

CLIENT ALERT

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Tax News, Views and Clues

CGT and Forward Purchase Agreements

Overturning an earlier decision of the Administrative Appeals Tribunal (AAT), the Federal Court has found that an arrangement involving a forward purchase agreement (FPA) for the sale of shares did not give rise to a capital gain in the hands of the taxpayer.

The taxpayer purchased shares in 1993 and sought to sell a large portion of those shares in 1996 by way of an FPA. The taxpayer was to receive \$3.53 per share in 1996 and fully franked dividends for the next four years. The taxpayer granted a warrant over the shares, obliging the holder to buy or sell shares at the contract date, but retained beneficial ownership over the shares.

By entering into the FPA, the taxpayer potentially limited the consideration for CGT and derived dividends over the next four years that would be sheltered from tax by franking credits.

The Commissioner contended that this right to retain ownership for four years had the characteristics of 'property' and hence the capital gain should be included in the taxpayer's assessable income

representing the value of the rights to retain ownership and benefit from the dividend flows until completion.

The Commissioner did not accept that consideration for the shares could simply be an amount set by the FPA and sought to assess the taxpayer on what he deemed to be additional 'non-cash consideration'. The Commissioner viewed the arrangement as conferring on the taxpayer a contractual right, as a result of retaining beneficial ownership of the shares over the period of the agreement.

The Court disagreed with the Commissioner's position, and found that the taxpayer's right to retain beneficial ownership of the shares did not constitute property and the right to the dividend stream was an asset for capital gains tax purposes.

Remission of Penalties

The Tax Office has recently released Practice Statement Law Administration PS LA 2007/3, which relates to the remission of penalties. The practice statement specifically covers:

- the failure to issue a tax invoice or adjustment note as

required by the GST legislation; and

- an entity and its agent both issuing separate tax invoices or separate adjustment notes contrary to the requirements of the GST legislation.

The practice statement is useful in providing guidance to small and medium sized businesses or partnerships with limited systems for the generation of tax invoices and adjustment notes.

The practice statement only deals with the administrative penalty regime and does not cover the remission of the general interest charge (GIC).

Work-related Expense Errors

The Tax Office has sent out 226,000 letters to taxpayers in respect of incorrect claims for work-related expenses in their 2005/06 tax returns.

Common errors anticipated for 2007 include:

- self education expense claims where there was an insufficient connection between the work activities and the education expense to warrant a deduction;

- car expenses using the cents per kilometre method, where the taxpayer is unable to support the claimed expenses;
- incorrectly claiming the entire amount of an asset purchase rather than calculating the asset's decline in value; and
- incorrect calculations regarding the taxpayer's home office expenses.

Family Trust and Interposed Entity Elections

Under the trust loss rules, a taxpayer is subject to concessional treatment, making it easier to claim prior year losses, if they have made a Family Trust Election (FTE) or an Interposed Entity Election (IEE). Also, elections may be necessary to preserve franking credits flowing through the trusts.

Due to the complexity of these rules and the potentially adverse consequences of failing to make the required elections, the Tax Office has allowed an extension to make retrospective elections as part of the 2004 income tax returns.

The Commissioner recently announced a further extension of time to make a one-off lodgement of an election up until 31 May 2007. This will allow taxpayers to retrospectively submit their FTEs and IEEs for 2004 and earlier income years. The procedures for lodging these extensions have been posted on the ATO website.

Settlement Payment Assessable

The Federal Court has found that a settlement payment made to a former accounting firm partner on his termination from the partnership was assessable

income. This overturned a previous decision of the AAT.

Originally, the AAT had held that a large portion of the settlement payment was a non-assessable 'un-dissected lump sum' and therefore should not be included in the partner's assessable income. The AAT did, however, find that the portion of the payment which represented timing differences should be assessable.

The Federal Court overturned this decision stating that the central issue was whether the settlement payment represented the taxpayer's share of the net income of the partnership and not whether the amount represented ordinary income in the taxpayer's hands.

The Court found that the AAT had erred in law and therefore remitted the issue back to the Tribunal for further consideration.

Share Buyback Arrangement

Overtaking an earlier decision of the Full Federal Court, the High Court has found that the proceeds from the sale of sell-back rights granted by St George Bank were assessable as ordinary income.

In February 2001, St George Bank granted sell-back rights to its shareholders as part of an off-market share buyback. The sell-back right entitled the shareholder to sell back one of their shares to St George at a fixed price above the current market value of the shares.

The mechanics of the arrangement resulted in the taxpayer receiving and then disposing of her sell-back rights.

The High Court held (in a 4:1 majority decision) that whether a receipt is income depends upon its nature in the recipient's hands and

not the nature of the expenditure incurred by the other party.

The Court said that while the rights acquired by the taxpayer were a product of her shareholding, they were 'severed' from that shareholding, and accordingly, the market value of the sell-back rights was held to be ordinary income.

The Tax Office has identified that this case affects over 80,000 taxpayers and it will be contacting them to provide advice on the decision and what it means for them.

Changes to Small Business Taxation

In an attempt to standardise the eligibility criteria for small business tax concessions, the government recently released the Exposure Draft Tax Laws Amendment (Small Business) Bill 2007.

The current regulations require small business to undertake separate eligibility tests for tax concessions relating to CGT, GST, PAYG and FBT. The proposed Bill aims to simplify the system by defining a small business entity as one which has turnover of less than \$2 million. Eligible entities would have access to the following concessions:

- simplified trading stock rules;
- simplified depreciation rules;
- amended assessment period limited to two years;
- immediate deductions for expenses which were previously required to be deducted on a pro-rata basis; and
- accounting for GST on a cash basis, enabling taxpayers to claim input tax credits when they actually pay for acquisitions.

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.