

# the report

tax news • views • clues June 2006



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## MONTHLY REPORT

*Tax News / Views / Clues*

### **Transfer of Property by Body Corporate Back to Developer**

The Tax Office has recently released an interpretative decision regarding the timing of CGT event A1 in relation to the transfer of property from a body corporate.

A developer built a block of three units and each unit was sold to an individual. A specific clause was included in the sale contract that required the body corporate to resolve to form a new lot, which was then sold back to the developer. The purchase price reflected that the sale back to the developer would occur.

The question arose as to the timing of when the disposal of the new lot occurred. The Tax Office considered that the new lot was disposed of when the original sale contract was entered into, on the basis that the original sale contract provided all the terms and conditions for the transfer of the new lot.

### **Separate Business Premises and the PSI Test**

In a recent decision, the Administrative Appeals Tribunal (AAT) considered the meaning of 'business premises' for the purposes of applying the personal services income (PSI) rules. The rules require that the business premises be separate from any premises used for private purposes.

In that case, the taxpayer successfully argued that the business premises were separate from the controller's residence.

The controller of the business was employed by the taxpayer to provide business consulting services to the taxpayer's clients. The business operated out of a two-storey building located on land which the controller used for private purposes.

It was found that the taxpayer satisfied the criteria set out under the business premises test despite the fact that the business premises and the personal residence were located on the same land. The business premises and the residence also shared common facilities such as a garage and driveway.

The AAT determined that to satisfy the test, it was not necessary for the business premises to be used solely for the business provided they were used 'mainly' by the business.

The issue has been referred back to the Commissioner for further consideration.

### **Main Residence Exemption — Testamentary Trusts**

The Tax Office has recently released ATO Interpretative Decision ID 2006/34, which considers the CGT consequences arising from the transfer of a residential property from a testamentary trust to a beneficiary under the terms of a will.

A capital gain made on the transfer of a residential property from a deceased estate to a beneficiary may be disregarded under certain circumstances.

In this case, a property was left to five individuals. The trustee of the estate sold the other individuals' interests in the property to one of the individuals. It was the view of the Tax Office that the exemption did not apply to the capital gain made on the sale of the four-fifths interest in the residential property.

### **GST — Improvements on the Land**

The Tax Office recently released GST Ruling GSTR 2006/6 in relation to the meaning of the term 'improvements on the land', which is mainly relevant to supplies of real property under the margin scheme.

In this ruling, the Tax Office explains its view that in order for there to be 'improvements on the land', there must have been some human intervention, physically located on the land, which enhances the value of the land at the relevant date.

As a result of this ruling, taxpayers will be able to more accurately determine whether improvements have been made to the real property they propose to sell under the margin scheme.

This ruling also provides examples of human intervention that enhance the value of the land, as well as human intervention that is not considered to enhance the value of the land.

### **Non-commercial Losses**

In a recent decision, the Administrative Appeals Tribunal (AAT) considered whether to uphold a decision made by the Tax Office in relation to the application of the non-commercial loss rules. The Tax Office deferred certain deductions to later income years for business activities under-taken by individual taxpayers.

Losses made by individuals in relation to business activities that fail to satisfy one of the relevant tests will be deferred to a later income year to be offset against assessable income generated from those business activities in the future.

However, the Tax Office may exempt a taxpayer from the loss deferral provisions provided that special circumstances existed, such as drought or bushfire, which prevented the taxpayer from satisfying one of the required tests. An exemption may also be granted if it can be objectively proven that there is a specific period of lead time between the commencement of business and the production of assessable income.

In the case under review, the taxpayer undertook an olive growing business, which made losses in each year of operation and failed to satisfy one of the required tests.

However, the taxpayer argued that the business activities would have satisfied the required tests but for the occurrence of a drought.

In addition, the taxpayer provided independent advice detailing that a plantation olive crop would yield income within five years of establishment.

The Tax Office did not exempt the taxpayer on the grounds that, in the absence of the drought, the business would still have had failed the required tests.

In addition, the number of olive trees planted, which would yield income in five years time, would not provide enough income to satisfy the required tests.

The AAT upheld the decision made by the Tax Office not to exempt the taxpayer from the loss deferral provisions under the non-commercial loss rules.

### Disaster Relief Payments

The Tax Office has released Tax Determination TD 2006/22, which provides that where a taxpayer who is suffering financial hardship as a result of a natural disaster has received a payment from a charity for the basic necessities of life, that payment will be exempt from income tax.

This applies to payments received for natural disasters such a flood, drought or bushfire.

### Trading Stock — Foreign Currency Exchange Gain

The Tax Office has released Taxation Determination TD 2006/29 which covers the situation where a taxpayer makes a foreign currency gain in relation to the payment for trading stock.

While special rules govern the calculation of the gain, the gain itself is ordinary income of a taxpayer.

This means that when a taxpayer is calculating their PAYG ‘instalment income’ for the purposes of preparing their BAS, they are required to include any foreign exchange gain in the instalment income.

➤ **TIP:** Some taxpayers may account for any foreign exchange gains and losses on a net basis; that is, they do not have separate accounts for both foreign exchange gains and foreign exchange losses.

The Tax Office has released a practice statement that allows for taxpayers to account for gains and losses on a net basis when calculating their PAYG instalment income.

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## FEDERAL BUDGET | JUNE 2006

### Personal Tax Cuts

The 2006/07 Federal Budget will provide personal tax cuts worth \$36.7 billion over the next four years. Significantly, the top marginal tax rate will drop from 47% to 45% and will apply to taxable income over \$150,001. The 42% marginal rate will also be cut to 40% and will apply from \$75,001 and the 30% band will again be widened. The resident tax rates for the 2005/06 and 2006/07 years are summarised below:

2005/06		2006/07 as per 2005/06 Budget		2006/07 as per 2006/07 Budget	
\$ Income	Rate	\$ Income	Rate	\$ Income	Rate
6,001–21,600	15%	6,001–21,600	15%	6,001–25,000	15%
21,601–63,000	30%	21,601–70,000	30%	25,001–75,000	30%
63,001–95,000	42%	70,001–125,000	42%	75,001–150,000	40%
95,001+	47%	125,001+	47%	150,001+	45%

## **FBT Changes**

- FBT rate reduced from 48.5% to 46.5% with effect from 1 April 2006.
- In-house fringe benefits tax-free threshold increased from \$500 to \$1,000, with effect from 1 April 2007.
- Minor benefits threshold increased from \$100 to \$300, with effect from 1 April 2007. Tax Office to review existing guidelines and provide further clarification in relation to what is 'irregular' and 'infrequent'.
- Reportable fringe benefits threshold increased from \$1,000 to \$2,000 (pre gross-up), with effect from 1 April 2007.

## **Superannuation**

The Government proposes dramatic changes to superannuation from 1 July 2007.

### *Contributions*

- Abolition of age-based limits for deductible superannuation contributions.
- Concessional deductible contributions subject to an effective annual ceiling of \$50,000 per person p.a. to age 75 (transitional rules for employees aged over 50).
- Deductible contributions exceeding \$50,000 taxed at the highest marginal rate.
- Undeducted contributions subject to an annual limit of \$150,000.
- Self-employed persons able to claim full deduction for their superannuation contributions.
- Employer ETPs unable to be rolled over.

### *Benefits*

- Abolition of Reasonable Benefit Limits.
- Benefits paid from a taxed fund to retirees from age 60 or above (either as a lump sum or pension) are tax-free.
- Benefits paid to persons aged 55–60 generally taxed under existing arrangements.
- Members who have reached preservation age may establish pension income streams or leave money within superannuation indefinitely and draw on it at their discretion (abolition of compulsory withdrawal).
- Pensions subject to simplified rules.
- Lump sum death benefit payments to dependants are tax-free.

### *Untaxed Superannuation Schemes*

For members aged over 60, lump sum benefits of up to \$700,000 taxed at 15%, any excess taxed at top marginal rate.

Pensions taxed at recipient's marginal rate less 10% offset.

## **Depreciation**

The diminishing value rate applied for calculating depreciation deductions will increase from 150% to 200% over the prime cost rate.

The new rate will apply to assets acquired on or after 10 May 2006.

## **Small Business: CGT**

The Government has announced the following changes to the small business Capital Gains Tax (CGT) concessions:

- The net asset value test will increase from \$5 million to \$6 million.
- A 'significant individual' test based on 20% ownership will replace the controlling individual test (based on 50% direct ownership).
- Modifications to the operation of the 15-year exemption, the retirement exemption, the small business rollover and the application of the concessions to partnerships.

These changes will apply to CGT events that occur in 2006/07 and subsequent income years.

## **Venture Capital**

The Government has announced a new investment vehicle called an early stage venture capital limited partnership (ESVCLP). The ESVCLP will allow income and capital gains to flow through to venture capital investors on a tax-exempt basis.

The rules will be limited to funds of up to \$100 million investing in companies with total assets of up to \$50 million. These rules will replace the existing PDF concessions.

## **Small Business Tax**

The Government has announced a greater alignment of the various small business tax concessions, including those under the STS, CGT, GST, FBT and PAYG instalment regimes, including:

- Align the STS and GST definitions of 'turnover'.
- Align the period over which STS and GST turnover is calculated.
- Increase the STS annual turnover threshold from \$1 million to \$2 million.
- Increase the GST cash accounting turnover threshold from \$1 million to \$2 million.
- Removal of the requirement that related businesses must have total depreciating assets of less than \$3 million.
- STS taxpayers will be able to pay quarterly PAYG instalments on the basis of GDP-adjusted notional tax.
- The depreciating asset rollover relief has been extended in certain circumstances.

These reforms are effective 1 July 2007.

## **Elected Family Trusts**

Family trust elections and interposed entity elections will be able to be revoked or varied in certain limited circumstances. The definition of family group will be broadened to include lineal descendants. Trust distributions to certain former members (including ex-spouses) will be exempt from family trust distribution tax.

## **Trusts**

The following new integrity measures concerning trusts have been announced:

- Resident trustees will be required to pay the tax on distributions to non-resident trustee beneficiaries from 1 July 2006.
- Trustees of closely held trusts to identify and report first-tier trustee beneficiary receipt of trust distributions only, (rather than the ultimate beneficiary(ies)).

## **High Wealth Individuals**

The Government has provided the Tax Office with additional resources to fund its tax compliance program for high wealth individuals and associated entities.

The High Wealth Individual Taskforce will focus on the timely identification of tax compliance risks and undertake additional audit activity for high-risk cases, including closely held private company groups.

## **GST**

Additional funding of \$46.4 million directed towards increased audit activity to raise an additional \$190 million.

GST integrity changes to the Margin Scheme to ensure anti-avoidance measures apply to GST and property.

Import entry threshold for courier and post will be raised to \$1,000. This will mean that a person can privately import goods to the value of \$1,000 without paying GST or import duty.

Backdating of the GST measure to 1 July 2000 to ensure that GST does not apply to bonus supplies of credits and text messages for phone cards.

GST on vouchers will only need to be remitted on the face value of the vouchers.

## **Wine Equalisation Tax**

There will be an increase in the producer rebate from \$290,000 to \$500,000.

## **Research and Development**

R&D offset claim period will be extended.

The 175% premium deduction can now be allocated to individual companies in a group that has increased R&D expenditure over the last three years.

R&D expenditure by a registered research agency (RRA) is now eligible for the tax offset and may be claimed by all the companies in the R&D group.

## **Fuel Tax Credit Regime**

The Energy Grants (Credits) Scheme will be replaced by the Fuel Tax Credit regime (FTC).

The FTC will have dramatic impact on road users and users of fuel off-road.

The FTC will be claimed through the Business Activity Statement (BAS).

A draft of the BAS has been released. Due to the claiming of credits through the BAS, the Tax Office has indicated that a GST review will also focus on any fuel tax credits claimed.

## **Abolition of State Taxes**

The Government has announced that it has agreed a timetable with the states and territories for the elimination of a range of state taxes.

This agreement is in line with the Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations.

It has been agreed that the states will abolish stamp duty on non-quotable marketable securities, leases, mortgages, bonds, debentures and other loan securities, credit arrangements, instalment purchase arrangements, rental arrangements, cheques, bills of exchange and promissory notes, and business conveyances other than real property.

While the timing will differ in each state, all of the above will be abolished by 1 July 2012.

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## **TAX RETURN CHECKLIST | 2005/06**

### **2006 — Individual Tax Returns**

#### *Income*

- Gross salary, wages, allowances, benefits, earnings, tips and director's fees
- Income from business activities
- PAYG payment summary amounts
- Any non-cash benefits received
- Lump sum and termination payments [All documentation should be provided, including an ETP payment summary from the employer or fund]
- Government social security payments, including pensions, unemployment and sickness benefits
- Capital gains from CGT asset sales (e.g. shares and real estate) [Information relating to dates and costs associated with acquisition and disposal will be required to determine the capital gain (if any). Remember that individuals, companies, trusts and superannuation funds can save tax if they qualify for the various CGT concessions]
- Annuities, including allocated pensions
- Income from trusts and partnerships [Statements of distribution should be provided]
- Rental income
- Interest and dividends (franked or unfranked) including any tax deducted [Dividend distribution statement will be required to confirm the dividend received]
- Foreign source (employment and pension) income [Details of any foreign tax paid will be required]
- Personal services income [Individual contractors who operate through a company or trust can potentially be taxed personally on the income instead of income being taxed at the company or trust level]

#### *Deductions*

- Investment and property expenses [Carefully detail interest claims]
- Professional subscriptions (not including sporting or social clubs)
- Expenditure records related to a taxpayer's employment, such as work-related motor vehicles, self-education, protective clothing, uniform expenses and home office expenses
- Donations of \$2 and over, depending on the recipient
- Superannuation contributions made by self-employed persons and those without employer superannuation support
- Tax agent's fees and other accounting and tax audit fees associated with managing tax affairs
- Special deductions (e.g. Australian films, investment shelters and forestry-type schemes)
- Bank fees (where the credit or deposit represents assessable income)
- Un-recouped prior year losses

- Non-commercial losses [Individuals must satisfy one of four tests to offset losses from certain non-commercial business activities against other income. A prime example is an employee who seeks to offset hobby-type farming or other business losses against salary or investment income]
- Sickness and accident insurance premiums, provided the premium incurred is against the loss of income

### **Rebates**

- Details of private health insurance, unless the premium is net of the rebate [Statement from health insurance provider will be required to determine entitlement to rebate]
- Details of superannuation contributions where no tax deduction can be claimed (maximum rebate of \$540 for \$3,000 superannuation spouse contribution)
- Any changes in dependants [Income of spouse will be required]
- Details of any income received in a lump sum which was accrued in earlier income years (e.g. assessable pensions)
- Details of medical expenses where the total exceeds \$1,500 [Tax offset of 20% available]
- Superannuation co-contributions for contributions made by eligible employees [Assessable income must be less than \$58,000]

Note: Low income taxpayers with a dependent child (under 21) or qualifying dependent student should check to see if they are eligible for Family Tax Assistance.

## **2006 — Companies, Partnerships, Trusts and Other Businesses**

### **Income**

- Trading income
- Other income (e.g. rent, interest, royalties)
- Stock on hand (and basis of valuation) — note any obsolete stock
- Work in progress
- Primary producer subsidies (if assessable)
- Capital gains from CGT assets sold (e.g. real estate) [Documentation should include dates and costs associated with acquisition and disposal]
- Dividends [Details of any franking credits will be required]
- Income from foreign sources [Details of foreign tax paid will be required]

### **Deductions**

- Losses can no longer be transferred between group companies
- Repairs and maintenance (not capital)
- Salaries, including fringe benefits
- Fringe benefits tax paid
- Rates, land taxes and insurance premiums
- Advertising expenses
- Interest on borrowed monies
- Deductions relating to foreign-source income are only deductible against foreign income of a similar class
- Prepayments are no longer immediately deductible, unless under \$1,000 or required to be prepaid by law
- Retirement payments and golden handshakes
- Bad debts actually written off during the year
- Donations of \$2 and over, depending on the recipient
- Commissions
- Legal expenses (not capital)
- Lease expenses for motor vehicles, premises and equipment
- Losses from previous years
- Superannuation contributions

- Subscriptions
- Car expenses [Remember to include petrol, repairs and parking and maintain a log book where necessary]
- Tax agent's fees and other accounting and tax audit fees
- Royalties paid [Only deductible where withholding tax has been paid]
- Travel expenses [Details of the purpose and destination of any interstate or overseas trip should be provided. Expenses must be fully documented where travel involves at least one night away from home. Travel diaries should be included where travel exceeds five nights]
- Eligible research and development expenditure by registered R&D company
- Bank fees (where the credit or deposit represents assessable income)
- Borrowing costs which are deductible over the shorter of five years or the life of the loan/facility
- Blackhole expenditure which may be deductible over five years

### *Liabilities*

- New loans taken out during the year and their purpose, including any new lease or hire purchase agreements
- Statements from the lending authority detailing the opening and closing balances of existing loans during the financial year
- Provisions for long service leave and annual leave
- Creditors on hand at the end of the financial year
- Details of loan accounts to directors, shareholders, beneficiaries and partners
- Accrued expenses (e.g. audit fees, interest payments and bonuses) and unearned revenue
- Commercial debts forgiven

### *Assets*

- Details of depreciable assets acquired and/or disposed of during this income year, including:
  - type of asset
  - date of acquisition/ disposal
  - consideration received/paid
- Details of CGT assets acquired, including the purchase price and other related costs
- Lease commitments
- Debtors on hand at the end of the financial year
- Commercial debts forgiven
- Division 7A interest and repayments made on any prior year loans to shareholders and associates

### *Other Information Required*

- Franking account details/movements
- Overseas transactions with related parties
- Exchange gains/losses
- Private companies — remuneration or loans to directors, shareholders and their relatives
- Changes to the capital of the company
- Whether family trust elections have been made in relation to trusts
- Consider if a group of companies should consolidate for tax purposes

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