

THE REPORT

November 2005

Tax News, Views & Clues

DIRECTORS

Paul Fiumara CA

Paul Haupt CA

Robert Schoenmaker CA

Gavin Johns CA

MONTHLY REPORT

- ☉ Personal Services Income
- ☉ Car Parking Expenses
- ☉ 'Tax Advice' Deduction Denied
- ☉ Defending against a Takeover
- ☉ Lodgement Responsibility
- ☉ GST — Guarantees and Indemnities

Personal Services Income

In a recent case, the Administrative Appeals Tribunal (AAT) has found that an IT consulting services company did not satisfy the 'personal services business' test and, as such, the company's income was assessable income for each of the individual contractors.

The taxpayer established a company to provide IT consulting services and technicians. The company's four technicians were contracted to external entities to work on a full-time basis. For the income years ended 30 June 2002 and 30 June 2003, the company derived total fee income of almost \$1 million.

As the result of an audit in 2004, the Tax Office declared that the company was not a personal services business, as it did not pass any of the personal services business tests. The Tax Office subsequently reassessed the company's fee income for each of the company's four technicians.

The personal services income (PSI) tests are designed to prevent individuals from alienating income generated from personal services through another entity.

In order to be outside the PSI measures, a company can satisfy certain tests as outlined below:

- **results test**

a contract is measured by an outcome or product and the contractor is liable to rectify any problems;
or

- no more than 80% of the business income is derived from a single source **and** you satisfy one of the following:

- **unrelated clients test**

you derive income from two or more unrelated clients and advertise available services; or

- **employment test**

you engage an individual(s) to perform 20% or more of the principal work; or

- **business premises test**

you exclusively use business premises that are physically separate from your home, or from the premises of the person for whom you are working.

The AAT held that the relevant service contracts did not pass the results test as they were more in line with employment contracts, as each technician was paid an hourly rate and there was no contracted result or outcome.

None of the remaining three tests could be satisfied as each consultant derived 100% of their income from one source, thus not satisfying the 80% requirement. Consequently, the AAT affirmed the Tax Office's amended assessments and the taxpayer's appeal was dismissed.

Car Parking Expenses

Generally, individual taxpayers are not entitled to a tax deduction for car parking expenses incurred while at their primary place of employment.

However, a recent interpretative decision provides that where a taxpayer travels from an unrelated place of employment to their primary place of employment and incurs a car parking expense, the expense will be an allowable deduction.

'Tax Advice' Deduction Denied

In a recent case, the federal court held that a taxpayer was not entitled to a deduction of \$49,550 for tax advice provided by a solicitor in establishing a superannuation fund.

In December 1998, the taxpayer was advised by his accountant that he could make a contribution to a non-complying superannuation fund and claim a tax deduction for that contribution.

A solicitor was engaged to set up the superannuation fund and prepare the associated documents.

The taxpayer and the solicitor agreed that the superannuation fund would be set up for \$450 and that his total charge would be 10% of the \$500,000 contribution made by the taxpayer to the superannuation fund (a balance of \$49,550).

However, the taxpayer was ultimately unable to claim a deduction for the \$500,000 contribution following decisions in subsequent tax cases. Nevertheless, the taxpayer claimed a deduction for the \$49,550 paid to the solicitor for tax advice provided.

The AAT denied the deduction on the grounds that no tax advice had been provided.

The federal court concluded that the solicitor was a recognised tax adviser and had in fact provided tax advice to the taxpayer when implementing the recommended structure.

However, no deduction could ultimately be granted as the taxpayer failed to produce evidence of what proportion of the fee directly related to tax advice, as opposed to other services.

- **CAUTION:** Taxpayers should take care to thoroughly apportion expenses incurred where amounts are only partly deductible.

Defending against a Takeover

In a recent interpretative decision, the Tax Office has confirmed that capital expenditure incurred by a taxpayer in defending their business against a possible takeover qualifies as expenditure that is deductible over time, even if the takeover does not eventuate.

The target company incurred capital expenditure by evaluating a takeover proposal, including legal fees, valuation costs and shareholder notification expenses. The proposal was ultimately unsuccessful.

Capital expenditure incurred by a taxpayer in defending their business against a possible takeover is deductible over time where the target company carries on a business for a taxable purpose.

- **TIP:** Expenditure of this type can be deducted over five years, including the year in which it is incurred. Similar types of capital expenditure that qualify for a deduction over five years include setting up a business structure, changing a business structure and certain equity-raising activities.

Lodgement Responsibility

In a recent interpretative decision, the Tax Office has stated that an appointed liquidator is the entity responsible for lodging a company's income tax return when it has control of the tax and financial records of the company.

A liquidator is responsible for the income tax requirements and liabilities of a company from their time of appointment.

For further clarification, Taxation Determination TD 94/68 outlines where the responsibility lies in situations where a receiver and/or an administrator has also been appointed to the company.

GST — Guarantees and Indemnities

The Tax Office recently released a draft GST ruling in relation to guarantees and indemnities, explaining what is a guarantee and what is an indemnity, and the treatment of these for GST purposes (they are both input taxed financial supplies).

Further, the draft ruling (which may only be used as guidance) explains the following arrangements and their GST treatment:

- warranties for goods, contracts of insurance and contracts of reinsurance (**not financial supplies**); and
- surety bonds that are guarantees, reinsurance of surety bonds, indemnities that are not contracts of insurance and performance bonds (**financial supplies**).

The above supplies are often made within a business environment. For example, an entity (the guarantor) may agree to make good the obligation of a debtor to a creditor if the debtor defaults. This is a guarantee for GST purposes and involves a financial supply.

Although the above terms are included in the GST legislation, they are not defined and an explanation of these did not previously exist.

[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.