

## THE REPORT

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*Tax News, Views & Clues*

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## MONTHLY REPORT

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### Super Fund Choice

From 1 July 2005, many Australian employees will be able to choose a superannuation fund into which their employer's superannuation guarantee contributions are paid. These new 'super choice' rules have important consequences, both for employers and employees.

Employers will be required to pay compulsory superannuation guarantee contributions into a complying superannuation fund for each of their eligible employees, and from 1 July 2005 certain employees will have the right to choose the fund their contributions are paid into.

The changes will provide employees with a choice as to who manages their investments for retirement. If an employee does not wish to change fund, their superannuation contributions will continue to be paid into the fund chosen by the employer. An employee may choose to change funds at any time. However, an employer can only accept one choice from an employee in a 12-month period.

### Tax Consequences

The introduction of super fund choice does not directly modify the tax treatment of superannuation contributions or payments; however, the proposed abolition of the superannuation surcharge means that contributions will be taxed at a maximum tax rate of 15% (currently 30%) instead of the top marginal tax rate of 48.5%.

➤ **TIP:** Seek financial advice to determine the best fund to suit your needs. Also, consider maximising your superannuation contributions in this new environment of choice and lower tax.

### Assessable Income from Sporting Activities

In a recent High Court decision, it was unanimously held that prize money, grants, sponsorship and appearance fees received by an elite sportsperson were assessable income.

The taxpayer was a police officer and trained as an Olympic javelin thrower.

In the 1998/99 income year, she received prize money (\$93,429), government sporting grants (\$27,900), sponsorships (\$12,419) and appearance fees (\$2,700) in addition to her salary. The Tax Office deemed each of these additional amounts to be assessable income. The taxpayer objected.

The matter was heard before both the Federal and Full Federal Courts until it ultimately reached the High Court as a test case.

The Tax Office argued that the additional amounts were assessable on the basis that the taxpayer derived them in the business of being an elite sportsperson.

The taxpayer argued that she was not carrying on a business and that such amounts were mere consequences of her participation in the sport.

The High Court upheld the Tax Office's appeal and declared that all of the additional amounts were assessable income on the basis that they were rewards from the conduct of her business of competing and winning in the athletics arena.

### Service Trusts

The Tax Office has recently released a draft tax ruling regarding the deductibility of service fees paid to associated service entities (e.g. service trusts).

It is common for professional firms to use service trusts to provide office space, administrative staff and equipment. The service trust charges the firm a fee, which is intended to be deductible.

The draft ruling is designed to supplement Taxation Ruling IT 276, which was issued in response to the Federal Court's 1977 decision in *Phillips v. FCT*. The draft ruling states that taxpayers cannot automatically rely on the service fee mark-ups used in the *Phillips* case. In order for service fees to be deductible, the amounts are required to be commercially realistic.

The Tax Office will investigate instances where, for example:

- the fees are excessive in relation to the benefits provided;
- the fees are calculated using fixed mark-ups; or
- the fees generate profits in the service entity and there is no clear separation of business activities.

The draft ruling includes many varied examples analysing different structures. It would be prudent to seek professional tax advice to confirm whether your service entity arrangement satisfies the Tax Office's requirements.

In addition to the draft tax ruling, The Tax Office has also released a guide regarding its approach towards service entities.

The guide provides a set of criteria that the Tax Office considers, if adopted by taxpayers, will demonstrate that the fees charged by the service entity are commercially realistic. The Tax Office requires taxpayers to show that the operations of the service entity are a genuine business that is separate from that of the professional services firm.

The Tax Office recommends that all professional services firms review their service agreement arrangements in light of the guide's recommendations. It will allow taxpayers twelve months to ensure that their own circumstances reflect the recommended mark-ups and other criteria outlined in the guide.

➤ **STOP PRESS:** The Tax Office has recently announced that it will typically confine its review of service trust agreements over the next 12 months to those involving large balances. Smaller businesses will have some time to review their existing agreements.

➤ **TIP:** Taxpayers who operate service entities should carefully review the Tax Office guide and address any issues over the next 12 months. This should reduce any risk of future adjustments should a Tax Office audit occur.

## Capital Allowances

The Tax Office has recently released three Interpretative Decisions regarding the deductibility of business-related costs under the capital allowances regime.

Tax law allows taxpayers a deduction for certain capital costs incurred in establishing or ceasing a business or raising capital. The costs are deductible over five consecutive years.

The decisions clarify the period of deductibility for capital payments, winding up costs and undeducted expenditure in the year of ceasing business.

## Tax Losses Deduction Denied

In a recent decision, the High Court unanimously ruled in favour of the Tax Office and held that a taxpayer was unable to deduct prior year and transferred losses as a result of the appointment of a liquidator to the taxpayer's parent company. It was held that this caused a failure in the continuity of ownership test.

The High Court disallowed the loss deduction on the basis that the appointment of a liquidator at the parent company level caused the ultimate shareholders to lose control of voting power. As a result, continuity of ownership had not been strictly maintained by the ultimate owners.

➤ **TIP:** This case highlights the need to trace ownership through to the ultimate owners (natural persons) in determining continuity of ownership in relation to tax losses.

## GST: Repairs under Warranty for Non-resident Entities

The Tax Office has released two draft GST determinations dealing with the GST consequences of repair arrangements for non-resident warranty providers.

The first draft determination, GSTD 2005/D3, discusses repair services supplied to Australian customers by Australian GST-registered repairers on behalf of a non-resident manufacturer.

The approach taken by the Tax Office in this draft determination is somewhat controversial given that the resident repairer is making good a warranty provided by a non-resident. If the ruling is adopted as per the draft, a number of businesses that have entered into arrangements to provide warranty repair services for non-resident companies may have to increase their prices by 10% to cover their GST obligations.

The second draft determination, GSTD 2005/D2, provides that a payment received by an Australian car dealer from a non-resident manufacturer under an offshore warranty is not subject to GST. The determination considers that there is no taxable supply made by the non-resident manufacturer to the Australian dealer.

➤ **TIP:** Taxpayers involved in the repair of imported goods should carefully consider their GST obligations.

### **Transfer of Assets between Trusts**

The Tax Office has recently released an interpretative decision (ID) concerning the transfer of an asset between two discretionary trusts for capital gains tax (CGT) purposes.

CGT event E2 typically occurs when a CGT asset is transferred to a trust. This causes the taxpayer who disposed of the asset to be assessed on any capital gain.

However, where the asset is transferred from one trust to another, CGT event E2 may not apply, provided the beneficiaries and terms of both trusts are the same at the time the asset is transferred.

The ID considers a case where the two trusts have the same beneficiaries and trust deed, but a different trustee, appointors and establishment date. The Tax Office considers that the establishment date and the trustee of the two trusts do not have to be the same. However, the ID outlines the Tax Office's view that the two trusts must have the same appointor. The Tax Office also indicates that the vesting dates must be the same.

As the appointor has the power to appoint and remove a trustee, it is considered that the identity of the appointor is a term of the trust. Consequently, as the terms of both trusts must be identical, both trusts must have the same appointer in order for the exemption to apply.

➤ **TIP:** The ability to transfer assets between identical trusts can provide useful planning opportunities for asset protection, estate planning and business structuring generally. Professional advice should be sought on this complex matter.

### **Family Trust Elections**

It is often necessary to make a family trust election in relation to a trust to ensure that deductions are more readily available for trust tax losses. An election may also be necessary to ensure that franking credits (tax offsets) can be utilised.

The trust can only make the election where it passes strict ownership and control tests. In making the election, the trust must nominate an individual known as the 'test individual'. Thereafter, the trustee will be restricted to making distributions to members of that individual's family, plus certain wholly owned entities and charitable organisations. Other trusts or companies may make similar elections so that the trust can distribute to them.

Distributions outside of this group result in penalty tax at the top marginal rate (family trust distribution tax).

The Tax Office has recently released two interpretative decisions (IDs) concerning family trusts that clarify which family members may be included in the family group.

The first ID considers the inclusion of stepchildren in the test individual's family. It states that if the spouse of the test individual dies, any stepchildren are no longer included in the defined family group.

The second ID looks at two different trusts with different test individuals who are brothers.

The Tax Office has declared that since the brothers are members of each others' families, their own trusts will be able to distribute to each other, provided additional elections are made, called interposed entity elections.

These elections in turn have a further impact on distribution flexibility and should be very carefully considered.

➤ **TIP:** Taxpayers should regularly review their trusts and consider whether elections are required to make use of tax losses or franking credits. The potential impact on distribution flexibility should also be considered.

## 2005/06 Financial Year Updates

The Tax Office has recently released the following statutory amounts/rates for the 2005/06 financial year:

- The car limit is \$57,009 — this is used to calculate depreciation deductions and is unchanged from the previous year.
- The luxury car tax threshold also remains equal to the car limit of \$57,009.
- The benchmark interest rate for shareholder loans is 7.30% per annum.
- The improvement threshold for CGT separate asset purposes is \$109,447.
- The age-based deduction limits for superannuation contributions by employers and eligible persons are:
  - under 35 yrs of age: \$14,603;
  - 35 to 49 yrs: \$40,560; and
  - 50 yrs and over: \$100,587.

## CGT — Cost Base

The Tax Office has recently released an interpretative decision stating that, following a demerger, an averaging method of calculation must be used to determine the cost base of shares held in each company.

Please contact us for further information.

## GST on Property

The Tax Office has recently released a number of interpretative decisions (IDs) in relation to GST on commercial and residential property.

The Tax Office has considered whether GST must be charged where an option is granted for the purchase of property for a specified amount up until a specified date. In exchange for the option, the buyer pays a percentage of the purchase price.

Whether GST is charged depends on the type of property supplied. The Tax Office has declared that if the option entitles the buyer to purchase a commercial property then the supplier must charge GST on the option fee. However, if the option relates to an existing residential premises which is itself input taxed, then no GST is charged on the option fee.

In another ID, the Tax Office has considered whether GST must be charged or claimed in relation to a credit arrangement entered into for the purchase of residential premises.

Broadly, a credit arrangement is where the purchaser of the property agrees to pay monthly instalments and interest for an extended period of time. The purchaser is entitled to occupy the residential property from the contract date until final payment. On final payment the title passes to the purchaser.

The credit arrangement is considered to be a financial supply and is input taxed. Consequently, no GST is charged on the interest component.

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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.