

Tax News, Views and Clues

Tax Effective Investment Schemes

In a recent decision, the Administrative Appeals Tribunal (AAT) disallowed deductions relating to a scheme involving a wine grape project.

Readers will be aware from previous editions that the Commissioner is seriously clamping down on tax effective investment schemes that are thinly disguised as providing taxpayers with a commercial benefit.

In this case, the taxpayer sought to claim 'excessive' deductions for a small amount of capital outlay through a series of 'round robin' financing arrangements, which the Commissioner argued served no commercial purpose other than to generate large upfront fees.

The AAT agreed with the Commissioner in applying Part IVA to the scheme, concluding that the taxpayer entered into the scheme with the sole or dominant purpose of obtaining a tax benefit, regardless of whether or not there were genuine commercial objectives.

Commissioner's Discretion — Non-commercial Losses

The Tax Office recently released a draft ruling providing guidelines on how the Commissioner's discretion, contained in the non-commercial loss provisions, may be exercised.

The non-commercial loss provisions prevent taxpayers from offsetting losses generated from a non-commercial business activity (e.g. a hobby farm) against the taxpayer's other assessable income.

There are four tests that apply to determine if a loss can be considered a business loss and hence deductible against the taxpayer's other income.

In addition to these tests, there is also a provision that allows the Commissioner to exercise his discretion in circumstances where he determines it would be unreasonable to defer the loss.

The ruling indicates that the Commissioner may exercise his discretion in the following circumstances:

- **special circumstances:** the business activity has been affected by special

circumstances outside of the taxpayer's control, specifically including: flood, drought or natural disaster;

- **nature of business:** an inherent characteristic of the business would necessarily cause the taxpayer to fail one of the tests mentioned above; and
- **objective expectation:** there is an objective expectation that during a commercially viable period of time, the activity will meet one of the four tests.

Partnership Losses Denied

In a recent decision, the AAT affirmed the Commissioner's decision to deny a taxpayer a deduction claimed regarding partnership losses

A partnership's assessable income is calculated as if the partnership were a taxpayer in its own right. However, in calculating the partnership's taxable income, deductions for tax losses are not included in the partnership return, but in the returns of the individual partners instead.

In September 2002, the taxpayer lodged an income tax return in which \$90,000 was claimed as a deduction for the taxpayer's share of the partnership's losses. However, three months later the taxpayer lodged an amended assessment deleting the deduction previously claimed.

The original return was assessed by the Commissioner (creating a tax shortfall amount). The Commissioner then made an amended assessment on the return in which the taxpayer had removed the deduction.

The AAT found that the taxpayer was not entitled to claim a deduction for the partnership losses, as there was no evidence that a partnership existed. In addition, there was no evidence that the liability had ever been incurred.

However, the taxpayer was not liable for an administrative penalty (equivalent to 10% of the tax shortfall) as the AAT held that the tax shortfall in question was not the result of false or misleading statements or taking a position that was not reasonably arguable. The AAT concluded that the shortfall amount arose from the Commissioner assessing the taxpayer on facts that were no longer valid.

Offshore Employee Super Scheme

In a recent decision, the AAT denied a taxpayer trust a deduction for contributions made to a New Zealand superannuation fund on behalf of an employee of the trust.

The taxpayer trust claimed a deduction of \$60,000 for a contribution made to a New Zealand superannuation fund in 2000.

The AAT held that there was only evidence of \$6,000 being contributed by the taxpayer. The balance of the payments were attached to a series of 'round robin' payments between related parties which could not be traced back to the taxpayer.

Furthermore, as the trustee of the fund had sole discretion to distribute the fund income, the fund did not qualify as a superannuation fund. A deduction was also denied as the expenditure was not in the ordinary course of the taxpayer's business.

In the event that the AAT was incorrect in its findings on deductibility, it further found that Part IVA would apply as the dominant purpose of entering into the scheme was to avoid tax.

Division 7A — Audit Selection Criteria

The Tax Office recently released guidelines indicating draft selection criteria for Division 7A audit cases.

Division 7A is a taxation integrity measure which targets payments, loans or debts forgiven by a private company in favour of a shareholder or shareholder's associate, on or after 4 December 1997. The Division applies to deem such payments to be dividends, unless they fall within certain specified exclusions.

The Tax Office has indicated that the broad criteria for case selection are as follows:

- a high proportion of company value being distributed through Division 7A transactions. This is evidenced where annual Division 7A transactions are greater than 50% of net assets;

- Division 7A transactions which have occurred in multiple income years, which would indicate that this type of repeat behaviour may not be inadvertent;
- Division 7A transactions which occurred after 1 July 2004, following changes to the legislation allowing tax practitioners to intervene prior to the lodgement of the tax return; and
- transactions which appear contrived and planned intentionally to avoid Division 7A.

Property Settlement Adjustments

A settlement adjustment is an adjustment that is made between the vendor and the purchaser in relation to matters such as rates and land tax on the sale of a property.

Given the large number of GST errors in relation to 'settlement adjustments' on Business Activity Statements, it is useful to consider GST Determination 2006/3, issued by the Tax Office last year.

This determination considers whether settlement adjustments for rates, taxes and other outgoings are taken into account in determining the consideration for the supply of real property.

It is useful because the legislation does not refer to 'settlement adjustments', and there is no readily available information regarding the GST implications of these adjustments. This determination seeks to help businesses by providing practical examples in relation to different settlement adjustment scenarios.

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