

## Tax News, Views and Clues

### Statute Barred Loans

The Tax Commissioner recently released a practice statement on the operation of the shareholder loan (deemed dividend) rules and statute barred loans.

As a general rule, where a loan made before the commencement of these rules becomes statute barred, it may give rise to a deemed dividend. A loan becomes statute barred when the lender can no longer seek recovery of that loan because of legal time limitations.

The Commissioner has decided that he will not undertake compliance action to amend assessments in relation to loans entered into prior to 4 December 1997 which have become statute barred.

The laws concerning when a loan will become statute barred are different in each state and territory. The Commissioner considers that to pursue such loans will give rise to inequality between taxpayers due to the different state and territory laws.

The Commissioner also considers that if a loan is refreshed after the statutory recovery period ends, it does not create a new loan to which Division 7A applied.

The practice statement is effective from 4 December 1997.

### Building Write-offs

The Tax Office has recently released a practice statement on deductions for construction expenditure on capital works, such as buildings or improvements. Such expenditure is typically deductible at a rate of 2.5% where the relevant building is used for income producing purposes.

Where a taxpayer has deducted an amount, the cost base of that asset is required to be reduced accordingly. Consequently, the deduction is often recaptured when the building is sold.

The Tax Office acknowledges that where a taxpayer acquires an existing building it may not be possible to obtain adequate information to determine the available deduction. While the taxpayer may obtain a valuation to determine the original construction cost, the cost of obtaining the valuation can be prohibitive. In such cases, the taxpayer may simply choose not to claim the available deductions.

Accordingly, the Commissioner stated that where the taxpayer cannot determine the amount of the available deduction, the taxpayer will not be required to adjust the cost base and reduced cost base of the asset to reflect

deductions which have not been claimed.

- **NOTE:** If information is available to determine the available deductions, the position outlined in the Commissioner's practice statement is not applicable.

### Employee Benefit Trusts and FBT

The Tax Office recently issued a press release on proposed amendments to FBT assessments for employee benefit trust (EBT) arrangements.

Employers who establish EBTs will make contributions to fund future payments for employees. A tax deduction is sought for contributions and fringe benefits tax may be payable.

As a result of several recent cases, contributions made to certain EBT arrangements have been held to be non-deductible. Where the contribution is not deductible, FBT will not be payable for the contribution.

The Tax Office announced that it will therefore be issuing amended FBT assessments to exclude the contributions in those cases. The Tax Office will notify employers if their FBT assessment will be amended.

- **NOTE:** If the amount of FBT is reduced, employers will not be able to claim the full amount of FBT paid as a tax deduction. Employers will be required to include the amount of the reduction as assessable income in the income year when the amended FBT assessment was issued.

## No Deductions for EBT Contributions

In a recent decision, the Administrative Appeals Tribunal (AAT) concluded that deductions claimed by a family trust for contributions made under an employee benefit trust (EBT) arrangement were not deductible.

The AAT stated that the contributions did not represent outgoings incurred in gaining or producing assessable income or in carrying on the business of the trust. In particular, there was no apparent business purpose for the contributions made.

The AAT found there was no evidence to suggest that the contributions were made to enhance the loyalty or productivity of the employees, nor to provide an incentive to continue in their employment. According to the AAT, the only motivation for making the contribution was tax savings.

- **TIP:** We recommend that any taxpayers with EBT arrangements review them and consider the likelihood of any non-deductible amounts or FBT amendments.

## Business Costs — 'Blackhole' Expenditure

The Government recently released draft legislation which expands the circumstances under which a deduction is available for 'blackhole' expenditure.

This is expenditure which is incurred by a business where there is no deduction available under tax law.

Under the current rules, taxpayers could deduct specific expenditure on a straight-line basis over five years. This included expenditure incurred to establish a business structure, convert a business structure, raise equity, defend a business against a takeover, and costs related to ceasing a business.

Under the proposed rules, taxpayers will continue to be entitled to a deduction on a straight-line basis over five years for certain business expenditure. The available deductions are expanded to include expenditure which is incurred in relation to a past, present or prospective business, to the extent that the business is, was, or is proposed to be carried on for a taxable purpose.

This includes expenditure on a business plan, the establishment of business premises, research into likely markets or profitability of a business, and capital investment in assets of the business.

In addition, shareholders, beneficiaries of trusts and partners will be able to deduct liquidation and deregistration costs where the company, trust or partnership carried on the business.

The deduction will only be available if the expenditure cannot be deducted under any other part of the tax law. It is noted also that if a taxpayer is not carrying on a business, the deduction will not be available.

If passed, the new rules will apply to expenditure incurred on or after 1 July 2005.

## CGT Cost Base

Under the same draft legislation, the Government also announced that it will expand the type of expenditure that can be included in the cost base and reduced cost base of assets for capital gains tax (CGT).

The following expenditure may now be included:

- Incidental costs of acquisition: Marketing expenses, search fees relating to a CGT asset, and borrowing expenses.
- Costs of ownership of the assets: The category of costs of ownership of assets acquired after 20 August 1991 has been expanded to include both capital and non-capital costs.
- Other expenditure incurred to improve the asset: Expenditure no longer needs to be incurred for the purpose of increasing the asset's value and it is no longer required to be reflected in the state of the asset at the time of the CGT event. It can also include expenditure to install or move the asset.

It is noted that the new rules specifically prevent expenditure on entertainment, penalties and bribes from being included in the cost base or reduced cost base of the asset.

If passed, the new rules will apply to CGT events happening after 1 July 2005.

- **TIP:** These new rules provide an opportunity to review asset cost bases in order to minimise potential CGT liabilities.

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.