

Tax News, Views and Clues

PAYG: Liability to Pay Instalment

The Tax Office has issued an Interpretative Decision (ID) that considers the point at which a liability to pay a PAYG instalment arises for the purposes of recording the payment in the company's franking account.

In broad terms, a company's franking account is used for the purpose of determining the extent to which a company can pay franked dividends to its shareholders.

In some cases, companies over-frank their dividends and force their franking account into a deficit. Where the deficit remains in existence at the end of the company's tax year, the Tax Office may impose penalties. In such circumstances, companies may wish to pay their PAYG instalments before the end of the company's tax year in an effort to reduce or eliminate the deficit and avoid penalties.

A PAYG instalment payment, however, can only be recorded in a franking account if it is paid pursuant to a liability.

The Tax Office holds that a PAYG instalment liability arises at the end of an instalment quarter. If a PAYG instalment is paid early (i.e. before the end of the quarter), the payment may not be recorded in the franking account until the end of the quarter.

- **TIP:** Companies should ensure that appropriate planning takes place to avoid a franking deficit and the potential imposition of penalties.

Deductions for Tax Penalty Expenses

The Tax Office has issued an Interpretative Decision (ID) allowing a taxpayer a deduction for legal expenses incurred in seeking advice regarding a tax penalty notice.

The ID considers a case where the taxpayer, a company director, received a penalty notice from the Tax Office regarding unpaid PAYG withholding debts of the company.

The taxpayer incurred expenses in seeking legal advice regarding the penalty notice. The legal advice sought pertained solely to the penalty notice and the required course of action.

Despite the penalties themselves not being deductible, the cost of legal advice is an allowable deduction where it relates to the tax affairs of an entity and the advice is provided by a recognised tax advisor such as a lawyer.

The Tax Office was satisfied that the taxpayer engaged the services of a recognised tax advisor. In addition, it considered that the term 'tax affairs' was broad enough to encompass issues pertaining to PAYG withholding.

On that basis, the taxpayer was allowed a deduction for the legal costs incurred.

Tax Office Appeal Unsuccessful

The Administrative Appeals Tribunal (AAT) has held that a taxpayer was able to rely on a GST Ruling that allowed the taxpayer to claim full input tax credits on due diligence costs, despite the Tax Office's submission that its own Ruling was not applicable.

The case involved a taxpayer who acquired the debts of another entity with a view to collecting them.

Before the acquisition, the taxpayer engaged a third party to provide due diligence services for the purpose of determining whether it should acquire the debts. The taxpayer claimed full input tax credits for the GST paid on the due diligence services.

Broadly, a taxpayer is entitled to an input tax credit equal to the GST paid on the purchase of goods or services used in carrying on the taxpayer's enterprise. Such purchases are referred to as creditable acquisitions.

The law, however, provides that an acquisition cannot be a creditable acquisition to the extent that it relates to making supplies that would be input taxed.

The Tax Office argued that the due diligence costs were related to the acquisition of the debts which are input taxed. On that basis, the Tax Office argued that the taxpayer could not claim the input tax credits.

The AAT disagreed with the Tax Office's argument and held that the Ruling applied to the taxpayer's circumstances. Accordingly, the taxpayer was entitled to full input tax credits.

Investigation of DIY Super Funds

The Tax Office has announced plans to double its superannuation fund audits to identify non-complying funds.

The Tax Office is concerned that a number of self-managed funds may not be complying fully with the superannuation laws. Common breaches include:

- a fund having more than four members;
- using an invalid trustee, such as a trust or partnership; and
- using the fund's investment money to purchase items not solely for the members' retirement.

The funds most likely to come under the scrutiny of the Tax Office include funds with offshore investments and those in operation for more than five years.

Funds in breach of the law could have their earnings taxed at 47% or 48.5% rather than the usual 15%. The increased tax rate would also apply to the capital of the fund.

Please contact us for further information.

- **CAUTION:** Ownership of items such as artwork, holiday or recreational properties, jewellery or other items which may not be strictly for commercial investment should be avoided unless you have obtained specific specialist advice and that advice has been reviewed recently.

R&D Claims under Review

The Tax Office has announced that it is reviewing claims for certain research and development (R&D) expenditure. The review has resulted from the Tax Office's examination of R&D schedules lodged for 2003 and its management of follow-up risk assessments.

The Tax Office is focusing on issues such as:

- whether all expenditure claimed in relation to the R&D concession was actually incurred; and
- whether the expenditure was incurred by the company claiming the deduction and not by another member within a non-consolidated group.

- **CAUTION:** It is very important that companies applying for R&D tax concessions keep accurate records of projects and expenditure in order to substantiate their claims.

Determining Residency Status

In a recent Taxation Ruling (TR), the Tax Office considered when a company, not incorporated in Australia, is a tax resident of Australia.

Australian tax residents are taxed on both their Australian and foreign-sourced income, while non-residents are taxed only on income that is sourced in Australia.

In addition to several alternative tests, a company is an Australian tax resident if it carries on business in Australia and its central management and control (CM&C) is located in Australia.

Broadly, the TR provides that a company that has significant operational activities, such as trading and manufacturing, relevant to its entire business, carries on business in the country where those operational activities take place.

A company whose activities are passive in nature will be regarded as carrying on a business in the place where the investment decisions are made.

A company's CM&C refers to the making of high-level decisions such as general policies and strategic directions. Typically, the company's board of directors makes those decisions.

Accordingly, the ruling provides that the CM&C of the company will, in most cases, be deemed to be in the country in which board meetings are held.

- **CAUTION:** Taxpayers should be aware that the Tax Office could question the location of a company's CM&C where the circumstances appear artificial or contrived.

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.