

Tax News, Views and Clues

Foreign Income and Deductions

The Tax Office has released an Interpretative Decision (ID) regarding the classification of income and deductions as of either Australian or foreign source.

Under the law, where a taxpayer incurs deductions in relation to income it derives from foreign sources, the deductions are limited to the amount of foreign income derived. Any excess is a foreign loss, which can only be offset against future foreign income of the same class.

The ID considers an Australian resident company operating an employment agency in Australia. The company receives income for placement advisory services it provides to foreign resident applicants who wish to gain employment in Australia. It also incurs a service fee from foreign consultants it engages to refer foreign applicants.

A foreign applicant was referred to the company by a consultant and the applicant entered into a contract for placement advisory services with the taxpayer.

The Tax Office forms the view that because the performance of the contract for placement advisory services is to be performed in Australia, the income will be Australian sourced. Accordingly, the fees paid by the resident taxpayer to the foreign consultants it engaged will be allowable deductions, even where the deductions exceed the income.

Discretion to Treat a Private Company as a Public Company

Where a complying superannuation fund (CSF) receives a dividend from a private company, the 'special income' rule applies to the dividend at a tax rate of 48.5% instead of the 15% tax rate that would normally apply to income received by a CSF. Where the dividend is from a public company, it will be taxed at the normal rate of 15%, as the 'special income' rule would not apply.

A recent Interpretative Decision (ID) discusses a case where a large CSF owns all the interests in a private company. The ID considers whether or not the

Commissioner should exercise his discretion to treat the company as a public company for income tax purposes (possibly to avoid the 'special income' rule).

In this case, the Commissioner refused to exercise his discretion to treat the private company as a public company because the company did not satisfy the ASX listing rules, and as it was owned by a superannuation fund, no one person beneficially owned shares in it.

➤ **CAUTION:** Taxpayers that control a CSF should avoid investments in private companies.

GST Refunds

The Tax Office has issued a media release reminding businesses that there is a four-year limit on making a GST refund claim.

As the GST is now in its fifth year, the limit stands to affect all businesses that lodged business activity statements from the beginning of the New Tax System.

In particular, businesses that lodged a quarterly BAS for the September 2000 quarter will now be affected.

Amortisation Deductions Denied

The Administrative Appeals Tribunal (AAT) has rejected a taxpayer's appeal and disallowed deductions for amortisation of intellectual property.

The taxpayer purchased a share in a copyright for \$27,500 under his accountant's scheme. The value assigned to the copyright enabled the taxpayer to claim annual amortisation for tax purposes of \$32,692 per year.

The Tax Office previously refused to issue a private ruling for the scheme and informed the accountant that the copyright's valuation was unacceptable.

Following the Tax Office's investigation, the deductions claimed by the taxpayer from 1998 to 2000 under the scheme were disallowed and a penalty of 10% was imposed for understatement of tax.

The AAT affirmed the Tax Office's decision and warned that investors should be cautious of schemes where the annual deductions totalled more than the one-off outlay.

Consolidation: Single Entity Rule

Readers will recall that the tax consolidation rules allow wholly owned entities to be grouped for tax purposes. The group then lodges a single tax return, and losses and tax credits are pooled.

The Tax Office has issued a ruling confirming the tax consequences of the Single Entity Rule (SER) under tax consolidation.

The SER deems each subsidiary member of a consolidated group to be a part of the head company rather than a separate legal entity.

The implications of the SER include:

- All transactions of group members are treated as having been undertaken by the head company;
- The assets of group members are taken to be owned by the head company; and
- Transactions and transfers between group members (e.g. dividends) are ignored for tax purposes.

Entities that are not members of the consolidated group are not affected by the SER. Accordingly, their income tax position will not be affected by the SER when they deal or transact with a member of a consolidated group.

CGT Main Residence Exemption

The Tax Office has recently released an Interpretative Decision (ID) concerning the capital gains tax (CGT) main residence exemption in a deceased estate situation.

The ID considers a case where the deceased lived in a dwelling acquired before the introduction of CGT until the time of their death in December 1999. Under the deceased's will, the dwelling was to be sold and the proceeds held on trust for the benefit of the deceased's children and grandchildren.

One of the deceased's children was dissatisfied with the terms of the will and lodged a claim in the Family Court. The Court granted the person a right to reside in the property from the date of the deceased's death until the trustee sold the dwelling.

The sale of the dwelling by the trustee would typically attract CGT. The law, however, provides

an exemption from CGT where the dwelling was also the main residence of an individual who had a right to occupy the dwelling under the deceased's will. Other conditions also apply.

The Tax Office formed the view that the exemption still applied in this case, although the right to occupy the deceased's dwelling was granted by court order.

Excess Franking Credits

Where a company receives a franked dividend, its assessable income is grossed-up by tax paid on the relevant profits and a corresponding tax credit is allowed. Where the company is unable to use the credits because its tax payable is insufficient, the excess credit is converted to an additional tax loss, which can be carried forward with other losses.

The Tax Office has released a relevant Interpretative Decision (ID). The ID considers whether a company that has prior year tax losses can choose to deduct some of those losses, eliminating taxable income so that credits can't be used, therefore creating an excess franking offset. This would freshen up tax losses.

An excess franking offset will arise where the amount of tax payable by a company is less than the franking credits it receives during the year, so that the offsets can't all be used.

In broad terms, the law does not allow a company to deduct an amount of prior year tax losses where it would result in the company having an amount of excess franking offsets for that income year. So prior year losses can only be deducted on the basis that adequate tax payable remains to utilise franking offsets.

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.