

Tax News, Views and Clues

Tax Effective Investment Scheme

The Federal Court has ruled that the Part IVA general anti-avoidance rules did not apply to a taxpayer's claims for deductions associated with his investment in a tea-tree farm.

Under the arrangement, although not compulsory, the taxpayer engaged the management company specifically named in the prospectus to manage the growing and harvesting process.

The taxpayer borrowed \$21,750 from a finance company associated with the promoter, of which \$21,000 was used to prepay the management company to obtain a \$1,500 discount.

The taxpayer sought to claim a deduction for the prepaid management fees. The Tax Office disallowed his claim on the grounds that the taxpayer was either not carrying on a business because of his limited involvement or because the transaction was a scheme entered into for the dominant purpose of obtaining a tax benefit.

Importantly, unlike other tax effective investment schemes, the actual tax savings in this case were less than the cash outlay.

This thereby resulted in a net cash outlay of about \$3,500.

The Federal Court held that the taxpayer was entitled to the relevant deductions on the basis that a business was being carried on.

In reaching this view, the Federal Court was satisfied that although the taxpayer was not actively engaged in the business, this was not essential, particularly given the expertise required.

Importantly, in reaching its decision, the Court found that although obtaining a tax benefit was one purpose of the taxpayer's investment, it was not the dominant purpose for entering into the transaction.

Accordingly, the Part IVA general anti-avoidance rules did not apply to disallow the taxpayer's deductions.

Partnership Losses Denied

The Administrative Appeals Tribunal (AAT) has rejected a taxpayer's claim that he was entitled to deduct his share of prior year partnership losses on the basis that no partnerships existed.

The losses were generated by property investments.

The taxpayer claimed that the investments were held by companies on behalf of the alleged partnerships, rather than for the companies' own benefit.

However, the taxpayer was unable to prove the existence of the partnerships. No partnership tax returns had been lodged, nor were any partnership agreements produced. There was also evidence that the taxpayer had represented to his bank that the businesses were carried on through companies (rather than partnerships).

As a result, the taxpayer could not satisfy the AAT that the losses were available to him through a partnership structure. Accordingly, deductions for the claimed partnership losses were disallowed.

Interestingly, the AAT commented that the taxpayer was considered 'an unlawful witness' who made 'an opportunistic attempt to gain an advantage to which he was not, and knew he was not 'entitled'.

➤ **TIP:** This case highlights the importance of maintaining comprehensive and consistent documentation to support a taxpayer's claims.

Shareholder Loans: Application of FBT

In a recent Interpretative Decision, the Tax Office considered whether a loan that is not a deemed dividend under shareholder loan rules (Division 7A) may, in certain circumstances, constitute a fringe benefit where the loan has a nil rate of interest.

The Tax Office considers a case where a private company has lent an amount to an employee, who is also a shareholder of the company. The loan is not a deemed dividend under the Division 7A deemed dividend rules because the loan satisfies the following criteria:

- the loan is unsecured and has a term of less than seven years;
- the interest rate charged on the loan equals the benchmark interest rate (applicable from the year following the year in which the loan is made); and
- a written agreement exists.

According to the Tax Office, where the loan is made to the employee 'in respect of the employee's employment' a loan fringe benefit will arise during the interest-free period. Accordingly, fringe benefits tax will apply.

➤ **TIP:** Broadly, FBT is a tax applicable to benefits provided by employers to their employees. With this in mind, if the loan was made to the employee in respect of their shareholding or family connection, and not their employment, FBT would not apply.

Please contact us for further information.

Capital Allowances

The Tax Office has recently released an Interpretative Decision (ID) regarding the deductibility of costs in relation to leased premises.

The ID considers a case where a partnership incurred expenditure to fit out leased premises at the commencement of the lease. On termination of the lease, the partnership ceased business and was required to restore the lease property to its original pre-lease condition.

According to the Tax Office, expenditure to restore leased premises would typically not be deductible under the general deduction provisions. However, the expenditure may be deductible equally over five years under specific provisions that exist in the tax law, on the basis that it is a cost incurred to stop carrying on a business.

- **TIP:** Capital allowance rules enable deductions over a five-year period for capital costs incurred:
- to establish your business structure;
 - to convert your business structure to a different structure;
 - to raise equity for your business;
 - to defend your business against a takeover;
 - in unsuccessfully attempting a takeover; and
 - to stop carrying on your business.

Please contact us for further information.

Superannuation Changes

The Federal Government has announced measures that will reduce the superannuation surcharge rate, as well as increase the superannuation savings of low-income earners.

The superannuation surcharge, a tax on the superannuation contributions of taxpayers earning over \$90,500, will drop from 15% to 12.5% over three years.

Under the co-contribution measure, taxpayers earning income of up to \$27,500 who make superannuation contributions will have each dollar of their contributions matched by the Government, up to \$1,000 annually.

The co-contribution amount of up to \$1,000 will reduce for taxpayers earning more than \$27,500 and be phased out all together at an income level of \$40,000.

Both measures will apply to contributions made on or after 1 July 2003.

Expanded GST Grouping Provisions

The GST grouping provisions allow entities to form one group for GST purposes. The main consequences of forming a GST group are:

- intra-group transactions are ignored for GST purposes;
- only one net GST amount is calculated for the group (GST liability minus available input tax credits); and
- joint and several liability is between group members in respect of indirect taxes.

The amending regulations relating to GST groups, which commenced on 1 April 2003, broaden the application of the grouping provisions in respect of partnerships and trusts.

Structures entitled to group under the new rules include:

- fixed trusts that are members of the same 90% owned group;
- trusts with common family members as beneficiaries; and
- partnerships that share common partner relationships.

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.