

Tax News, Views and Clues

CGT Main Residence Exemption

The Tax Office has released an Interpretative Decision considering the application of the capital gains tax main residence exemption, where a taxpayer has converted their main residence into business premises.

A capital gain or loss arising on the disposal of an individual's main residence is typically ignored for income tax purposes.

Where a taxpayer has been absent from their main residence and has used it for the purpose of producing assessable income, a partial or full exemption from capital gains tax may be available. This rule is broadly referred to as the 'absence rule'.

In the case under review, the taxpayer vacated their main residence and immediately began a process of converting it into business premises. At the end of the conversion, the taxpayer rented the property out and subsequently sold the property for a capital gain.

At the time the taxpayer disposed of the property, he wished to take advantage of the 'absence rule'.

The Tax Office denied the taxpayer's application of the 'absence rule' on the basis that the property could no longer be considered a dwelling as it was no longer suitable as residential accommodation. Consequently, the taxpayer was only entitled to a partial exemption for the period preceding the conversion into commercial premises.

GST Treatment of Residential Premises

The Federal Court has dismissed a taxpayer's appeal that the sale of a strata-titled unit was an input taxed supply for GST purposes.

Broadly, the sale of premises used for residential accommodation is input taxed. However, the sale of residential premises that are 'commercial residential premises' such as hotels, motels, etc. are subject to GST. Likewise, new residential premises will be subject to GST where the vendor is registered for GST.

In the case under review, the taxpayer was a member of a GST-registered partnership. A motel was purchased by the partnership with a view to using it as residential apartments. Following the conversion of the motel, one of the newly fitted apartments was sold at a price excluding GST.

The taxpayer argued that the sale was input taxed as the apartment was not 'new residential premises', as it had been previously sold as residential premises.

The Tax Office disagreed and argued that the original sale of the motel was not a sale of residential premises and accordingly, the sale was not input taxed. GST was therefore to be applied on the sale of the apartment on the basis that it was 'new residential premises' when the apartment was sold.

On appeal, the Federal Court held that the prior use of the premises as a motel did not meet the definition of 'residential premises' as the term 'residence' requires a degree of permanent or long-term commitment which are not characteristics of a motel.

- **TIP:** This case highlights the complexities with property development and the availability of input tax credits. Some careful planning and advice may save businesses thousands of dollars.

Tax Deductible Gifts

The Tax Office has released a draft tax ruling explaining when a gift will be an allowable deduction.

The draft ruling describes a gift as having the following characteristics:

- the gift results in a transfer of beneficial interest in property;
- the transfer is actually made (i.e. it is not an anticipated or planned gift);
- the transfer is made voluntarily;
- the transfer arises by way of benefaction (i.e. the recipient is advantaged in a material sense as a result of the transfer); and
- no material benefit or advantage is received by the giver by way of return.

Special anti-avoidance rules may also deny a deduction. For example, no deduction is available where the gift recipient bears responsibility as a result of the transfer, so that the recipient ultimately receives a benefit that is considerably less than the nominal value for which the giver seeks a tax deduction.

A deduction may also be denied where the giver or an associate of the giver retains the right to use the donated property.

- **TIP:** Examples of gifts that may be allowable deductions include money and various types of property (including trading stock).

Interest on Compensation Payment Assessable

The Administrative Appeals Tribunal (AAT) recently held that an amount of interest received by a taxpayer was assessable income even though it was calculated on a capital compensation payment which was not taxable.

In the case under review, the taxpayer was a landholder whose land had been compulsorily acquired by a state government department.

Pursuant to a court order, the state government department was to pay the taxpayer \$4,300,400 for the land compulsorily acquired, as well as interest at the rate of 9.75% per annum.

Payments were made by the state government department over a number of years. A dispute arose between the parties concerning an amount which was to represent full and final settlement of the matter.

By the time the matter was finally settled, the taxpayer had ultimately received over \$5.3 million in both cash and property.

The taxpayer disclosed what he thought to be the interest component as income in his income tax return but included a notation that he did not accept that any portion of the compensation proceeds constituted income, and he reserved the right to object. The Tax Office assessed the taxpayer liable to pay tax on the interest, and the taxpayer objected.

The taxpayer put forward an argument that has been successful in prior cases. That is, because the compensation sum could not be precisely dissected between capital and interest, the entire sum should be deemed to be capital and therefore not subject to tax.

The AAT rejected the taxpayer's argument and agreed with the Tax Commissioner that the amounts could be dissected with precision.

Accordingly, the AAT held that the interest component was assessable income.

Small Business CGT Concessions: Trusts

The Tax Office has recently released an Interpretative Decision that focuses on what a *connected entity* is in the context of applying the capital gains tax (CGT) small business concessions for a discretionary trust.

The CGT small business concessions operate to reduce or disregard a capital gain if certain conditions are met.

Broadly, one of these conditions is that the CGT asset must have been an *active asset* used in the taxpayer's business or in the business of a *connected entity*.

An entity will be a *connected entity* if either entity controls the other entity or both entities are controlled by the same third party.

Control of an entity is determined by reference to specific tests contained within the law.

Broadly, in the case of a discretionary trust, an entity controls the trust if it receives at least 40% of the trust's income or capital distributions.

In the case where the trust has made no distributions of income and capital, the trustee can nominate up to four beneficiaries as being controllers of the trust.

For further information, please contact our office.

- **CAUTION:** The Tax Office has recently announced a review of entities claiming the CGT small business concessions. In order to avoid penalties, ensure that all required conditions are met.

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.