

THE REPORT

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Tax News, Views & Clues

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MONTHLY REPORT

Business Acquisitions — Due Diligence

A purchaser of a business entity may find themselves inheriting unexpected tax liabilities unless a detailed tax due diligence process is undertaken to identify undisclosed liabilities.

It is prudent to work through a detailed tax due diligence checklist for any acquisition.

Common ‘hot’ areas for review as part of tax due diligence include:

- income tax, fringe benefits tax, payroll tax and WorkCover returns to ensure all liabilities have been dealt with;
- the entity’s GST issues and compliance;
- the impact of tax consolidation — is the entity from an existing consolidated group so it may have joint and several liability for group taxes?;
- any losses in the target entity — have the losses been properly carried forward and utilised by the target entity?;
- recent acquisitions, disposals and restructures that may trigger CGT events;
- potential tax liabilities under various loan arrangements; and
- the need for tax warranties and/or indemnities from the vendor where issues arise.

We recommend seeking professional advice in relation to any acquisition to avoid the potential for nasty surprises in relation to tax.

Distributions to Certain Entities

New legislation applicable to certain loans, payments and debts forgiven by a trustee of a trust has recently been introduced into Parliament.

Under current law, if a private company has an unpaid distribution from a trust, and the trust makes a loan to a shareholder of the private company, the loan can be deemed to be an unfranked dividend. This law is designed to prevent a trustee from sheltering trust income at the company tax rate while lending the money to the ultimate owners or controllers.

The proposed changes expand the application of this law by including payments and forgiven debts, as well as loans, within its operation.

In relation to loans, an element of flexibility is also introduced by allowing a full repayment, or preparation of a loan agreement, by the tax return lodgment date.

- **CAUTION:** Loans in particular, out of either private companies or trusts, can result in very significant tax penalties. Please contact us to address any issues arising out of existing loans.

Small Business CGT Concessions

Changes have been introduced into Parliament in relation to the CGT small business concession maximum net asset requirement.

Readers will recall that various CGT concessions are available to small business owners, subject to certain conditions. A threshold condition is that the taxpayer’s net assets (and those of related entities) cannot exceed \$5 million.

Under the current law a beneficiary of a trust can be deemed to control the trust in certain circumstances.

This results in the assets of the beneficiary being aggregated with the assets of the trust.

This makes it difficult for the trustee, as taxpayer, to satisfy the test requiring that net assets not exceed \$5 million.

Under the proposed law, an entity will be taken to control a discretionary trust only if, for any of the previous four income years:

- the trustee paid to the entity, or certain associates of the entity, any income or capital of the trust; and
- the amount paid is at least 40% of the income or capital paid by the trustee for that income year.

If the amount paid or applied is between 40% and 50%, the Commissioner's discretion may be exercised. The proposed law will also exclude tax-exempt entities or deductible gift recipients. This means that distributions to those entities will not cause the aggregation of assets with the trust's assets when the concession is applied.

These proposed changes are a definite step in the right direction as the current law prevents many small businesses from taking advantage of the concessions.

- **CAUTION:** Please note, neither the House of Representatives nor the Senate have yet passed these changes. The current law is still applicable.

Default on Instalment Sales Contracts

The Australian Taxation Office (ATO) has recently released two interpretative decisions regarding the tax treatment of monies received or paid by a taxpayer in event of a third party defaulting on a long-term contract.

The taxpayer sold properties under instalment sales contracts with vendor terms. The purchaser initially paid a deposit to the taxpayer, followed by instalments made up of principal and interest.

The arrangement was such that title to the property would not pass to the purchaser until the contract had been paid out in full.

After making several instalments, the purchaser defaulted on the contract. At the time, the taxpayer divided the money received into principal and interest components, including only the interest received in its assessable income.

The ATO held that the monies retained by the taxpayer after the contract default were profit made in the ordinary course of carrying on a business of buying and selling residential properties, and were, therefore, ordinary income.

Following the default on the contract, the taxpayer made a payment to the defaulting purchaser to persuade them to leave the property in good condition and facilitate the resale of the property. The ATO held that this payment was an allowable deduction as it was necessarily incurred in the carrying on of the business of the taxpayer.

GST Treatment of Land Sold on Instalment Basis

The ATO has also recently released an interpretative decision in respect of land sold on an instalment basis.

The ATO has declared that where the accruals basis of GST accounting is used, the sale of land on an instalment basis will attract GST upon payment of the first instalment.

This is to be contrasted with the terms of settlement under a standard land contract where the ATO accepts that the payment of a deposit is a security deposit and GST is not triggered until the time of final settlement.

This decision, while not a binding ruling, shows that supplies of land are not as straightforward as some taxpayers might imagine. Both the form and substance of a contract are important in determining supply for GST purposes.

Apportionment of Investment Advisors Fees

The ATO has recently released another interpretative decision, this time regarding the deductibility of ongoing financial advisory fees. Where a taxpayer incurs the fees receiving financial advice for both their self-managed superannuation fund and their private investment portfolio, only the fees relating to the taxpayer's personal portfolio may be deducted in their personal income tax return.

The superannuation fund's share of the fees will be a deduction in the fund to the extent that the fees are incurred in gaining or producing assessable income for the fund.

Net Asset Value Test — Which Liabilities to be Included?

In two further interpretative decisions, the ATO has clarified its position on the liabilities to be included in the maximum net asset test for the CGT small business concessions.

The legislation includes the phrase 'liabilities of the entity that are related to the assets'. The ATO states that this does not require each liability to be directly related to a particular asset and general liabilities should also be included. For example a bank overdraft used to provide working capital for a business should be included in the calculation.

The ATO has also stated that only legally enforceable debts and presently existing obligations are to be included. Contingent liabilities or future obligations should be left out.

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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.