

## Tax News, Views and Clues

### Compensation Payments

In a recent case, the Administrative Appeals Tribunal (AAT) has confirmed that compensation payments received by a taxpayer after turning age 65 were assessable income even though the taxpayer argued that they were capital in nature.

The taxpayer was unable to work due to ill health and received fortnightly compensation payments. Upon turning age 65 in March 1994, the taxpayer's payments continued to be taxed as income. The taxpayer objected on the grounds that the receipts represented payment of a capital sum for loss of earning capacity.

In response, the Tax Office argued that the payments were ordinary income in the hands of the taxpayer regardless of age and should therefore be included in assessable income. The Tax Office argued that payments were ordinary income because they were received periodically, on a regular basis, and they supplemented income.

The AAT agreed with the Tax Office's arguments and held that the payments were assessable income. The AAT held that the amount could not be capital as it

was not a fixed sum and it was unable to be redeemed (i.e. received as a capital lump sum).

### Small Business CGT Concessions

Certain small business taxpayers may be entitled to CGT concessions on disposal of their CGT assets.

In order to apply the small business CGT concessions, the asset disposed of must have satisfied the active asset test. The test requires that the asset must have been an active asset in the taxpayer's business just before the earlier of:

- its disposal; and
- the cessation of the relevant business (if the relevant business has ceased in the previous 12 months before the disposal).

In regard to the second requirement, the Tax Office has declared in a recent Interpretative Decision (ID) that the sale of shares in the relevant business is not a *cessation* of that business.

The ID examines a case where the taxpayer owned premises that were used in the business of a partnership. One of the partnership entities was connected to the

taxpayer through a common controller. As a result, the premises were an active asset of the taxpayer even though the taxpayer did not use the premises in the course of carrying on its own business.

At a later date, the partnership entity ceased being connected to the taxpayer when the common controller sold its shares. However, the entity continued to carry on the same business.

Subsequently, the taxpayer sold the premises and made a capital gain. The taxpayer argued that the premises were an active asset just before the cessation of the partnership business, which occurred on disposal of its shares.

Therefore, the active asset test would be satisfied and the concessions would be available to reduce the capital gain.

The Tax Office rejected this argument and emphasised that the sale of shares did not constitute a cessation of business. As such, the taxpayer was not entitled to the CGT concessions, as the active asset test could not be satisfied.

- **TIP:** Small businesses should carefully consider their entitlement to small business CGT concessions whenever an asset is sold.

## Foreign Rental Income

The Tax Office has recently released an Interpretative Decision (ID), which considers whether rental income from property outside of Australia is assessable income of Australian tax residents.

The assessable income of an Australian resident includes income from all sources, whether in or outside of Australia. However, in relation to foreign-sourced income, a Double Tax Agreement (DTA) between Australia and the contracting nation must be considered, as the DTA typically takes precedence.

This ID reviews the assessability of income derived by an Australian resident taxpayer from a rental property in Switzerland.

Under the DTA between Australia and Switzerland, rental income derived by an Australian tax resident from real property in Switzerland may be taxed in Switzerland.

The Tax Office considers that the phrase 'may be taxed' indicates that Switzerland has a non-exclusive taxing right. Accordingly, the rental income may potentially be taxed in both countries.

Where foreign tax has been paid on income subject to Australian tax, a foreign tax credit is typically available against the Australian tax payable.

➤ **CAUTION:** It is critical to receive professional taxation advice when dealing with foreign income to ensure that correct tax is paid and any available foreign tax credit is claimed.

## Deductibility of Legal Fees

The Administrative Appeals Tribunal (AAT) has recently held that a taxpayer company was entitled to deduct legal expenses incurred in settling a damages claim even though it had not produced any income.

The taxpayer owned a large rural property that had a leased dwelling situated on it.

In lieu of rental payments, the tenant agreed to provide certain services on the property with the taxpayer's agent being responsible for maintenance on the dwelling.

A legal dispute arose following the tenant's injury in connection with maintenance of the property.

In settling the dispute, the taxpayer and its agent incurred approximately \$39,780 in legal fees.

The Tax Office disallowed the legal expense deduction on the basis that there was no nexus between incurring the legal expenses and the taxpayer's income producing activities.

However, the AAT accepted that the taxpayer held the dwelling separately for the purposes of producing assessable income and that the function of maintaining the property by the agent was incidental and relevant to that purpose.

Consequently, even though no rental income was derived, the AAT found that the legal expenses incurred by the taxpayer were an allowable deduction.

## Changes to GST Laws on Property Sales

The Federal Government has recently introduced a number of important changes to the GST laws, which will impact the sale and purchase of real property.

The new laws are, in part, designed to stop arrangements whereby entities reduce or eliminate GST on supplies of real property through the use of the going concern, GST group and GST joint venture provisions.

It is very important that sellers of residential properties undertake a review of their structures and operations in order to ensure that there are no adverse GST implications or 'hidden' GST costs.

➤ **CAUTION:** GST needs to be carefully considered prior to completing any sales or purchase of real property.

## Evidence for Expenses Substantiation

The Tax Office has recently released a Practice Statement (PS) providing guidance to individual taxpayers as to generally accepted documentation that may be used to substantiate deductions in the tax return.

The PS outlines that individuals without a receipt for work-related expenses may still be able to claim a deduction by maintaining other records, which include:

- online banking and credit card statements;
- online, email and photocopied receipts; and
- BPay records.

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.