

the report

tax news • views • clues **JUNE 2007**



DFK HIRN NEWEY

Chartered Accountants

MONTHLY REPORT

- Loss Not Deductible on Sale of Land
- Timing of Asset Depreciation
- Change in Extent of Creditable Purpose
- Small Business CGT Changes
- Loan Repayments Held to be Fringe Benefits
- 2007 Motor Vehicle Claims

FEDERAL BUDGET JUNE 07

- Personal Income Tax Cuts Improve Australia's Competitiveness
 - Medicare Levy
 - Dependent Spouse Rebate
- Simpler Tax for Small Business
- Superannuation Reforms
- Tax Consolidation — Further Improvements
- Simplification of Income Tax Returns
- Assistance programme for new business owners
- Company Loss Recoupment Rules
 - Same Business Test (SBT)
 - Continuity of Ownership Test (COT)
- Other Indirect Tax Changes
- Forestry Managed Investment Schemes
- Film Production Tax Incentives
- Thin Capitalisation
- Venture Capital

TAX RETURN CHECKLIST - 2006/07

- 2007 — Individual Tax Returns
 - Income
 - Deductions
 - Rebates
- 2007 — Companies, Partnerships, Trusts and Other Businesses
 - Income
 - Deductions
 - Liabilities
 - Assets
 - Other Information Required

MONTHLY REPORT

Loss Not Deductible on Sale of Land

In a recent decision, the Federal Court upheld a previous ruling by the Administrative Appeals Tribunal (AAT), finding that a loss arising on the sale of land purchased as a capital asset was not deductible.

The taxpayer, a shelf company, purchased a block of land from a non-resident businessman who had previously obtained the necessary approvals to build a dormitory for rental to overseas students. Shortly after acquiring the land, the taxpayer entered into a lease of the dormitory with a third party. Land development opportunities were only later considered as a possible option.

The businessman then became the beneficial owner of the taxpayer company, with the shares held on trust by his Australian solicitor.

The taxpayer eventually sold the land at a significant loss and claimed a capital loss in its tax return. The taxpayer, upon receiving further advice, obtained an amendment to the tax return, treating the sale of the land as a sale of a revenue asset, for the purpose of claiming an ordinary tax loss.

Both Courts found that the loss on the sale of the land was not deductible as a revenue loss, because the sale was clearly of a capital asset. In coming to its conclusion, the Federal Court indicated that a profit making intention or scheme cannot just be a subsequent consideration, but must be a 'not insignificant aspect' of the taxpayer's activities.

The Federal Court also upheld the AAT's penalty decision. The taxpayer has appealed this decision to the Full Federal Court.

Timing of Asset Depreciation

In a recent Taxation Determination, the Tax Office provided guidance in relation to when a depreciating asset is considered to begin its decline in value.

The determination indicates that a depreciable asset does not begin to decline in value until it is installed and ready for use. Merely holding a depreciating asset in anticipation of using it in carrying on a business is not sufficient to constitute use of the asset and hence the business cannot commence to depreciate the asset.

Change in Extent of Creditable Purpose

In a recent GST Ruling GSTR 2006/4, the Commissioner outlined his position on the meaning of 'creditable purpose' and 'extent of creditable purpose' in the context of claiming the correct amount of input tax credits. The ruling also provides further guidance regarding adjustments where there is a later change in extent of creditable purpose.

Broadly, if a taxpayer is registered or required to be registered for GST, it is liable for GST on taxable supplies it makes. The taxpayer is also entitled to input tax credits for creditable acquisitions made in carrying on its business.

Input tax credits can only be claimed for acquisitions or importations which are creditable. An acquisition or importation is undertaken for a creditable purpose to the extent that it is required in carrying on an enterprise and is not of a private nature.

The ruling provides examples where acquisitions and importations are only partly creditable. Under these circumstances, the taxpayer is only entitled to an input tax credit to the extent of the creditable purpose.

Small Business CGT Changes

Readers will remember from our 2006 Federal Budget edition, that the Government was aiming to pass a raft of changes to the small business capital gains tax concessions making it easier for taxpayers to gain access to them.

These amendments received Royal Assent on 12 April 2007, and were largely unchanged from when they were first reported.

Approximately 32 amendments to the legislation have been made, which are all designed to improve accessibility to the concessions and reduce the compliance burden for small business taxpayers.

The concessions allow small business taxpayers crystallising a gain on or after 21 September 1999 to discount that capital gain by 50%, provided they satisfy the relevant conditions and the asset has been held for longer than 12 months.

The amendments, which will apply retrospectively from 1 July 2006, affect the entry criteria to access to the concessions.

The 'controlling individual' (50% ownership) test has been replaced with a 'significant individual' (20% ownership) test. This test includes an interest in the voting power, and dividends and capital distributions of the entity. Subsequently this test provides more stakeholders in the business the ability to access the concessions.

The maximum net asset value test totalling \$5 million now includes the negative asset values of the taxpayer (and a connected entity). This means that where a taxpayer has a company whose liabilities are greater than its assets, this negative value can be included as part of the taxpayer's net asset value calculation.

A subsequent amendment to the legislation, announced in a recent treasurer's press release, should also see the maximum net asset value test threshold increase to \$6 million from 1 July 2007.

Loan Repayments Held to be Fringe Benefits

In a recent decision the Federal Court held that loan repayments made by a company to its employees were in respect of their employment and were subject to fringe benefits tax (FBT).

The taxpayer company was in the business of purchasing race horses and forming syndicated partnerships. It was owned and managed by, and employed, a husband and wife. As a small business, working capital injections were required from time to time, so the two owners made loans to the company.

Personal expenses of the two owners were subsequently reimbursed by the company and this was treated as a repayment of the loans.

The Commissioner assessed those loan repayments as liable to fringe benefits tax. Broadly, a fringe benefit is a right, privilege, service or facility which is conferred to an employee, or an associate of an employee which is in respect of the employee's employment.

The Federal Court agreed with the Commissioner's finding that the loan repayments were in respect of their employment, as the company had no other employees and would not be able to operate without their work as employees. In addition, the release of the debts owed to the owners was regarded as a release of their own personal obligations including a mortgage and school fees.

The taxpayer has appealed this decision to the Full Federal Court.

2007 Motor Vehicle Claims

The following table provides the updated rates for motor vehicle expense claims on a per kilometre basis for the 2006/07 income year.

Type of car	Engine capacity	2005/06 rate per km (cents)	2006/07 rate per km (cents)
Small car	0 – 1,600cc	55	58
Medium car	1,601 – 2,600cc	66	69
Large car	2,601+cc	67	70

[return to contents](#)

FEDERAL BUDGET | JUNE 2007

Personal Income Tax Cuts Improve Australia's Competitiveness

Australian taxpayers will share in tax cuts worth \$31.5 billion over the next four years. The 30% threshold will increase from \$25,001 to \$30,001 on 1 July 2007. From 1 July 2008, the 40% threshold will increase from \$75,001 to \$80,001 and the top marginal rate (45%) threshold will increase from \$150,001 to \$180,001.

The tax rates for the 2007 to 2009 years will now be as follows:

2006/07 Current	
\$ Income	Rate
6,001–25,000	15%
25,001–75,000	30%
75,001–150,000	40%
150,001+	45%

2007/08 From 1 July 2007	
\$ Income	Rate
6,001–30,000	15%
30,001–75,000	30%
75,001–150,000	40%
150,001+	45%

2008/09 From 1 July 2008	
\$ Income	Rate
6,001–30,000	15%
30,001–80,000	30%
80,001–180,000	40%
180,001+	45%

Medicare Levy

From 1 July 2006, the Medicare levy low income thresholds have increased to \$16,740 for singles and \$28,247 for families.

Dependent Spouse Rebate

The dependent spouse rebate will increase from \$1,655 to \$2,100 from 1 July 2007.

Simpler Tax for Small Business

It will now be easier for small businesses to meet their tax obligations as follows:

- Businesses with turnover of less than \$75,000 will no longer be required to register for GST.
- The GST registration threshold for non profit bodies will be increased to \$150,000.
- Purchases by businesses of less than \$75 will no longer require an approved tax invoice to claim an input tax credit.
- The eligibility criteria for a variety of small business concessions covering GST, CGT, the Simplified Tax System, FBT and PAYG will be streamlined so they all apply to businesses with a turnover of less than \$2 million.

Superannuation Reforms

Broader superannuation CGT roll-over relief will apply in the event of marriage breakdowns to encompass asset transfers from a self managed super fund to another complying fund (effective 1 July 2007).

One-off doubling of government superannuation co-contributions will apply for eligible contributions made in 2005/06.

Tax Consolidation — Further Improvements

The Government has announced that it will improve the income tax laws relating to consolidated groups to ensure that the rules operate as intended and to reduce compliance costs. Whilst no detail was provided, the changes will impact the tax cost setting rules, the CGT provisions and the uniform capital allowance rules.

The measures will generally take effect from the commencement of the consolidation regime (1 July 2002), although some measures will have a more recent commencement date.

The Government also announced specific measures, to take effect from 1 July 2007, to remove taxation impediments to the restructuring of conglomerates containing authorised deposit taking institutions (ADIs). These apply where a non-operating holding company is appointed as the head company of the consolidated group.

Simplification of Income Tax Returns

Commencing 1 July 2007, the Tax Office will allow taxpayers to access an online pre-filled income tax return.

The prepared returns will automatically include a taxpayer's salary, wages, allowances, dividends, interest, distributions from managed funds, government payments, Medicare out-of-pocket expenses, health insurance information and HECS/HELP details.

If the taxpayer is satisfied with the pre-filled return, they will be able to lodge their return immediately online. If taxpayers have additional information to provide, such as income from investments, this can be added to the return.

Assistance programme for new business owners

The Government will introduce a New Business Intensive Assistance Programme to assist new business owners who may be unfamiliar with GST, record keeping obligations and the completion of the Business Activity Statement. The Government will spend \$40 million over four years to provide more face-to-face and telephone tax assistance to new businesses, providing advice on such matters as registering for the Tax Office's business portal, establishing an effective GST record keeping system, and electronic reporting obligations such as PAYG withholding.

Company Loss Recoupment Rules

Same Business Test (SBT)

- Companies whose total income exceeds \$100 million will once again be able to access the SBT in recouping carried forward losses, effective from 1 July 2005.
- The SBT applying to consolidated groups has also been clarified. The entry history rule, which applies the pre-consolidation history of a subsidiary member to the head entity, will be disregarded in applying the SBT with effect from 1 July 2002.

Continuity of Ownership Test (COT)

- Companies will not fail COT simply because they have multiple classes of shares, with effect from 1 July 2002.
- The meaning of 'voting power' has been defined to mean the power to vote on a poll for the election of a director to a company, with effect from 1 July 2007.

Other Indirect Tax Changes

- The Government has committed an extra \$15 million to GST administration and SGC collection, which will result in greater audit activity and increased debt collection.

- From July 2008, some employers will be able to remit PAYG on an annual basis (for persons voluntarily registering for GST).
- For some small taxpayers making mixed supplies, there will be increased discretion by the Tax Office to allow more simplified accounting methodologies in completing Business Activity Statements.
- There will be an extension of the 175% premium for R&D to some subsidiaries of overseas corporations where intellectual property is owned overseas (effective 1 July 2007).

Forestry Managed Investment Schemes

From 1 July 2007, investors in forestry managed investment schemes (MISs) will only be entitled to immediate upfront deductions where at least 70% of the expenditure is directly related to developing forestry.

In addition, existing and future investors will be allowed to trade their interests in forestry MISs provided that the initial investors held their interests for at least four years.

Film Production Tax Incentives

From 1 July 2007, a rebate will be introduced to provide a refundable tax rebate of up to 40% for domestic feature films and 20% for eligible domestic media productions including TV series and documentaries.

Eligible international films will receive a rebate of up to 15% (currently 12.5%) for certain eligible expenditure. Minimum expenditure levels will apply.

Thin Capitalisation

The thin capitalisation three-year transitional period introduced as a result of the adoption of IFRS has now been extended by one year. Taxpayers will be able to determine their allowable debt using Australian General Accepted Accounting Principles as they existed pre-1 January 2005. This will be available until 30 June 2009 (or substituted accounting period).

In addition, measures will be introduced to ensure that taxpayers are not disadvantaged by the exclusion of certain equity interests from the thin capitalisation rules.

Venture Capital

Tax concessions for foreign residents investing in venture capital limited partnerships (VCLPs) and Australian venture capital funds (AVCFs) will be relaxed, effective from 2007/08:

- up to 20% of committed capital in VCLPs and AVCFs can be invested in companies and unit trusts located outside Australia; and
- eligible partners in conditionally registered VCLPs and AVCFs that become fully registered will be exempt from tax on gains derived from investments made while conditionally registered.

Certain investment restrictions will apply to ensure that investments made by early stage VCLPs are channelled toward early stage capital activities.

[return to contents](#)

TAX RETURN CHECKLIST | 2006/07

2007 — 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.

2007 — 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

[return to contents](#)

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.