

THE REPORT

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Tax News, Views & Clues

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MONTHLY REPORT

Tax Office to Investigate Cash Economy Industries

The Tax Office has announced plans to conduct a strong compliance drive in industries that are susceptible to cash payments, non-lodgment, failure to register for GST, poor record keeping and over-claimed input tax credits. The compliance drive will focus on micro-businesses (annual turnover of less than \$2 million) in the following industries:

- tourism and hospitality;
- horse racing and export;
- restaurants, cafes and takeaway shops;
- licensed hotels and registered clubs;
- adult entertainment; and
- motor vehicle trading and wholesaling.

In addition, the Tax Office plans unannounced registration checks of businesses, desk audits and expanded data-matching procedures to check for lodgment compliance and accurate reporting of income.

Streaming of Franking Credits

The Tax Office recently released an Interpretative Decision (ID), which considers whether to penalise a company for streaming franking credits to only one class of shareholders.

Broadly, the Commissioner may penalise a company for making a distribution of franking credits to a class of members that receives a greater benefit from the franking credits than the members excluded from the distribution would have. This is known as streaming.

A typical situation is where franked dividends are distributed to Australian resident members in preference to non-resident members, as the Australian shareholders potentially gain the greatest benefit from franking credits.

The Commissioner, when determining whether a distribution is streamed, will generally consider the members':

- tax residence status;
- entitlements to franking credits; and
- ability to pass on franking credits (companies only).

Broadly, if all members would benefit from franking credits evenly, then the company would not be considered to be streaming.

Joint Venture Receipt Taxable as Ordinary Income

In a recent case, the AAT has upheld the Commissioner's assessment and confirmed that payments received by a taxpayer were from a profit-making scheme and were assessable as income.

In 1985, the taxpayer was a party to an unincorporated joint venture created to develop infrastructure projects. Following a falling out, the taxpayer left the joint venture in 1987 and ultimately received a settlement of \$1,228,500.

The taxpayer declared the aggregate receipt as capital in his 1988 income tax return. In 1994, following a tax audit, the Commissioner issued an amended 1988 assessment including the full \$1,228,500 as assessable income, as being the proceeds from a profit-making scheme.

The taxpayer argued that the amounts received were for intellectual property rights and were a non-assessable capital gain as they were acquired before the commencement of capital gains tax.

The AAT considered that the payment may in part be representative of the intellectual property transferred by the taxpayer, but formed the view that there was insufficient evidence to establish its value.

Consequently, the AAT agreed with the Commissioner and held that the taxpayer's actions had shown that there was a profit-making scheme throughout the negotiation of the joint venture. The AAT held that the full amount of \$1,228,500 was assessable income.

- **CAUTION:** Cases such as this show the importance of thoroughly and properly documenting the basis of transactions undertaken.

GST and Long-term Contracts

The GST laws provide that supplies made under contracts that were entered into prior to the introduction of GST will be GST-free until 1 July 2005.

Recent amendments to the GST laws now allow suppliers and recipients to revise the prices associated with certain long-term non-reviewable contracts to incorporate GST. This provides the supplier of goods or services under such a contract with an opportunity to recover from the recipient the GST payable after 1 July 2005.

There are three options the supplier and recipient can choose in regard to the GST position of long-term non-reviewable contracts:

1. The price remains the same and the supplier accounts for GST on 1/11th of this price.
2. The contract price is revised and the supplier accounts for 1/11th of the revised price.
3. The contract price is not revised and the recipient of the supply pays 10% GST on top of the price under the contract.

If both parties cannot agree, an arbitration process with an independent assessor will commence.

The new laws represent an opportunity for suppliers to clarify GST recovery issues with recipients of existing long-term contracts. However, varying a contract by increasing the price of supply may result in the imposition of stamp duty.

- **TIP:** Suppliers and recipients should analyse the effect of altering prices in long-term contracts and the impact of GST on the transactions made under the contract.

Exempt Benefits: Loan Arrangements

In a recent Interpretative Decision (ID), the Tax Office has declared that a loan used by an employee to purchase a laptop computer does not qualify as an exempt benefit under the Fringe Benefits Tax (FBT) provisions.

Under the FBT provisions, certain expense payments in respect of eligible work related items are exempt from FBT. A laptop computer is defined as an eligible work related item.

In the case under review, an employee obtained a personal loan and used the funds to purchase a laptop computer. The employee then repaid the loan via a salary sacrifice arrangement (SSA), whereby the employer made the loan repayments on the employee's behalf.

Under the SSA, the employer is making loan repayments for the benefit of the employee and this represents an expense payment fringe benefit.

To be exempt from FBT, the expense payment must be in respect of the work related item, in this case the laptop computer.

The Tax Office formed the view that the employer was not making the expense payments towards the purchase of the laptop computer, but rather, was making payments towards the employee's personal loan obligations.

Accordingly, the expense payment was not in respect of the laptop computer. As such, the expense payment was not an exempt benefit but was held to be a taxable fringe benefit.

- **TIP:** Taxpayers should seek professional FBT advice when structuring a SSA to ensure that the most beneficial outcome is achieved.

Travel Deductions: Cents per Kilometre

The Tax Office has released the 2004/05 cents per kilometre rates.

Taxpayers who use their car for business purposes, and choose the cents per kilometre method for claiming travel expenses, can use these rates to determine the amount of their deduction for the 2004/05 income year.

The 2004/05 rates for non-rotary engine cars are:

- 0–1,600 cc — 52 cents per kilometre;
 - 1,601–2,600 cc — 62 cents per kilometre; and
 - 2,601+ cc — 63 cents per kilometre.
- **CAUTION:** Taxpayers electing the cents per kilometre method can claim up to a maximum of 5,000 business kilometres.

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DUE DILIGENCE - ACTION CHECKLIST

Tax

1. Review a detailed group structure diagram and provide a summary of share ownership. In particular, review for any ownership by trusts.
2. Review tax returns for the last four years, and supporting work papers, including detailed reconciliations of profit/loss per the financial statements and taxable income/loss.
3. Review copies of company franking accounts for each of those years, including details of dividends paid and the extent of franking.
4. Review copies of both accounting and tax fixed asset registers and related fixed asset reconciliation schedules for those years.
5. Review a schedule of any carried-forward revenue and capital gains tax losses of the company and details of losses utilised during the last five years, and ascertain whether there are any losses transferred in or out.
6. Review copies of FBT returns and supporting work papers for the last four years.
7. Review copies of any correspondence with the ATO for the past four years, including (but not limited to):
 - all private ruling requests, requests for the expression of the Commissioner's opinion or objections lodged, and all responses received;
 - requests for an amended assessment; and
 - requests for information from the ATO, whether as part of a formal audit or otherwise, and all responses provided. Otherwise, confirm that the company has no knowledge of any intended audit activity.
8. Review the consolidated group that the company is a member of for tax purposes. Review details of any tax sharing agreements entered into.
9. Review position papers supporting any positions adopted by the company in relation to tax matters in the past four years.
10. Review details of any significant transfers of employee leave entitlements to or from the company in the past four years.
11. Obtain details of any direct or indirect interests held in foreign entities.
12. Obtain details of any foreign permanent establishments of the company, including any offices, employees, substantial equipment or projects in foreign countries.

13. Obtain details of all interest, royalties and dividends paid to non-residents and withheld and/or remitted in the past four years.
14. Obtain details of any insurance premiums paid to non-resident insurers in the past four years.
15. Obtain details of all income derived from foreign sources, and foreign taxes paid in the past four years.
16. Determine whether there is any ownership of the company by non-residents, and any interests held by the company in offshore entities.
17. Assess the company's interest expense over the last four years, and any interest deductions disallowed under the thin capitalisation rules (if applicable).
18. Determine whether there have been any capital gains tax rollovers to or from the company since 1985. Obtain details of the assets involved, their cost base and potential market value at the time of transfer.
19. Determine whether there have been any asset rollovers for depreciation purposes involving the company.
20. Obtain details of any changes in share ownership of the company since incorporation. Detail significant or abnormal changes in indirect ownership through interposed group companies.
21. Determine whether the company acquired any of its assets before 19 September 1985.
22. Review the nature of foreign currency transactions undertaken by the company and its policy concerning the tax and accounting treatment of foreign currency movements.
23. Review any intra-group asset transfers during the last four years.
24. Determine whether any debts owed by or to the company have been forgiven in the past four years, and if so, what tax adjustments or capital loss claims resulted.
25. Determine whether the company received dividends from shares held for less than 45 days, or from shares where there is diminished risk of ownership.
26. Determine whether all appropriate returns have been lodged and all appropriate accruals have been made in respect of applicable taxes, including, but not limited to:
 - Income tax;
 - FBT;
 - GST;
 - Payroll tax;
 - PAYG;
 - Superannuation Guarantee Charge;
 - Stamp duty;
 - Customs duty; and
 - Franking additional tax, franking deficit tax, or deficit deferral tax.
27. Determine whether there have been any transactions with any international related parties in the past four years. Consider transfer pricing issues.
28. Assess whether any transactions may not have been undertaken on arm's length (market value) terms between related parties, including both domestic and international transactions.
29. Obtain proof of future tax benefits and/or deferred tax liability balances and:
 - review for reasonableness;
 - ensure appropriate tax rates have been applied; and
 - assess whether the future income tax benefit should be carried forward.
30. Determine whether there are, or have been:
 - any significant items in dispute with the ATO (i.e. outstanding ruling requests, ATO audit issues, objections to assessments, appeals);
 - any 'exposures' relating to inter-company pricing or allocation of expenses between related entities;
 - any aggressive tax positions taken in tax returns and whether they are adequately provided for in the relevant balance sheets; and

- any liabilities for tax penalties.
31. Review any private rulings or advice upon which the company is relying.
 32. Summarise the taxation implications for the purchaser and the company (the entities and shareholders) that will arise from the proposed transaction; including, but not limited to:
 - entitlement to carry forward tax losses;
 - CGT and cost base issues; and
 - stamp duty and other taxes payable.

GST and Other Indirect Taxes

33. Review GST returns for all periods from 1 July 2000, including summary sheets, schedules and other documents used in the preparation of the BAS returns.
34. Obtain and review a copy of the Running Balance Account from the Australian Taxation Office and review.
35. Review copies of any Recipient Created Tax Invoice agreements, sample copies of invoices and adjustment notes issued by the company.
36. Review copies of any material agency agreements, franchise agreements, lease agreements, loyalty payments or rights agreements.
37. Review copies of any assessments or requests for payment received from the ATO.
38. Assess whether the entity is part of a group, partnership or joint venture.
39. If a member of a group, determine whether there are any other members of the group with outstanding income tax, GST or other liabilities that could be offset against the Running Balance Account.
40. Determine whether all BASs have been lodged for the period since 1 July 2000 and payments have been made in respect of both GST and PAYG.
41. Determine whether payroll tax returns have been lodged and payroll tax paid in each jurisdiction.
42. Consider whether the entity is appropriately grouped or not grouped for payroll tax purposes.
43. Assess whether the amount of salary and wages shown in the accounts approximates that which has been declared for payroll tax.
44. Review to ensure that independent contractors have been properly treated for tax purposes.
45. Determine whether there are any outstanding assessments or refund claims.

WorkCover

46. Review copies of WorkCover premiums for the last three years.
47. Review WorkCover correspondence to determine whether there are any documents advising of WorkCover premium rates or industry classifications, outstanding claims or claims history.
48. Determine whether WorkCover premiums and payments are up to date.
49. Assess whether there are any outstanding obligations, assessments or challenges currently undertaken in relation to WorkCover.

Superannuation

50. Review copies of all superannuation guarantee payments for the most recent financial year.
51. Determine whether all superannuation guarantee payments have been made.

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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.