

# CLIENT ALERT

March 2008

## Refund of Overpaid Income Tax Instalments

The Tax Office recently completed a review of credit balances on activity statement accounts.

The Tax Office stated that its review identified that some credit balances were the result of overpaid income tax instalments, which were often for small amounts. The Tax Office stated:

‘Any credit identified as an overpayment of income tax instalments will be included on your next income tax assessment as ‘other amounts refundable’ from the income tax account.’

## Labor’s Tax Reforms

24 November 2007 ushered in a new era for the Australian political landscape with the Labor party winning the Federal election. As part of its election campaign, Labor promised various tax reforms which included changes to personal income tax, and measures to assist families with the increasing cost of raising children. A brief discussion of the various reforms follows:-

### Personal income tax

Labor has stated that it will support the tax cuts outlined in the 2007/08 Budget. However, tax cuts for individuals earning

more than \$180,000 will be deferred until the 2013/14 income year. Labor’s proposed reforms will see the personal income tax system having three tax rates by the 2013/14 income year (from the current four), and the reduction of the highest marginal tax rate to 40%.

The Low Income Tax Offset (LITO) will be gradually increased. The Senior Australians Tax Offset (SATO) will be adjusted in line with the increase in the LITO. These changes have as yet not been legislated.

### Abolishing tax deductions for political donations

Labor is proposing to abolish tax deductions for donations or contributions to political parties, including membership fees, from 1 July 2008.

### Assisting families

A range of ‘family friendly’ measures will be introduced, and scheduled to go into effect on 1 July 2008, including:

- increasing the child care tax rebate to 50%, payable quarterly;
- providing a limited 50% Education Tax Refund for families receiving Family Tax Benefit Part A (FTB-A) or who have school-attending children receiving Youth Allowance; and

- limiting eligibility for Family Tax Benefit Part B (FTB-B) to families with a combined adjusted taxable income of less than \$250,000.

### Reverse changes to family trusts

Labor is proposing to reverse the changes made to family trusts that were introduced in September 2007.

The changes saw the broadening of the definition of ‘family’ and ‘family group’, changing the test individual for a family trust in limited circumstances, and allowing the revoking of family trust elections and interposed entity elections in limited circumstances. The proposed date of effect is 1 July 2008.

- **TIP:** Labor’s proposed reversal means taxpayers will only be able to access the changes introduced in September 2007 in the current income year.

### PSI and the Results Test

In a recent Federal Court case, two taxpayers generating PSI lost their appeals against the Commissioner. The case concerned the Commissioner’s refusal to grant the taxpayers PSB determinations on the basis that they did not satisfy the results test.

The Court found that the relationship between the taxpayers and the company

engaging their services was that of an employer–employee because:

- the taxpayers were not liable to rectify any defects in the work performed;
- payment for the services rendered was not pegged to the completion of any specific tasks; and
- no further equipment was required to be provided by the taxpayers for the efficient performance of the tasks.

If a taxpayer meets the requirements of the result test, they will be regarded as carrying on a PSB and be excluded from the PSI regime. The results test requires a taxpayer to meet three conditions:

- the income is paid to achieve a specific result or outcome;
  - the taxpayer provides any necessary tools or equipment to do the work; and
  - the taxpayer is liable to rectify any defects in the work.
- **TIP:** In determining whether a taxpayer meets the conditions of the results test, it is the economic substance and not the legal substance that is important.

## Trust Cloning

Trust cloning refers to the practice of transferring an asset between two trusts that have the same beneficiaries and terms. Generally, when an asset is transferred between two trusts, CGT implications will be triggered. However, where the beneficiaries and terms of the two trusts are similar, a CGT exception applies.

The Tax Office previously released a Taxation Ruling which provides its view on when the CGT exception applies. Since the release of the ruling, the Tax Office has become aware of examples where trusts, particularly discretionary trusts, may not be the same and therefore assets transferred between the trusts will trigger a CGT event.

The Tax Office is encouraging taxpayers or their advisers who have relied on the exception, but who are now concerned that the exception test was not satisfied, to contact it or lodge a private ruling.

## Wesfarmers' Acquisition of Coles

The Tax Office has released a Class Ruling providing its view on the tax implications for a Coles shareholder following the acquisition of Coles by Wesfarmers.

The ruling provides that Coles shareholders are able to disregard any capital gains arising from the acquisition by accessing the script for script rollover relief. However, the capital gains are not disregarded to the extent that the capital proceeds include the cash consideration received.

## GIC and SIC Rates Released

The Tax Office has released the general interest charge and shortfall interest charge rates for the third quarter of the 2007/08 income year. The rates are as follows:

Rate	Annual (%)	Daily (%)
GIC	14.15	0.03866120
SIC	10.15	0.02773224

The Tax Office has also released the interest rate for overpayments (IOP), early payments (IEP) and delays in refund (DRI) for the third quarter of the 2007/08 income year. The applicable interest rate is 7.15%.

## FBT and Minor Benefits

In a recent Taxation Ruling, the Commissioner expressed that a fringe benefit provided by an employer to their employees (or associate) will only attract the minor benefits exemption where:

- the notional taxable value of each benefit is less than \$300; and
- having regard to the circumstances, including a consideration of the infrequency and irregularity, it would be unreasonable to treat the benefit as a fringe benefit.

Further, the Ruling states that even if the notional taxable value of a benefit is less than \$300, the benefit is not necessarily an exempt benefit. There are certain fringe benefits that are specifically excluded from the operation of the minor benefits exemption.

If the minor benefits exemption applies to a benefit, no FBT liability arises from the provision of that benefit.

## Wash Sale Arrangements

The Tax Office has stated recently in a Taxation Ruling that the Commissioner may make a determination to cancel any tax benefits obtained in connection with a 'wash sale' arrangement. Whether the Commissioner makes a

determination to cancel any tax benefits obtained will depend on the facts of the particular situation.

An arrangement where a taxpayer disposes of an asset in order to apply a resulting capital loss against a capital gain previously incurred (or deduction against assessable income), and both capital assets are significantly similar, may attract the Commissioner's adverse attention.

## **Alert On Stapled Securities**

The Tax Office has issued a Taxpayer Alert warning taxpayers investing in stapled securities that it is considering whether they are entitled to a deduction when the stapled securities are sold on the ASX at a loss, or on the occurrence of an Assignment Event.

In particular, the Tax Office is considering whether the structure of a stapled security constitutes a scheme to obtain a tax benefit therefore denying any deductions arising from its disposal.

A stapled security is an arrangement where a company issues a security consisting of a note and a preference share to resident investors. The Tax Office said that in these arrangements the company issuing the securities suggests that an investor may claim deductions for losses in certain circumstances. These circumstances include the assignment, transfer or surrender of the note, or conversion or disposal of the stapled security.

## **Classifying holders of share-based derivative products**

The tax treatment of profits and losses for holders of share-based derivatives depends on whether the holder is property characterised as:

- a trader;
- a speculator: or
- an investor.

Where a taxpayer uses derivatives as a hedge, the tax treatment of the hedging transaction will be affected by the nature of the risk being hedged.

## **Traders**

A trader is a person who carries on a business of routinely and systematically taking positions in respect of securities or derivatives for the purpose of producing income. There are many factors that are relevant in determining whether a person is a trader.

These include;

- the repetition, regularity and frequency of positions taken;
- the turnover of the activities;
- the size of positions taken;
- the use of a systematic trading strategy;
- the preparation of a business plan including budgets and targets;
- the amount of capital committed to the activities;
- the use of finance and borrowings
- the engagement of professional advisers;
- the carrying out of market research; and

- prior involvement or experience in securities trading.

No one factor is determinative. Rather they all contribute to an overall conclusion as to whether the activities of buying and selling securities, and/or writing and taking options, constitutes the carrying on of a business of securities trading.

## **Tax treatment**

If a person is taxed as a trader, then;

- the cost of purchasing of securities will be allowable as a deduction for trading stock;
- the proceeds of selling securities and receiving option premiums will be assessable income; and
- trading losses will be on revenue account and may be deducted against the person's other assessable income.

## **Speculators**

### **What is a speculator?**

A speculator is a person who enters into a securities position not in the course of carrying on a business but with a profit-making intention (as opposed to entering the position in relation to the holding of shares as a long-term investment).

### **Tax treatment**

Profits from a position entered into with a profit-making purpose are treated as ordinary income. It does not matter that the taxpayer is not carrying on a business. The profit and income is calculated at the conclusion of the profit-making undertaking or plan.

Correspondingly a loss made by a speculator will be a loss on revenue. The cost of acquiring securities as part of the profit-making undertaking or plan will not be deductible. Rather any loss and deduction will be calculated at the conclusion.

## **Investors**

### **What is an investor?**

An investor is a person who is not a trader or a speculator.

It is possible for a taxpayer to be treated as an investor in relation to ETO, warrant and CFD activities. This would be the case

if the derivatives position is taken to hedge a physical shareholding of the taxpayer that is held as a long-term investment. However, in the absence of such a hedging purpose, it is likely that the ATO will consider derivatives transactions to be made with a profit-making purpose and therefore taxed on revenue account.

### **Tax treatment**

If a person is taxed as an investor, the gains and losses will be taxed under the CGT rules.

It is common for taxpayers who enter into a share transaction to make a 'quick profit' to return

that profit as a capital gain rather than ordinary income. For example, a taxpayer may subscribe for shares under an IPO with the intention of selling the shares on the first day of trading and hopefully make a 'stag' profit. There is no intention to hold the shares as a long-term investment to derive dividends. Rather the arrangement constitutes a profit-making plan that should properly be taxed on revenue account.

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