

BDJ NEWS

Barnes Dowell James

Chartered Accountants and Business Advisers

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TAX NEWS, VIEWS & CLUES

STOP PRESS

Is It Time To Lock Into A Fixed Rate On Your Mortgage?

Many economists are predicting that interest rates are set to rise after the federal election so it may be a good time to consider taking a fixed rate on your mortgage.

We are very pleased to make available what we believe to be an ultra competitive loan through **Mortgageport**, where for a limited time only you can lock your interest rate in on your home loan for three (3) years at 6.54% p.a. (Comparison rate is 6.76%)

There is no application fee and no ongoing fees and also the fixed rate loan has a 100% offset facility.

This (3) three-year fixed interest rate is also lower than the major banks standard variable rates at the moment.

Other than the really competitive interest rate - the other big feature of this loan is the 100% offset facility – this feature is usually only available on variable interest rate loans. Having the feature available on a fixed rate loan allows you to not only lock into a fixed rate today but it also allows you to place any surplus funds into the offset account and receive a full interest rate reduction for the amount on deposit. This gives you the ability to manage your interest rate exposure better than ever before and may even help you out from a taxation point of view if you are borrowing funds for investment purposes.

For more information on this loan and to let us explain how the low rate and offset may be able to help you please give us a call.

FAMILY TRUST ELECTIONS AND FRANKING CREDITS

Where shares are acquired within a trust after 31 December 1997, there is a 45-day holding period rule which may prevent trust beneficiaries from accessing franking credits on dividend distributions.

Broadly, because discretionary trust beneficiaries do not have a fixed interest in shares, they are taken not to be the owners of shares at risk for the required 45-day period. Therefore, beneficiaries do not satisfy a *qualified person* requirement so franking credits may not be available.

Where the relevant discretionary trust makes a family trust election, the shares in the trust are taken to be beneficially owned by the trustee and therefore beneficiaries can access the franking credits, provided the shares are held for more than 45 days.

TIP: Where shares acquired after 31 December 1997 are owned via a discretionary trust, a family trust election should be carefully contemplated. In addition, as discussed in recent editions, the opportunity for trustees to make retrospective elections was recently announced.

GENERAL INTEREST CHARGE

The Tax Office has indicated that the general interest charge (GIC) rate for the quarter July to September 2004 is 12.51% — down from 12.57% for the previous quarter.

TRUST LOSS DEDUCTIONS DENIED

The Administrative Appeals Tribunal (AAT) recently disallowed trust loss deductions in a case involving distributions of trust net income between three related trusts. In the 1996 income year, the first trust conferred a present entitlement to over \$1.2 million of its net income to the second trust, which resolved to confer a present entitlement to \$859,806 of its trust net income to the third related trust that had carry-forward losses of exactly \$859,806. Neither amounts were physically paid or transferred as resolved, nor were the amounts invested on commercial terms.

The AAT found that this series of transactions constituted an income injection scheme, as both resolutions were constructed to enable the trustee of the third trust to derive the assessable income of \$859,806, which was totally offset by its losses.

Accordingly, the taxpayer failed the income injection test and the Tax Office's disallowance of the claimed tax losses was upheld.

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DEBT/EQUITY ARRANGEMENTS

The Tax Office has recently released an Interpretative Decision regarding the implications of material changes to loan agreements and the application of the debt and equity tests.

These tests classify instruments under financial arrangements as either being debt (loan) or equity (shares). Accordingly, these tests determine whether the return paid by the company on the instrument is treated as a dividend (and potentially frankable) or treated as interest on a debt (deductible). These tests focus on the economic substance of the instrument's components over their legal form. Where an instrument satisfies both the debt and equity test, it will be treated as debt.

Under the law, the debt and equity tests are applied to arrangements such as loan agreements and preference shares at the time the arrangement comes into existence.

Where the components of the arrangement (e.g. terms of a loan) are subsequently changed, the tests are to be reapplied to determine whether or not the change is a material change that varies its classification from debt to equity or vice versa.

TIP: Taxpayers should ensure that any debt or equity instruments related to their financing arrangements are re-examined after a change in the instrument's terms.

CAPITAL WORKS

The Tax Office has issued an Interpretative Decision (ID) regarding the deductibility of capital works that aren't currently producing assessable income.

The ID considers a case where the taxpayer has constructed a building and leased it to a related company. The lessee did not pay commercial rent for the building due to insufficient cash flow and only paid the taxpayer's outgoings (e.g. rates, insurance etc.).

Under the law, an amount may be deducted for capital works in an income year if:

- there is a construction expenditure area;
- there is a pool of construction expenditure for that area; and
- the area is used, amongst other things, for the purpose for producing assessable income.

It is a well-established principle that assessable income is not required in the year in which the expenditure has been incurred. However, there must be either assessable income in future years or there must have been assessable income in the past.

In the case considered in the ID, no assessable income was produced and the taxpayer only satisfied the first two of the above three requirements. However, the receipt of commercial rent by the taxpayer in the future will increase as the cash flow of the lessee improves.

Due to the relative briefness of the lower rent period, the Tax Office was satisfied that the building's sole purpose was always to produce assessable income and hence capital works deductions were allowed in the current income year.

GST: RECORDING CONSIDERATION IN THE ABSENCE OF PAYMENT

The Tax Office has released a Draft GST Determination regarding the GST liability and input tax credit entitlements in the absence of actual payments for transactions.

The Tax Office states that book entries can amount to the provision or receipt of payment for GST purposes provided that an agreement to 'set-off' the mutual liabilities is in place between the parties. Such a set-off can occur where each party has made a supply to the other and each party is required to pay the other for the supply made to it. The agreement between the parties may be written, oral or implied.

Both parties will still retain their GST liability and entitlement for input tax credits, but no invoices are issued. Consideration in this case is taken to be provided on the date that the book entries are made.

Please contact us for further information.

TAXPAYER WINS ANTI-AVOIDANCE APPEAL

The Administrative Appeals Tribunal (AAT) has ruled in favour of a taxpayer who was issued amended assessments by the Tax Office on the grounds that the taxpayer's company structure was a scheme to reduce income tax.

The taxpayer, an information analyst, provided professional services to clients through a company of which he and his wife were directors and shareholders. The company received income for the professional services rendered by the taxpayer and paid the taxpayer and his wife salaries and superannuation benefits.

The Tax Office issued amended assessments for the 1995, 1996 and 1997 income years that increased the taxpayer's assessable income to match the fees received by the company. The Tax Office acted on the assertion that the taxpayer's company structure was a scheme to reduce income tax and alleged that the company structure allowed the taxpayer to reduce his personal tax liability and pay his wife excessive superannuation benefits.

The AAT found that the company structure was required for the taxpayer to operate his business effectively and that the income paid was fair and reasonable for the work performed. The AAT also held that the Tax Office was wrong to assess the taxpayer on the fees generated by the company based solely on the grounds that the taxpayer's professional activities generated the company's income.



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CGT A MAJOR FOCUS FOR ATO IN 2004/05

The Tax Office has announced that capital gains tax (CGT) will be a major area of focus in its 2004/05 compliance program. All taxpayers, from individuals, to small and large businesses, stand to be affected. Major areas of increased CGT scrutiny include:

- The Tax Office believes that some legal practitioners may not fully consider the implications of CGT and CGT record keeping when advising clients.
- Real property transaction data matching is already in place and the Tax Office plans to expand its operations with several state revenue offices in order to ensure that capital gains are being correctly disclosed by taxpayers.

- The incorrect use of Small Business CGT concessions by micro-businesses and small and medium enterprises will be examined.
- The sale of 'high value/high growth' properties will be scrutinised where signs of deliberate evasion may be present.

SUPERANNUATION TAX REDUCTION STRATEGIES

The Tax Office has recently confirmed that several commonly used superannuation tax reduction strategies will not attract the anti-avoidance provisions of the law. Two of the strategies that are allowable under the law include:

- an individual taxpayer withdrawing an Eligible Termination Payment (ETP) from their superannuation fund and then re-contributing a similar amount to the same fund or another fund (e.g. a spouse's fund) for the purpose of establishing a superannuation pension; and
- an individual taxpayer making a large undeducted contribution to their superannuation fund before they receive an ETP.

Both strategies take advantage of the law's concessional ETP treatment. The first strategy reduces the assessable portion of the annual pension while the second reduces the amount of the tax payable on the ETP.

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