80 frequently asked questions on Division 7A.

Readers may recall that Division 7A operates to ensure that certain payments, including loans and debts forgiven by a private company to shareholders, are treated as dividends in the hands of the recipient.

The booklet covers a broad range of questions about the application of Division 7A.

Contact us for further information.

Directors' Liability — Unpaid PAYE

The NSW Court of Appeal has held that directors of a group of insolvent building companies were personally liable to pay penalties equal to the companies' unpaid PAYE instalments totalling approximately \$275,000.

The Court found that the directors failed to provide evidence as to why the monies owed remained unpaid following the sale of an overseas operation. Further, no repayment agreement had been negotiated with the Tax Office,

nor had an administrator been sought, as required by the law, despite there being evidence that the group was insolvent.

Medicare Levy Surcharge

The Administration Appeals Tribunal (AAT) has held that a taxpayer was not entitled to an exemption in respect of the Medicare levy surcharge.

The Medicare levy surcharge applies to taxpayers whose taxable income exceeds \$50,000 (or \$100,000 combined for couples) and who do not have adequate private health insurance. The surcharge is equal to 1% of the taxpayer's income and must be paid in addition to the Medicare levy of 1.5%. Where the taxpayer has more than one dependant, the threshold is increased by \$1,500 for each dependant after the first.

In this particular case, the AAT rejected the taxpayer's argument that he was exempt from the surcharge.

The AAT determined that the taxpayer's former wife did not qualify as a 'dependant' for the purpose of the exemption. The basis for this decision was that she did not fall within the definition of 'spouse' which requires that two people live together on a bona fide domestic basis as husband and wife, whether or not they are legally married.

The taxpayer did not reside with his former wife, nor did he have any other dependants. As his taxable income for the year exceeded the threshold of \$50,000, the AAT held that he was ineligible for an exemption.

- **TIP:** This case highlights the need to exercise caution when interpreting the law. Assistance should be sought if you are unsure of your legal obligations.

Contact us for further information.

GST: Vouchers

The Tax Office has issued a GST ruling outlining its view on how GST applies to vouchers.

According to the ruling, certain vouchers that meet specific criteria may qualify for deferred tax treatment. Specifically, for vouchers that qualify, GST is payable on a taxable supply made on the redemption of the voucher, rather than at the point of supply of the voucher itself.

The ruling distinguishes between single-function vouchers and multi-function vouchers with only single-function vouchers meeting the specific criteria.

A single-function voucher ceases to be a voucher upon redemption or expiration. Examples of such vouchers include a single bus ticket or a gift voucher.

- **TIP:** This is an important ruling for businesses issuing vouchers. These businesses should, at the very least, have the current GST treatment of those vouchers reviewed and also seek to examine the accounting systems used to track issued vouchers.

Contact us for further information.

Super Change for Temporary Residents

Recent amendments to the law will ensure that international visitors working in Australia on eligible temporary resident visas are allowed to access all superannuation contributions made on their behalves during their employment, once they depart Australia permanently.

The change is retrospective and applies to anyone who has ever visited Australia on an eligible temporary resident visa.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also, changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.