

# the report

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## MONTHLY REPORT

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## MONTHLY REPORT

### *Common Mistakes in Claiming Rental Property Deductions*

The Tax Office has recently released a guide to help taxpayers claim deductions on a property they lease. The guide outlines common mistakes made on income tax returns, some of the more common of which are outlined below:

- claiming the cost of improvements such as remodelling or adding sections to the property as repairs when these should be claimed as capital works deductions;
  - over-claiming deductions of interest where a loan was taken for both private and income-producing purposes;
  - claiming deductions for items that have been incorrectly identified as depreciating assets; and
  - claiming deductions on a property that is only available for rent for a portion of the year (i.e. a holiday house).
- **TIP:** When preparing your personal income tax return, make sure to consult the Tax Office guide: Rental properties 2005–06, to ensure that depreciating assets have been identified correctly and their effective lives are reasonable.

### *Trust Cloning — Potential Exception to CGT Events E1 and E2*

The Tax Office has recently released Taxation Ruling TR 2006/4, which discusses the circumstances where the beneficiaries and terms of two trusts are considered to be the same for the purpose of applying an exception to CGT events E1 and E2.

Broadly, CGT event E1 applies where a trust is created over an asset. CGT event E2 applies where a CGT asset is transferred to an existing trust. In the ruling, the Commissioner indicates that these events do not occur where the CGT asset is transferred from one trust to another, and the beneficiaries and terms of both trust deeds are the same.

- **TIP:** This may be useful where one trust carries on a business and also holds valuable assets such as land and buildings. By transferring the assets to a new 'cloned' trust and leasing those assets back to the original trust, the risk associated with carrying on the business is mitigated.

### *CGT and Foreign Residents*

On 22 June 2006 the Taxation Laws Amendment (2006 Measures No. 4) Bill 2006 was introduced into the House of Representatives. The main amendment the Bill introduces is the treatment of capital gains tax (CGT) in the hands of foreign residents. The Bill aims to narrow the range of assets on which a foreign resident will be subject to Australian CGT, namely:

- Australian real property; and
- business assets of a foreign resident's permanent establishment operating in Australia (not including Australian real property).

As an integrity measure, the Bill also applies CGT to the non-portfolio interests of foreign residents operating through interposed entities. This is where more than 50% of the interposed entities' assets are attributable (whether directly or indirectly through one or more interposed entities) to Australian real property.

If enacted the key implications are:

- a foreign resident who has invested in non-property sectors in Australia should be able to exit Australia with no CGT consequences;
- foreign resident private equity investors will no longer face losing 30% on their Australian investments; and
- investing through a subsidiary will become more attractive than a branch structure.

### *Tax Implications of Government Payments to Industry*

The Tax Office has recently released a ruling that discusses the Commissioner's view on government payments to industry, which aid in continuing, ceasing or commencing business. In the ruling, the Commissioner indicates that a payment to a company to continue its business should be included in assessable income.

A payment made to commence or cease a business is not assessable as income; however, it is recognised that these payments may be considered to be assessable recoupments. The ruling identifies the following payments to industry as assessable recoupments:

- a payment received to assist the recipient to commence the business with the purchase of a depreciating asset;
- a payment made to cease or commence a business, which reimburses the cost of professional taxation advice; and
- the cost of finalising a business that includes a payment to stop carrying on the business.

## Share Capital Tainting Rules

Taxation Laws Amendment (2006 Measures No. 3) Bill makes amendments to the *Income Tax Assessment Act 1997* regarding a company's share capital account. Broadly, a company's share capital account will become tainted where an amount is transferred from an account, other than:

- an amount that can be identified as share capital;
- certain amounts that are transferred under debt/equity swaps;
- certain amounts that are transferred from an option premium reserve; and
- certain amounts that are transferred in connection with the demutualisation of an insurance company at the time of demutualisation.

When a company's share capital account becomes tainted a franking debit arises in the company's franking account at the end of the franking period in which the transfer occurs. A tainted share capital account is treated as a profit account and any subsequent distributions are treated as unfrankable. If the company then chooses to untaint its franking account, a further franking debit may arise and untainting tax may be payable.

- **TIP:** To ensure a transfer does not cause the share capital account to become tainted, constantly review all transfers into the share capital account.

## GST and Contracts, Again!

As with GST regimes around the world, a majority of court and tribunal cases will rest upon whether one party has the contractual ability to recover GST from the other party. The Victorian Civil and Administrative Tribunal (the tribunal) recently presided over a case concerning GST and a retail tenancy agreement. The tenant sought a refund of GST paid to the landlord (amongst other things).

The tenant had argued that the landlord was not registered for GST and that the GST payment made was 'payment for which there was a total failure of consideration'. The landlord argued that the GST did not need to be refunded as the GST was remitted to the Tax Office and the tenant was entitled to input tax credits on the payment. The tribunal held that the rental agreement did not contain specific GST indemnity clauses for the tenant to indemnify the landlord for any GST outstanding and that the GST clauses contained in the rental agreement were very narrow in their application.

The landlord had also leased out the premises in his capacity as a non-GST registered individual rather than through a GST registered partnership of which the landlord was a partner.

In summary, the tribunal held that GST should be refunded to the tenant as it was incorrectly paid across to the landlord.

- **TIP:** The case highlights the importance of adequate GST recovery clauses and that when it comes to GST, a one-size-fits-all clause will not suffice. Although standard GST clauses may suit in some circumstances, different transactions will require different GST clauses.

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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.