

## Tax News, Views and Clues

### Part IVA Applies to Vineyard Project

In a recent decision, the Administrative Appeals Tribunal (AAT) has held that the general anti-avoidance rule in Part IVA of the *Income Tax Assessment Act 1936* applied to a taxpayer's investment in a vineyard.

In 1997, the taxpayer invested in a marketed viticulture project that offered future income from grape production. The day-to-day management and operation of the vineyard was carried out by the manager of the project.

For the 1997, 1998 and 1999 income years, the taxpayer claimed deductions for outgoings including management fees, licence costs and prepaid interest.

The taxpayer's investment was funded by a limited-recourse loan that resulted in a tax deduction of over seven times the taxpayer's initial cash outflow.

Due to the age of the vines, the taxpayer didn't derive any income from his vine plots in the first three years. As a result, the Tax Office denied the associated deductions on the basis that

there were no income-producing activities.

The taxpayer argued that he invested in the project to diversify his income-producing investments in the long term and that the resulting tax benefit was relatively small (\$8,000) compared to taxpayer's total personal tax payable (\$99,000).

However, due to the nature and substance of the arrangement, the AAT held that the investment was more like a passive investment than carrying on a business, and held that Part IVA applied.

➤ **CAUTION:** Taxpayers should be prudent when considering investment in schemes that promote themselves as being overly tax-effective.

### Settlement was Taxable ETP

In a recent decision, the AAT has found that a payment made to a taxpayer by his former employer was an eligible termination payment (ETP) as the payment resulted from the termination of the taxpayer's employment.

The taxpayer had entered into a deed of release with his former

employer, and received a \$3.1 million termination payment in relation to continual hurt and abuse suffered during the period of his employment. The Tax Office held that this amount was assessable income.

The taxpayer argued that despite the wording of the deed, the payment was not made as a result of his termination, but rather as compensation for the hurt and humiliation caused by the former employer. The taxpayer argued that the amount was a capital payment, not an ETP, and was not assessable income.

The AAT held that the hurt and humiliation described did not meet the definition of 'personal injury' required to exclude the amount from the ETP definition.

In addition, the AAT rejected the taxpayer's appeal on the basis that the purpose of the payment was to secure the taxpayer's resignation. Consequently the payment was considered to be a taxable ETP.

➤ **TIP:** Taxpayers should be aware that special taxation rates apply to ETPs depending on type and duration of employment.

## Tax Office Audits

The Tax Office has announced that it has raised an extra \$2 billion in revenue in the 2004/05 financial year from its expanded audit programs. The record total amount of revenue raised from audit activities topped \$8.7 billion.

Large businesses came under the most audit scrutiny, with 89% of the Top 100 listed companies having some type of audit in 2004/05. This resulted in over \$4.8 billion in extra revenue.

In the small to medium (SME) business sector, audits and investigations provided the Tax Office with an extra \$3.1 billion. The Tax Office plans to focus on capital gains tax, shareholder loans and the cash economy in SMEs in 2005/06. It has plans to review the operations of 800 small businesses in total.

- **TIP:** Taxpayers should consider a prudential review to identify any exposures, and ensure that thorough and complete records are maintained to minimise disruption from any audit activity.

## Derivation of Management Fees

In a recent decision, the Administrative Appeals Tribunal (AAT) has held that management fees charged by a taxpayer for services performed were not assessable until the fees were actually 'quantified, accepted and charged'.

In 2001, the taxpayer charged a management fee to its parent company for services rendered in the 1999 and 2000 income years. The Tax Office held that the fees were assessable in the years to which they pertained and issued amended assessments.

The Tax Office argued that the fees were assessable as the taxpayer was in a position to sue for payment as the services had previously been provided.

The taxpayer argued that the management fees were assessable income only in the 2001 income year, as this was the year they were quantified, accepted and became recoverable.

The AAT agreed in principle with the taxpayer and held that the management fees only became assessable in 2002, once they were entered in the taxpayer's accounts and became recoverable.

## Input Tax Credits

The Tax Office has recently released two Interpretative Decisions (IDs) regarding the treatment of input tax credits when calculating allowable deductions for telephone and car expenses.

Where a taxpayer is registered for GST, allowable deductions must not include any input tax credits that the taxpayer is entitled to claim.

In regard to a telephone account used 50% for business and 50% for private purposes, the taxpayer is limited to a deduction of only the 50% related to business use. The proportion must be reduced by any associated input tax credits before an allowable deduction is claimed.

The tax law contains four methods for determining allowable car expenses. Under the 'one-third of actual expenses' method, or the logbook method, deductions are potentially available for the expense amount, net of input tax credits.

## GST: Going Concern Clauses

The GST Act provides that the supply of a going concern is GST-free. The seller of the business does not have to account for GST on the sale and the buyer does not have to fund the GST component. Further, as stamp duty usually applies to the GST-inclusive sale price, the stamp duty liability is reduced.

In a recent case, the seller of commercial property (subject to a lease) was required by the Tax Office to account for GST on the sale. Although the buyer and seller were registered for GST, the contract signed between the parties did not state that the parties had agreed that the sale was the supply of a going concern.

The GST Act requires that both parties must 'agree in writing' that a supply is a going concern. The absence of such a clause resulted in the seller having to account for GST on the sale. Consequently, the seller had to remit GST to the Tax Office and was not in a position to recover this cost from the purchaser, as the contract did not contain any 'GST recovery' clauses.

The case highlights the importance of considering and documenting GST implications when negotiating a sale price, so that the exemption will apply. Parties to a contract should not presume that oral communications, intentions and post-contractual actions will make up for the absence of an agreement in writing.

- **TIP:** In order to ensure that the seller isn't left with a GST liability, it is vital that the taxpayer negotiating a sale of a going concern ensures that the agreement is in writing.

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.