

NEWSLETTER – EASTER APRIL 2006

Introduction

The following represents some important information arising from recent legislation and other matters of interest

Self Education Expenses

You can only claim deductions for the expenses associated with self-education that are related to your income earning activities while you are studying. If your self-education is to help you get a new job, you cannot claim these expenses.

The cost of certain educational activities are not classified as self-education, but may be deductible as 'other work-related expenses.' These include formal education courses provided by professional associations, seminars, or conferences that are connected to your work activities but do not relate to your course of education

Super Splitting

From 1 January 2006 you can divert superannuation contributions made on your behalf to your spouse.

This provides couples with an avenue to share their superannuation benefits. In particular, it allows single income families access to two ETP low rate thresholds and two RBL in a similar way to dual income families.

The maximum diversion amounts are
85% of deductible contributions (e.g. employer, super guarantee or salary sacrificed contributions) and

100% of personal contributions with no tax deduction allowable (e.g. undeducted contributions)

The legislation allows 100% of all contributions to be diverted and a superannuation fund will only have 85% of the contribution available after payment of the contributions tax.

An application to split contributions will need to be made in respect of a financial year after the end of that year. The application, specifying the amount to be split, must include a statement by the spouse to the effect that he or she is under 55 years of age or alternatively is under 65 years of age and is not permanently retired.

It is important to note that not all superannuation funds will offer contribution splitting as the superannuation contribution splitting measure is a voluntary regime which means that superannuation funds decide whether or not they will offer splitting to their members.

Service Entity Update

The Commissioner of Taxation has indicated an easing of the retrospective application of the proposed ruling and accompanying booklet on service entities. He also indicated that the safe harbour mark ups contained in the booklet accompanying the draft ruling may be reconsidered to provide a more helpful guide to applicable taxpayers.

This recent announcement from the ATO has met with positive reaction from the various professional bodies. Prior to this announcement, the draft ruling issued in early May 2005 and the subsequent release in early July 2005 of the accompanying booklet, met with concern from the professional bodies on various aspects, some of which are detailed below.

Departure from ATO's previous position regarding service entities where deductibility was allowed on the basis that connected with income earning activities and were not grossly excessive

- Possible retrospective application
- Failure to recognise asset protection strategy as legitimate reason for use of such entities
- Basis used to determine high risk cases where
 - a) service fees are over \$1 million, and
 - b) 50% or more of the gross income of the firm is being directed into service fees

The above has recently been clarified in that the basic threshold for triggering the ATO's interest in service entities is where the gross income of the firm is more than \$1 million and more than 50% of that gross income is directed into the service entity.

Forfeiture of Deposits

The receipt of a deposit for the sale of an asset, for example, a property that subsequently does not settle may result in capital gains tax.

Tax ruling TR1999/19: "Treatment of Forfeited Deposits", sets out the consequences of forfeited deposit under normal contractual arrangements. If there is no "continuum of events" or if no other attempts to sell the asset are made, then regardless of whether the asset in question is the taxpayer's main residence or not, the deposit is an assessable capital gain.



If a deposit is received for the sale of an asset and the asset is the main residence of the taxpayer, then, if the taxpayer continues to sell the asset, the deposit in this instance is not assessable.

Example 1

A main residence was acquired after 19 September 1985. In June 2005 a contract for the sale of the residence for \$400,000 was signed and a deposit for \$40,000 was paid under the contract. In August 2005 the purchase defaulted and the contract was terminated and the deposit was forfeited. The residence was immediately remarketed and in November 2005 it was resold for 350,000. As the forfeited deposit was received as part of the 'continuum of events', the forfeited deposit forms part of the capital proceeds from the disposal of the residence and is eligible for the main residence exemption.

Example 2

Assuming the same facts as Example 1, except that when the residence was remarketed it was unable to be resold. The residence was then withdrawn from the market and remains unsold. As there has been no disposal of the underlying asset, the main residence exemption cannot apply. In this case, the vendor has sold a contractual right and not the main residence, the result that the forfeited deposit (less incidental costs) constitutes a capital gain in the 2005-2006 year.

Mature Age Workers' Tax Offset

This tax offset aims to encourage and reward mature age workers who stay in the workforce. The maximum tax offset is \$500 and is available from 1 July 2004.

To be eligible for the MAWTO the taxpayer must

- be an Australian resident for tax purposes
- be aged 55 years or more at the end of the income year, and
- have received net income from working.

Net income from working is the total amounts of assessable income that are mainly a reward for your personal efforts or skills, less any related deductions. Income from working includes salary and wages, allowances, business income etc. It does not include interest income, dividends, trust distributions and other income unrelated to your personal efforts or skills.

The MAWTO is calculated automatically by the ATO based on the information provided in the tax

return. The offset can only reduce your tax liability to nil and any unused portions cannot be refunded or transferred to another taxpayer.

GST and the Sale of Land

Since the introduction of the GST legislation in 2000, much confusion remains as to its possible implication on the acquisition and sale of land.

A recent case, ETO Pty Ltd v Idameneo No 123 Pty Ltd, goes some way to clarifying such confusion. In this case, there was no dispute that the land was a taxable supply and therefore subject to GST. Rather the issue that arose was in the interpretation of the contract. The defence argued that only part of the land was subject to GST.

The court held that the vendor was to provide the purchaser with a tax invoice for the sale of land which was to include the amount of GST payable. Here, a tax invoice was not provided and the purchaser was led to believe that the agreed price was entirely taxable and inclusive of GST.

To avoid such complications when buying or selling land, it is important to determine whether the agreed price is partly or wholly inclusive of GST and that the sale contract clearly states the GST position.

HECS-HELP 2005-2006

In 2003 the Federal Government announced reforms for financing students through university. HELP was introduced to assist students in paying higher education fees. It replaced the previously available HECS.

Similar to HECS, HELP was a minimum taxable income threshold in which students must commence repayment of HELP loans through the taxation system once their repayment income is over the minimum income threshold.

The HECS-HELP minimum repayment threshold has risen from \$35,000 in 2004-2005 to \$36,185 for 2005-2006. Repayment income includes taxable income, total fringe benefits, any amount of rental loss and any exempt foreign employment income.

Once repayment income is above the minimum repayment threshold for any particular year, the ATO will calculate the compulsory repayment which is repayment income multiplied by the repayment rate (according to the table below). The repayment rate increases as repayment income increases up to a maximum of 8% for repayment income above \$67,200.

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The 2005-2006 repayment income thresholds commence at incomes of \$36,185 where it cuts in at 4% and increases on a graduated scale until it hits 8% at incomes of \$67,200 and above.

Record Keeping

We are often asked about record keeping and in particular, what level of compliance is required by taxpayers to substantiate their assessable income and allowable deductions. The requirements are different for different taxpayers.

For Individuals

What records do they need to keep?

- payments received
- expenses incurred relating to payments received
- acquisitions or disposals of assets
- tax deductible gifts of donations
- medical expenses
- Electronic Lodgement Declaration

How long do they keep these?

Keep for a period of 5 years from the date you lodge your tax return. If you claim a deduction for decline in value then you must keep records for 5 years from the date of your last claim in decline in value.

If you are a SPOR taxpayer, then you are eligible for a two year period of review and thus must retain your records for two years from the date of lodgement of your tax return. To be SPOR taxpayer you must be a individual who derives income only from salary or wages, interest and or dividends. Further, you cannot claim deductions for anything other than gifts or donations, account keeping fees or government charges on account transactions, and or expenses of managing tax affairs.

Partnerships

What records do they need to keep?

Receipts, including records of sales, cash register tapes, deposit books and bank statements

Purchases, including expense payment records, receipts from small cash purchases, cheque butts and a log book for car expenses

GST records : tax invoices, adjustment notes and any other document that records an election, choice, estimate, determination or calculation made for the purposes of GST law (in some circumstances the record is to be kept for a period of five years after the election ceases to have effect)

Wages records, including worker payment records, tax file number declarations (employment declarations) withholding declarations and superannuation records

Records of amounts withheld from payments where no ABN was quoted

Year-end records, such as stock take sheets, creditors lists, debtors lists and depreciating asset worksheets, and

Records of CGT assets (these need to be kept for five years after the sale of the assets).

How long do they keep these?

You must keep the above records for 5 years after they are prepared, obtained or the transaction completed (whichever is the later)

You must keep the following records for at least 1 month if reconciled with the actual sales, or 5 years if not reconciled: receipts for sales you make, including credit card docketts (merchant's copy) and cash register tapes.

Companies

What records do they need to keep?

Any documents that are relevant for the purpose of ascertaining the company's income and expenditure

Documents containing any particulars of any election, estimate, determination or calculation made by the company and the basis on which these were made.

How long do they keep these?

You must keep the above records for 5 years after they are prepared, obtained or the transaction completed (whichever is the later)

The period of retention may extend beyond 5 years. This will occur where the period within which the Commissioner may amend an assessment of the relevant taxpayer has been extended beyond 5 years. Where the amendment period is thus extended, the records must be retained to the end of the extended amendment period.

Trusts

What records do they need to keep? The Trustee must retain any documents that are relevant for the purpose of ascertaining the trust's income and expenditure

Also any documents containing particulars of any election, estimate, determination or calculation made by the trust and the basis on which these were made.

How long do they keep these?

The Trustee must keep the above records for 5 years after they are prepared, obtained or the transaction completed (whichever is the later).

Managed Superannuation Funds*What records must be kept and how long must they keep these?*

The Trustee of an SMSF is required to keep accurate records that explain the transactions and financial position of the fund for a minimum of 5 years.

In addition, the Trustee must keep annual operating statements and an annual statement of financial position for a minimum of 5 years. Trustee meeting minutes and decisions as well as records of all changes of Trustees' and Members' written consent to be appointed as Trustees must be kept for a minimum of 10 years. Copies of all annual returns lodged and reports given to members must all be retained for a minimum of 10 years.

Meaning of 'carrying on an enterprise'

The ATO has recently issued a new draft ruling on the concept of "carrying on an enterprise" which is central to the ABN and GST regimes.

The ruling cover issues such as

- 1 What is an 'enterprise' for ABN purposes?
- 2 Who is carrying on an enterprise?
- 3 When is an enterprise being carried on?

A number of changes have been made to the previous draft ruling in particular the sections on commencement activities and land subdivisions.

Commencement of an enterprise.

Activities carried out by a entity that are part of a process of beginning or bringing into existence an enterprise are considered to be an activity of carrying on an enterprise. The ultimate outcome of the activities and whether or not an ongoing enterprise eventuates is not a determinative factor. If the activities have the character of those ordinarily undertaken to commence an enterprise, they will be accepted as falling within the definition. This would be so even if the eventual enterprise carried out differs from the one originally contemplated.

Activities that are of a private nature or too remote from completion are not considered as commencement activities of an enterprise. For example, if a person undertakes a tour of a winery

with the intention of establishing a future business in the wine industry, this will not be considered as commencement activities by the ATO.

Activities undertaken to establish an entity, for example drawing up of a trust deed and the settlement of trust property cannot be considered as commencement activities because the trust cannot commence activities until it is in existence.

Isolated transactions and sales of real property

The issue to be decided when considering real property is whether the activities are carrying on an enterprise in that they are revenue nature or an adventure or concern in the nature of trade. The ATO has provided the following list in deciding the above :

- There is a change of purpose for which the land is held
- Additional land is acquired to be added to the original land
- The parcel of land is brought into account as a business asset
- There is a plan to subdivide the land
- There is a business organisation
- Funds were borrowed to fund the acquisition of subdivision
- Interest on money borrowed was claimed as an expense
- Level of development of the land beyond that necessary to secure council approval for the subdivision
- Buildings have been erected on the land

However, in order to determine if isolated transactions are carrying on an enterprise, the facts and circumstances of each case need to be examined separately.

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