

## THE REPORT

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### Tax News, Views & Clues

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### MONTHLY REPORT

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- **FOREIGN INCOME AND DEDUCTIONS**
- **DISCRETION TO TREAT A PRIVATE COMPANY AS A PUBLIC COMPANY**
- **GST REFUNDS**
- **AMORTISATION DEDUCTIONS DENIED**
- **CONSOLIDATION: SINGLE ENTITY RULE**
- **CGT MAIN RESIDENCE EXEMPTION**
- **EXCESS FRANKING CREDITS**

### TOTAL FINANCE CORPORATION

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- **FACTORING/DEBTOR FINANCING**

## MONTHLY REPORT

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### Foreign Income and Deductions

The Tax Office has released an Interpretative Decision (ID) regarding the classification of income and deductions as of either Australian or foreign source.

Under the law, where a taxpayer incurs deductions in relation to income it derives from foreign sources, the deductions are limited to the amount of foreign income derived. Any excess is a foreign loss, which can only be offset against future foreign income of the same class.

The ID considers an Australian resident company operating an employment agency in Australia. The company receives income for placement advisory services it provides to foreign resident applicants who wish to gain employment in Australia. It also incurs a service fee from foreign consultants it engages to refer foreign applicants.

A foreign applicant was referred to the company by a consultant and the applicant entered into a contract for placement advisory services with the taxpayer.

The Tax Office forms the view that because the performance of the contract for placement advisory services is to be performed in Australia, the income will be Australian sourced. Accordingly, the fees paid by the resident taxpayer to the foreign consultants it engaged will be allowable deductions, even where the deductions exceed the income.

### Discretion to Treat a Private Company as a Public Company

Where a complying superannuation fund (CSF) receives a dividend from a private company, the 'special income' rule applies to the dividend at a tax rate of 48.5% instead of the 15% tax rate that would normally apply to income received by a CSF. Where the dividend is from a public company, it will be taxed at the normal rate of 15%, as the 'special income' rule would not apply.

A recent Interpretative Decision (ID) discusses a case where a large CSF owns all the interests in a private company. The ID considers whether or not the Commissioner should exercise his discretion to treat the company as a public company for income tax purposes (possibly to avoid the 'special income' rule).

In this case, the Commissioner refused to exercise his discretion to treat the private company as a public company because the company did not satisfy the ASX listing rules, and as it was owned by a superannuation fund, no one person beneficially owned shares in it.

➤ **CAUTION:** Taxpayers that control a CSF should avoid investments in private companies.

### GST Refunds

The Tax Office has issued a media release reminding businesses that there is a four-year limit on making a GST refund claim.

As the GST is now in its fifth year, the limit stands to affect all businesses that lodged business activity statements from the beginning of the New Tax System.

In particular, businesses that lodged a quarterly BAS for the September 2000 quarter will now be affected.

### Amortisation Deductions Denied

The Administrative Appeals Tribunal (AAT) has rejected a taxpayer's appeal and disallowed deductions for amortisation of intellectual property.

The taxpayer purchased a share in a copyright for \$27,500 under his accountant's scheme. The value assigned to the copyright enabled the taxpayer to claim annual amortisation for tax purposes of \$32,692 per year.

The Tax Office previously refused to issue a private ruling for the scheme and informed the accountant that the copyright's valuation was unacceptable.

Following the Tax Office's investigation, the deductions claimed by the taxpayer from 1998 to 2000 under the scheme were disallowed and a penalty of 10% was imposed for under-statement of tax.

The AAT affirmed the Tax Office's decision and warned that investors should be cautious of schemes where the annual deductions totalled more than the one-off outlay.

## Consolidation: Single Entity Rule

Readers will recall that the tax consolidation rules allow wholly owned entities to be grouped for tax purposes. The group then lodges a single tax return, and losses and tax credits are pooled.

The Tax Office has issued a ruling confirming the tax consequences of the Single Entity Rule (SER) under tax consolidation.

The SER deems each subsidiary member of a consolidated group to be a part of the head company rather than a separate legal entity.

The implications of the SER include:

All transactions of group members are treated as having been undertaken by the head company;

The assets of group members are taken to be owned by the head company; and

Transactions and transfers between group members (e.g. dividends) are ignored for tax purposes.

Entities that are not members of the consolidated group are not affected by the SER. Accordingly, their income tax position will not be affected by the SER when they deal or transact with a member of a consolidated group

## CGT Main Residence Exemption

The Tax Office has recently released an Interpretative Decision (ID) concerning the capital gains tax (CGT) main residence exemption in a deceased estate situation.

The ID considers a case where the deceased lived in a dwelling acquired before the introduction of CGT until the time of their death in December 1999. Under the deceased's will, the dwelling was to be sold and the proceeds held on trust for the benefit of the deceased's children and grandchildren.

One of the deceased's children was dissatisfied with the terms of the will and lodged a claim in the Family Court. The Court granted the person a right to reside in the property from the date of the deceased's death until the trustee sold the dwelling.

The sale of the dwelling by the trustee would typically attract CGT. The law, however, provides an exemption from CGT where the dwelling was also the main residence of an individual who had a right to occupy the dwelling under the deceased's will. Other conditions also apply.

The Tax Office formed the view that the exemption still applied in this case, although the right to occupy the deceased's dwelling was granted by court order.

## Excess Franking Credits

Where a company receives a franked dividend, its assessable income is grossed-up by tax paid on the relevant profits and a corresponding tax credit is allowed. Where the company is unable to use the credits because its tax payable is insufficient, the excess credit is converted to an additional tax loss, which can be carried forward with other losses.

The Tax Office has released a relevant Interpretative Decision (ID). The ID considers whether a company that has prior year tax losses can choose to deduct some of those losses, eliminating

taxable income so that credits can't be used, therefore creating an excess franking offset. This would freshen up tax losses.

An excess franking offset will arise where the amount of tax payable by a company is less than the franking credits it receives during the year, so that the offsets can't all be used.

In broad terms, the law does not allow a company to deduct an amount of prior year tax losses where it would result in the company having an amount of excess franking offsets for that income year. So prior year losses can only be deducted on the basis that adequate tax payable remains to utilise franking offsets

**RETURN TO CONTENTS**

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## **FACTORING / DEBTOR FINANCING**

Cash flow is often one of the great uncertainties in any business. Predicting exactly when customers will pay their accounts and then having to balance outgoings and stock purchases to these times can be a difficult juggling act for many managers and proprietors. If only all customers would pay COD, then the cash flow predictions would be more accurate.

Many of the expenses now appearing on the balance sheets of companies can be reduced or eliminated when they take into account the possibilities of factoring their accounts receivables i.e. their invoices.

Factoring is an alternate source of financing for small to medium sized businesses by purchasing your commercial accounts receivable for cash, typically within 24 to 48 hours.

By releasing the assets frozen in the accounts receivables, most companies will immediately experience accelerated cash flow to increase sales volume, repay existing debts and take advantage of supplier discounts.

You can achieve growth through:

- # Increased cash flow and reduced overheads
- # Increased production and sales
- # Greater operating efficiency
- # Reduced credit and collection costs

Additionally, most factor companies can provide the level of professional credit administration and control typically found in large corporations.

There are a number of factor and debtor financing companies who understand that the business owners and managers have businesses to run and don't want to waste time on accounting and collection problems. Looking at the options of factoring and/or debtor financing can simply eliminate these problems.

***For more information about your specific cash flow needs call Bruce Cruickshank at Total Finance Corporation Pty Ltd Ph: (07) 3266-9101, Fax: (07) 3266-9101 or Mobile: 0400 179 560.***

## Q&A of FACTORING/DEBTOR FINANCING

### ***What services are included in an agreement?***

Some companies specialise in invoice discounting - the business of purchasing debts on an ongoing basis without any sales ledger collection and credit services. This is best suited to companies who employ a financial controller and in house credit department.

Other companies provide a full service factoring facility to all their clients. This includes a complete receivable and management service, which would normally be beyond the resources of small and medium business owners.

### ***Are there any extra costs associated with this agreement?***

Many companies require you to put up a security deposit or bricks and mortar as security, and can include application and approval costs. There are a number of companies that have no fees for application and have no requirement for bricks and mortar security, the only charges that are normally levied is by the government to register the documents with the Australian Securities Commission.

### ***How flexible is the funding? Can I increase my factoring limit as my business grows?***

Most factor and debtor finance companies are committed to helping your business to achieve the cash flow you need to fund the growth of your business. Flexibility for the client is perhaps the greatest attraction of factoring.

### ***When are reserve releases paid to me?***

Companies vary in the time that reserve releases are paid to the client. Some companies only release the reserve on a monthly basis and then pay the client on the fifteenth day of the next month after they were paid. In effect, this means that if your debtor paid the invoice on the first of July, the reserve released wouldn't be paid to your account until the fifteenth of August.

Other companies are committed to enhancing your cash flow and can release your reserves twice a month and deposit direct into your account within two working days so your money is back where it belongs - working for your business.

### ***What reports do I receive? How easy are the reports to understand?***

Most companies will supply a fully computerised printout of all payments received, some produce these monthly, while other produce these twice monthly. Most companies will also produce a complete aged trial balance (monthly) so as to provide the client with an accurate record of the monthly transactions. These reports, in most instances, are easy to understand and allow you to always be up to date with what is happening within your portfolio. Some companies to maintain the portfolio of each the client's debtors effect the appointment of an experienced account executive. In effect, they work for your company from the office of the Factor Company. Your company's account executive will be fully conversant with your client's account and able to give you information at any time.

### ***How often do invoices get purchased?***

To effect the purchase of your accounts receivable invoices, some companies will purchase these on a weekly or monthly basis and sometimes on a specific day of the week, eg. Thursday. Whereas, other companies will accept your invoices whenever you want to factor them - daily, weekly or monthly. The choice is yours. You decide on the time that best suits your cash flow needs and then send the invoices to the factor. Acceptable invoices accompanied by delivery details are usually funded within 24-48 hours of receipt to the factor's office. In most cases the proceeds can be directly into your bank account on that day and you would be notified of the amount of the deposit at the same time so that the funds are available to you as soon as possible.

Beware of the issue regarding the amount of invoices some factor companies will purchase. In the instance where one of your company's debtors exceeds a certain percent, in most cases 30% of the debtor ledger, the factor, in some cases, will not factor your company because of the exposure risk.

### ***Do I have to factor all my invoices?***

Some companies wish to have all of your debtors to factor, but then some are more flexible to the needs of their clients. These companies will allow you to choose whether to factor all of your invoices or only the amount you need to meet your cash flow needs. There are certain times of the year you may need to, or may like to factor more to give you the ready cash to take advantage of a discount on raw materials or pay for temporary help to meet a dead line. Flexibility for the client is the key to successful factoring.

### ***Is credit checking of my debtors included in the service?***

Providing accurate credit analysis is probably the most vital service a factor company can provide. The success of any company depends on its ability to make sound credit decisions.

Not all factor companies offer this service without charging for it, but usually in most instances they have extensive experience in the banking and finance industries and have access to a number of sources of credit information. They can be willing to help their clients to develop strong credit policies and reduce potential bad debts. You can refer a potential customer and obtain a credit evaluation and credit limit recommendations before you take an order and deliver the goods or service.

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