R&G
TAX REPORT

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Tax News, Views and Clues

ATO Compliance Targets 2002/03

The Tax Office has released its compliance program for 2002/03. Included are the following focus areas, in addition to those outlined in our Dec 2002/Jan 2003 issue:

- Individuals — review residency status of working holiday-makers and backpackers claiming the tax-free threshold and monitor emerging tax avoidance schemes.
- Micro business — review of record keeping and cash management, follow up where information on activity statements and tax returns is inconsistent with previous periods or similar businesses.
- Small to medium business — review correctness of claims for tax losses, commerciality of management fees and royalty payments.
- Superannuation — review superannuation guarantee payments made by businesses to ensure adequate payments are being made. Review self-managed superannuation funds for breach of investment restrictions.

No Deduction for Unsubstantiated Claims

In a recent Administrative Appeals Tribunal (AAT) hearing, a taxpayer was disallowed certain work-related deductions for motor vehicle, home office and depreciation expenses due to his inability to properly substantiate his claims.

The taxpayer failed in his claim for motor vehicle expenses and computer depreciation, as he was unable to prove that he was the owner or the lessee of the relevant assets.

The taxpayer also claimed home office expenses, being 35% of the rent paid on his apartment. (Typically this percentage is the amount of floor space taken up by the home office.)

Despite the AAT being satisfied that the taxpayer was entitled to some deduction for home office expenses, the taxpayer acknowledged that his home office did not take up 35% of the floor space of the apartment. Accordingly, the deduction was not allowed.

> **CAUTION:** The Tax Office has indicated in its 2002/03 compliance program that there will be a strong focus on individuals' work-related deductions. So make sure you can substantiate your claims!

GST Treatment of Lease Incentives

The Tax Office has released a Draft GST Ruling outlining its preliminary views on the GST treatment of commercial property lease incentives.

The draft ruling is fairly complex and depends greatly on the circumstances of each case. In particular, the draft ruling considers the GST treatment of the following incentives from both the landlord's and tenant's perspectives:

- cash incentives;
- fit-out incentives and plant;
- income guarantees; and
- rent-free or discounted periods.

> **CAUTION:** The application of this ruling has far reaching effects across all industry sectors. It is important that businesses obtain advice on the GST effect of any lease incentives.

Contact us for further information.

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GST Consequences When Taking Trading Stock for Private Use

The Tax Office has issued a draft goods and services tax determination addressing the GST consequences when a partner in a partnership takes goods held as trading stock for private or domestic use.

The draft ruling provides that where goods have been acquired by a partnership, an input tax credit has been claimed and when those goods are subsequently taken out of the business by a partner for private use, an increasing adjustment must be made for GST.

This means reducing the input tax credit claimed in the partnership's business activity statement for the month when the goods were taken. Contact us for further information.

No Business... No Deduction!!

The Federal Court recently disallowed deductions claimed by a trust on the basis that no business was being conducted.

The taxpayer was a beneficiary of the trust which took over an existing aviation business originally operated by a related entity. The business consisted of aircraft shows with the taxpayer's husband as pilot, although he was not employed by the trust.

The Tax Office had previously audited the related entity and there were no concerns raised as to whether it was carrying on a business.

However, the trust derived no income for the 1996 year from air show activities but incurred outgoings totalling $108,580, for which it claimed deductions. The Commissioner disallowed the deductions.

As a result the trust net income overall increased, resulting in an increase in the taxpayer's assessable income as beneficiary.

The Court observed that the absence of operations between the end of 1994 and June 1996, as well as the absence of a suitable aircraft for three years prior to the arrival of a new aircraft in late 1995 was inconsistent with the trust carrying on a business of air show activities. It was irrelevant that the Tax Office had accepted that a business was being conducted in a previous audit.

The Court held that the air show activities were related to the husband's hobby, and therefore, no deduction was available to the trust for the outgoings incurred.

➢ **TIP:** This case highlights the fact that the question of whether an entity is carrying on a business must be carefully considered on an ongoing basis.

Taxation of Discretionary Trusts

In response to a Board of Taxation report on the taxation of discretionary trusts, the Government announced it will introduce new legislation to replace existing tax law that treats certain trust amounts as loans.

The Board recommended:

- The current flow-through treatment of distributions of non-assessable amounts by discretionary trusts should be retained.
- With the introduction of trust integrity measures in recent years, there is no need for fundamental change to the tax treatment of discretionary trusts.
- The deemed dividend rules should be improved to more effectively prevent beneficiaries accessing trust income that has only been taxed at the company tax rate.
- The Tax Office should clarify its view about the deductibility of interest on borrowings used to finance non-assessable distributions to beneficiaries of discretionary trusts.

We will keep you informed of further developments.

Government Extends Debt/Equity Transitional Period

The debt/equity rules commenced on 1 July 2001.

Readers may recall that the debt/equity rules classify interests in companies as debt or equity. This distinction is important, as it will determine, among other things, whether certain payments made are deductible interest payments (on debt) or frankable distributions of profit (on equity).

Broadly, a loan to a company may be considered equity if it might not be fully repaid within 10 years and a commercial interest rate is not applied.

The transitional rules in the debt/equity provisions delayed their application to related party 'at call' loans. Originally, the transitional period was to end on 31 December 2002, however, the Government recently announced that this period would be extended to 30 June 2004 for loans to a related party that do not have a fixed term and that are repayable on demand.

In any event, to avoid this issue, consideration could be given to making all non-interest bearing loans documented and fixed for a period of less than 10 years.

➢ **TIP:** Taxpayers should take this opportunity to review all related party 'at call' loans and ensure that they are appropriately documented and classified.

Please contact us for further information.