

## THE REPORT

June 2004

### Tax News, Views & Clues

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## MONTHLY REPORT

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### Lodgement Opportunity for Trust Elections

The Australian Taxation Office (ATO) has issued a practice statement that sets out a once-off opportunity for trusts to lodge family trust elections (FTEs) and/or interposed entity elections (IEEs) for prior income years.

This opportunity is only available to entities that have acted as if they were a 'family entity' up until 30 June 2004. In order to satisfy this requirement, the entity must pass the family control test and not have made a distribution of income or capital to any individual outside a defined family group.

An entity may choose to lodge a FTE in order to receive concessional treatment in relation to trust losses, company losses and franking credits. Concessions include:

- tests required to be satisfied under trust loss rules in order to access tax losses either do not apply, or apply in a modified way;
- under company loss rules, where a loss is incurred by a company owned by a trust, the trustee of the family trust will be taken to beneficially own the shares in the company. This makes continuity of ownership easier to satisfy, so losses are easier to recoup in the company; and
- in relation to franking credits, a FTE enables a trustee to satisfy a simpler 45-day share-holding rule to access franking credits. Otherwise more complex and difficult tests apply.

Once a trust makes a FTE, any distributions of income or capital outside the family group will be taxed at the top marginal rate plus the Medicare levy.

Where a trust has already lodged an election for a specified year, it will be able to ask the ATO to treat the election as if it applied to an earlier income year.

An entity will be unable to revoke a previously lodged election unless the entity ceases to exist.

- **TIP:** If a FTE has not been made in recent years an entitlement to tax losses or franking credits may have been missed. Taxpayers should carefully consider this one time opportunity to bring elections up to date where required. Naturally, the restriction of future distributions to within the family group should be carefully considered.

### Subdivided Farm Land

The ATO has released two interpretative decisions regarding the tax consequences of the sale of land that was originally used for farming purposes.

Once a taxpayer is well established in the business of development, subdivision and sale of land, the ATO indicates that the land will be regarded as trading stock. The asset's current use, as opposed to its use on acquisition, determines whether or not it is trading stock.

In the case in question, a company involved in farming and investing bought land with the initial intention of using it for primary production. A change in purpose followed and the land was subdivided to be sold for residential housing. As the land's use had genuinely changed, the land was declared to be trading stock from the time of change. The taxpayer would then have the ability to value the stock at its cost or market value at that time. The ultimate profit on the sale of the trading stock (land) will be then taxable.

### ATO 'Field Visit' Activity

The ATO plans to increase the number of its GST 'field visits' in order to ensure correct compliance across all industries. Except for walk-ins (usually only to check ABN and/or GST registration), an ATO officer will contact a company's nominated representative to arrange a meeting time. The ATO says its field officers will identify themselves, explain the purpose of the call and what information is required to be available at the time of the field visit.

In recent times, the ATO has requested financial data to be available electronically for computer analysis. The ATO says this process is used when the taxpayer has kept electronic records and the audit objectives 'require the field officer to look at multiple transactions'. The ATO might want the

electronic data to be provided to the ATO on a disk or CD-ROM in order to ‘enable the field officer to identify discrepancies and verify transactions in a timely and cost-effective way’.

At the time of the field visit you might consider doing any or all of the following:

- obtaining the name and contact details of the ATO field officer and the officer’s immediate manager or supervisor;
- having all the requested information available (but be fully aware of what you are providing);
- keeping copies of all information provided to the ATO (including electronic information); and
- seeking clarification if you are unsure about any aspect of the field visit, or why a particular question is being asked.

The ATO has wide-ranging powers to conduct its investigations and can require many types and forms of information to be provided.

- **TIP:** We consider a professional adviser should be present at any ATO field visit. Prior to the visit, you and your adviser might wish to examine the relevant BAS and accompanying documents to ensure correct preparation and compliance.

## CGT: Lease Surrender Payment by Lessee

The ATO has recently released an interpretative decision regarding the CGT consequences of a lease surrender payment made by a lessee.

Under the law, a lease is considered to be a CGT asset of a lessee. The lessee’s cost base of a lease includes the costs incurred in acquiring the lease plus any incidental costs of acquisition or disposal.

Where a lessee pays consideration to the lessor to surrender a lease, this payment cannot be included in the cost base of the lease, as it does not qualify under the law as an incidental cost of acquisition or disposal.

As a result, there should be no capital loss arising to the lessee as a result of making a payment to surrender the lease.

## Non-resident Capital Gains

The ATO has released an interpretative decision in relation to the assessability of capital gains made by a non-resident for tax purposes.

The non-resident purchased property in Australia and upon subsequent sale, had made a net capital gain.

Under the law, assessable income of a non-resident includes net capital gains where the relevant asset had the necessary connection with Australia.

Where the non-resident is a resident of a country with which Australia does not have a double tax agreement (DTA), domestic Australian law solely determines the assessability of Australian income and capital gains.

Therefore, an Australian capital gain made by a non-resident is statutory income and is to be included in their assessable income.

- **Tip:** The ATO does not comment on the position where the non-resident is a resident of a country that does not have a DTA with Australia. In such cases, the relevant DTA should be considered in relation to the taxpayer’s circumstances, as well as in relation to the Australian law.

## FBT: 2004 Private Use of Motor Vehicle Other than a Car Rates

The rates to be applied where the cents per kilometre basis is used for the FBT year commencing 1 April 2004 in relation to the private use of a motor vehicle, other than a car, are outlined below.

Engine capacity	Rate per kilometre
0 – 2500 cc	38 cents
Over 2500 cc	46 cents
Motor cycles	11 cents

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## FEDERAL BUDGET 2004/2005

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### Budget Overview

The Federal Budget was handed down on the evening of 11 May 2004.

For the 2004/05 financial year, the major estimates by the Government were as follows:

- \$2.4 billion cash surplus;
- GDP growth to moderate slightly to 3.5%;
- unemployment maintained around 5.75%; and
- inflation to decline to 1.75%.

The Budget includes:

- \$19.2 billion package for families (over five years);
- \$14.7 billion worth of income tax cuts (over four years);
- \$2.1 billion superannuation co-contribution scheme enhancement;
- \$5.3 billion boost to science and innovation;
- \$3.1 billion funding for AusLink, the new land transport infrastructure program;
- \$461 million to support carers (over five years);
- \$2.2 billion to the aged care sector (over five years); and
- \$755 million extra towards national security (over five years).

An outline of significant taxation announcements follows.

### Personal Income Tax Cuts

Personal income tax rates will be cut from 1 July 2004 and again from 1 July 2005 as shown below.

Tax Rate Commences			Tax Rate
Current (\$)	2004/05 (\$)	2005/06 (\$)	
6,000	6,000	6,000	17%
21,600	21,600	21,600	30%
52,000	58,000	63,000	42%
62,500	70,000	80,000	47%

For a top marginal rate taxpayer, the cuts will result in a tax saving of \$21 per week (from 1 July 2004) plus a further \$21 per week (from 1 July 2005). Medicare levy low-income thresholds will also increase marginally.

### Super Surcharge Slashed

To improve the incentive for superannuation contributions, the Government proposes to reduce the surcharge rates to 12.5% for 2004/05, 10.0% for 2005/06 and 7.5% for 2006/07 and later years.

Reductions previously proposed were 13.5% for 2004/05 and 12.5% for 2005/06 and subsequent years.

## Private Company Loans

Private companies will avoid the deemed dividend rules where loans to shareholders or associates are repaid, or put on a commercial basis by the due date for lodgment of the company's tax return. Currently, a potential deemed dividend arises unless a complying loan agreement exists before funds are advanced.

At the earliest, the change will apply for the 2004/05 income year.

## Loss Recoupment Rules

The Government has proposed changes to the operation of the loss recoupment rules.

The continuity of ownership test will be simplified for certain widely held companies.

Broadly, eligible companies will not be required to trace underlying ownership through interests of less than 10% or through managed funds, non-profit organisations and other widely held entities.

The changes will apply to loss years commencing on or after 1 July 2002.

In addition, companies and consolidated groups with total income exceeding \$100 million will be denied access to the same business test from 1 July 2004.

## Consolidation: Greater Flexibility

The consolidation regime contains a number of irrevocable elections, including elections for the cost base of assets and recovery of losses.

To allow more flexibility in the initial years, taxpayers will be able to revoke some of these elections up until 31 December 2004.

The election to form a consolidated group remains irrevocable.

Other changes will also be made to clarify particular areas of the consolidation regime, with effect from 1 July 2002.

## Retirement Income System

Initiatives for the Retirement Income System include:

- From 1 July 2005, those at preservation age (currently 55) who have not retired, will be able to access their superannuation as a non-commutable income stream.
- All eligible termination payments (ETPs) rolled into a superannuation fund on or after 1 July 2004 are to be preserved.
- Retirees under 65 will not have to work to make superannuation contributions after 1 July 2004. Those over 65 will only have to satisfy a work test on an annual basis.
- From 1 July 2004, super funds will be required to start paying benefits to members as soon as practicable after they reach 75 years of age.

## Capital Gains Tax

Shareholders will now be able to realise a capital loss prior to the cancellation of shares in a company where the shares are declared worthless by any insolvency practitioner.

Currently, a CGT loss is only available when a liquidator is able to declare shares worthless.

After 20 February 2004, all taxpayers must exclude input tax credits from the CGT cost base for an asset where credits have been claimed. Previously this was not always required.

## Retrospective Family Trust Elections

Concessional rules apply in relation to tax losses and franking credits for trusts which make a *family trust election* in a tax return for a relevant year.

The Government has now announced that eligible trusts will be allowed to make retrospective family trust elections at any time to access these concessions.

## Imputation Changes: New Companies Benefit

The imputation rules will be changed to allow a private company to pay fully franked dividends in the first year of operation before actually paying any tax. The franking credits will be calculated on a reasonable estimate of the company's tax liability.

## Increased ATO Audit Activity

The Government will provide the ATO with an additional \$216 million to fund a focus on:

- employers — PAYG, SGC and FBT obligations;
- businesses with turnover below \$100 million — CGT compliance, tax losses and complex financial arrangements;
- individuals — CGT and depreciation in relation to rental properties; and
- self-managed superannuation funds — super surcharge compliance.

## FBT

The following will be FBT exempt:

- benefits provided to employees of ambulance services up to a grossed up value of \$17,000 p.a.<sup>1</sup>;
- incidental home purchase costs incurred within four years of relocating<sup>1</sup>;
- printers for use with portable computers and personal digital assistants (PDAs)<sup>2</sup>; and
- the cost of relocation consultants<sup>2</sup>.

The FBT free ceiling for long service awards is to increase to \$1,000 plus \$100 per year over 15 years. The requirements to qualify for remote area housing will also be eased<sup>2</sup>.

<sup>1</sup> From 1 April 2004.

<sup>2</sup> From 1 April 2005.

## Family Assistance

A maternity payment will replace existing maternity and baby bonuses from 1 July 2004. The maternity payment will not be income tested. The payment will be \$3,000 per child from July 2004, \$4000 from July 2006 and \$5,000 from July 2008. Family tax benefits will also be increased with easier access.

## Indirect Tax Measures

The Government has revised estimated collections of GST up by \$1.1 billion for the 2004 year and by \$560 million for 2005. A number of indirect tax changes were also announced, including:

- Entities that are voluntarily registered (with turnovers of less than \$50,000 or \$100,000 for non-profit entities) will be allowed to report and pay their GST on an annual basis.
- Small businesses (turnover below \$2 million) will now be able to annually apportion the private/business use of assets (e.g. cars, computers etc.).
- There will be changes for barter trade schemes. Supplies will no longer be input taxed financial supplies and will now be taxable.
- The Government will rebate \$290,000 p.a. of wine equalisation tax (WET) to every wine producer.
- Taxpayers who become quarterly PAYG instalment remitters as a result of registering for GST will gain an extra year to commence paying instalments as an annual remitter.

**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.

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