

Tax News, Views and Clues

Financing Arrangements: Input Tax Credits

Taxpayers are entitled to claim input tax credits (ITC) in respect of lease payments made under a financing arrangement. The availability of the ITCs varies depending on the type of arrangement entered into and whether the taxpayer accounts on a cash or accruals basis for GST.

Finance or operating lease

- Under the accruals method, ITCs are claimed periodically as the individual payments become due over the course of the lease term.
- Under the cash method, ITCs can only be attributed if the payment has actually been made (for accruals, the holding of a tax invoice is sufficient).

Hire purchase (HP)

- Under the accruals method, available ITC can be claimed up front as a lump sum.
- Under the cash method, any available ITC is spread out over the term of the HP agreement as payments are made.

Chattel mortgage

- As the goods are actually acquired, available input tax credits are claimed up-front as a lump sum.

Please contact us for further information.

Deductions Against Personal Services Income

The Tax Office has released a taxation ruling addressing the deductions available against personal services income (PSI) of individuals and personal services entities (PSE) such as companies, trusts or partnerships that are not conducting a personal services business (PSB).

Broadly, PSI means income that is derived mainly from the personal efforts or skill of an individual. In some cases, the individual may not be an employee but may work solely or predominantly for one entity and may seek to claim deductions that are typically not available to employees.

In other cases, an individual may operate through a company, partnership or trust to derive income that is mainly for the individual's personal efforts or skill.

In such cases, the PSI rules are intended to ensure that the deductions claimed are limited to those that would be available to an employee.

Examples of deductions that will not be allowed include deductions for rent, mortgage interest, rates or land tax that relate to an individual's residence, and certain superannuation contributions.

Where a PSE's income includes an individual's PSI, the individual and not the PSE is treated as having derived that income.

- **CAUTION:** The PSI rules are complex and result in the disallowance of deductions and the taxing of individuals on PSI otherwise derived by a company, trust or partnership.

CGT Small Business Concession

The Tax Office has released an interpretative decision outlining its view on whether a company that has different classes of shares can have a 'controlling individual' for the purpose of determining whether the CGT small business concessions apply.

Where a small business taxpayer makes a capital gain on the disposal of an asset, it may be eligible to obtain CGT relief under one or more of the following CGT concessions (provided that certain conditions are satisfied):

- The 15-year asset exemption (which provides a full exemption from CGT).
- The 50% active asset reduction (which reduces the capital gain on active assets by 50%).
- The retirement exemption (which disregards capital gains up to a lifetime maximum of \$500,000 provided the proceeds are used to pay an ETP).
- The asset rollover exemption (which disregards a capital gain made on the disposal of an asset where the asset is replaced. Instead, the gain is used to reduce the cost base of the replacement asset).

If the taxpayer makes a capital gain on the disposal of a share in a company, the 'controlling individual test' must be satisfied in addition to the other conditions.

Broadly, a controlling individual of a company is one who has the right to exercise at least 50% of the voting power in the company and receive at least 50% of any dividend the company may pay.

The Tax Office considers a case where a company has two different classes of shares, each held by different shareholders. A distribution can be made to either class of shares to the exclusion of the other class.

The Tax Office states that, under these circumstances, the company cannot satisfy the controlling individual test because there is no certainty in relation to distribution entitlements.

- **TIP:** Significant tax savings can be made if a taxpayer is able to structure transactions such that one or more of the available concessions apply.

Where a small business taxpayer is an individual or a trust, the general 50% CGT discount may also be available.

Please contact us for further information.

Taxpayer Deductions Denied

The Administrative Appeals Tribunal (AAT) has disallowed a taxpayer deductions for expenses incurred because he was not carrying on a business or deriving assessable income.

The taxpayer was an inventor and had set up a company (of which he was a director) to sell his inventions.

The issue before the AAT was whether the taxpayer was entitled to claim deductions for expenses incurred by the taxpayer individually. The AAT observed that the taxpayer 'did not differentiate between his private expenditure and his company's activities'.

The taxpayer worked for the company with no expectation of earning a salary. Further, the receipt of dividend income from the company was unlikely as the company had accumulated substantial losses.

In the absence of any income, the AAT was not satisfied that there was a sufficient nexus between the expenses and the gaining of assessable income. As there was also no reasonable expectation that the taxpayer's activities would generate a profit, it was not convinced that he was carrying on a business.

Accordingly, the AAT held that no deduction was available to the taxpayer.

Reasonable Allowance Limits 2003/04

The Tax Office has released a ruling that outlines the amounts it considers reasonable for various allowances paid to employees for the 2003/04 year of income.

Employees who receive these allowances up to the reasonable amount specified in the ruling are not required to substantiate actual expenses incurred.

The allowances covered include:

- overtime meal allowances paid under an award;
- domestic travel allowances for accommodation, food, drink and incidental travel costs;
- travel allowances for employee truck drivers; and
- overseas travel allowances for food, drink and incidental travel costs (excluding accommodation).

The reasonable award overtime meal allowance for the 2003/04 income year is \$19.75 per meal.

Reasonable travel allowance amounts vary by city or country centre. Reasonable allowances are specified in the ruling for a broad range of travel destinations.

- **CAUTION:** If an allowance paid exceeds the reasonable amount specified in the ruling, the entire claim must be substantiated, not just the excess over the reasonable amount.

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.