

# CLIENT ALERT

March 2010

## **ATO comes down hard on monies owed to 'bucket' companies**

*Editor: By way of background, for many years now the Tax Office has accepted that trusts could make distributions to private companies but not actually have to pay the amount. These were called unpaid present entitlements.*

*These amounts were taxed in the hands of the company and the trustee was able to continue to use the funds for the benefit of all the beneficiaries.*

*The Tax Office has now reversed that longstanding view and issued a draft ruling that many see, at the very least, as contentious.*

### **New draft ruling**

The new draft ruling means that, generally speaking, where a trust does not physically pay out a distribution to a private company, the Tax Office will deem that a loan has been provided by the private company to the trust.

Where that occurs, the amount owing under the 'newly created loan' may be treated as a dividend to the shareholders of the company.

### **"Carve-out" for existing unpaid distributions**

However, distributions made before 16 December 2009 are not affected by the ATO's new interpretation, and will therefore not generally be treated as loans (or dividends).

*Editor: We have not gone into the technical side of this issue which is quite complicated to the uninitiated.*

*However, while we will be in contact with clients over the next short while, we recommend that any clients who may be concerned with how this draft ruling could affect them should contact our office.*

*For what it's worth, this is a draft ruling and it is possible, but not likely, that the ATO will change its view. In addition, the Tax Office's position has yet to be tested in Court.*

## **Declare offshore income or wear the consequences**

The Tax Commissioner has announced that the net is closing in on tax havens and has made a new offer for people who may not have declared all income from offshore activities.

"This is a chance for people with undeclared income, for example interest earned offshore, to contact the Tax Office and sort out their affairs. The offer is open until 30 June 2010."

The Tax Office made a similar offer in 2007 which produced more than 3,000 disclosures with a total of over \$306 million in omitted income.

Compared to 2007, the new offer increases the shortfall penalty from 5% to 10% where a person's additional income from offshore activities is more than \$20,000 in a tax year.

Those with additional taxable income of \$20,000 or less in a tax year will not have to pay a shortfall penalty for that year.

People can now approach the Tax Office anonymously for an indication of whether it would initiate an investigation to determine whether there is a potential breach of the criminal law.

## **Defamation payout not assessable**

The Full Federal Court has held that damages awarded to a company and calculated on a 'lost profits basis' were not assessable.

The taxpayer company was awarded for \$844,624 in damages against the defendant for publishing false and misleading statements as to the nature and quality of laser eye surgery services provided.

The Court held that even though the damages were based on the anticipated net income that the taxpayer had lost from surgical procedures not performed as a result of the defamatory publications, the damage was to the corporation's reputation which is part of what enables it to earn money.

An injury to that reputation diminishes its capacity to earn because it reduces the corporation's ability to induce others to do business with it.

The Court said that an award of damages for that injury is therefore no different from an award for the loss of an arm or any other injury impairing earning capacity.

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## Five new Tax Alerts

In a rush of blood to the head, the ATO has issued five tax alerts on 'dodgy' arrangements.

- Life insurance bonds issued by tax haven entities – the alert warns taxpayers to be cautious about investing in life insurance policies issued from insurance companies based in tax havens, such as Vanuatu.
- Offshore super trust arrangements – trust structures that masquerade as superannuation funds to avoid tax on money shifted into Australia.
- Sham mortgage arrangements – promoted as 'mortgage management plans' which promise to help home owners repay their home loan sooner and claim tax deductions to which they are not entitled.
- R&D schemes – this alert warns people to be cautious of investment schemes that abuse the research and development (R&D) tax offset.
- 'Option' arrangements – that attempt to artificially create up-front deductions whereby an employer makes a 'deductible' cash contribution to a trust which then pays it back to acquire options from the employer.

## ATO appeals case – education expenses/Youth Allowance

*Editor: Towards the end of 2009, in what is seen as a landmark decision, the Full Federal Court held that a taxpayer, who received a Youth Allowance as a university student, was entitled to a tax deduction for her education expenses.*

The Tax Office has now advised that it has sought special leave to appeal against this decision (the Anstis case) in the High Court.

Until the matter is resolved by the High Court, the Tax Office will continue to apply its view that education expenses are not deductible for tax purposes against various Commonwealth educational assistance schemes.

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## End of the 2009/10 FBT Year

The end of the 2009/10 fringe benefits tax (FBT) year, 31 March, is rapidly approaching and that means, after this date, FBT returns will soon be due for lodgment.

Where we usually prepare the FBT return for your business, we ask that you collect all relevant FBT records relating to any benefits provided, such as:

- ◆ motor vehicles;
- ◆ car parking;
- ◆ entertainment;
- ◆ expense payments; and
- ◆ living away from home allowances;

together with travel diaries, employee declarations, etc.

*Editor: Please call if you need to make an appointment or discuss the records needed. The following is some general information about FBT as it may apply to you and your business.*

### FBT rate

The FBT rate of tax for the year ended 31 March 2010 is 46.5%.

### Minor benefits exemption

Fringe benefits with a taxable value of less than \$300 may be exempt from FBT if they are provided on an irregular and infrequent basis.

For a benefit to qualify for this exemption, the benefit must have a GST-inclusive taxable value of less than \$300.

### Entertainment – what is it and when are you caught for FBT?

*Editor: Entertainment is always a problem for FBT purposes because it relates to the provision of food and drink which sometimes is not liable to FBT – travel – and sometimes is – staff parties.*

The following are some examples of what is entertainment:

- ◆ restaurants where family and clients are entertained;
- ◆ food and drinks provided at a staff social function;

- ◆ entertainment and drinks provided to employees on Friday nights;
- ◆ the cost of taking staff and their partners out to lunch; and
- ◆ cost of taxis and limousines to and from entertainment venues.

An employer who has provided meal entertainment fringe benefits may work out the taxable value of their meal entertainment under one of these three methods:

- 50/50 split method;
- 12 week register method; or
- actual expenditure incurred on meal entertainment method.

*Editor: If you think that you may have provided 'entertainment benefits', the method we can help you choose to determine the FBT taxable value can substantially reduce the FBT payable.*

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## **Rental properties – travel expenses**

*Editor: The following is about claims by taxpayers with rental properties and demonstrates how we can help you with those claims.*

### **What travel expenses can taxpayers with a rental property claim?**

Taxpayers can claim:

- ◆ preparing the property for new tenants (except for the first tenants);
- ◆ inspecting the property during or at the conclusion of tenancy;
- ◆ undertaking repairs, where those repairs are a consequence of the damage or wear and tear incurred while being rented out;
- ◆ maintenance of the property, such as cleaning and gardening, while it is rented or available for rent;
- ◆ collecting the rent; and
- ◆ visiting their agent to discuss their rental property.

### **Domestic travel requiring an overnight stay**

A rental property may be located so far from where a taxpayer lives that it would be unreasonable to expect them not to stay near the property overnight when making an inspection.

If this is the sole reason for the trip, they are entitled to claim a deduction for travel expenses incurred in travelling to the rental property.

Where an overnight stay is involved, they would be entitled to claim for meals and accommodation.