

## Capital Gains Tax — Restructuring Jointly Held Shares

In a recent decision in *Johnson and Commissioner of Taxation* [2007] AATA 1322 (16 May 2007), the Administrative Appeals Tribunal (AAT) confirmed the Commissioner's view that the taxpayer was liable for CGT in relation to the restructuring of his joint holding of shares.

Under section 108–7 of the *Income Tax Assessment Act 1997* (ITAA 1997), individuals who own a CGT asset as joint tenants are treated as if they each owned an equal separate CGT asset. CGT assets include shares held in a company.

Broadly, disposal of a jointly held CGT asset would trigger CGT event A1 for each joint tenant under Subdivision 104–A of ITAA 1997. Accordingly, a capital gain is made if the proceeds exceed the asset's cost base or a capital loss is made if the cost base is greater than the proceeds received.

In this case, the taxpayer restructured the joint holding of his shares, such that each joint holder would hold 50% of the shares in their own right. The taxpayer contended that this restructure did not trigger CGT event A1 on the premise that it was always intended that each joint holder owned 50% of the shares in their own right. Accordingly, the restructure was merely giving effect to that intention.

The Commissioner, in reference to section 176 of the *Corporations Act 2001*, argued that a share register is taken to be an accurate record of events, in the absence of evidence to the contrary. In this case, the share register disclosed that the shares were held in joint ownership. The restructuring of the shares held by the taxpayer resulted in the taxpayer disposing of their joint interest of all the shares in return for 50% of the total number of shares. Accordingly, CGT event A1 would apply to the disposal of the joint interests in the shares.

The AAT found that there was no evidence to demonstrate that the share register was not accurate in describing the holding of the shares as joint ownership. This supported the Commissioner's position that CGT event A1 would apply to the taxpayer's restructuring of the shares and therefore the taxpayer was liable for any capital gain arising on the restructure.

Furthermore, the AAT also found that there was no rollover relief available that would disregard the taxpayer's capital gain made.

## Payment to Director Considered Bona Fide Redundancy

In a recent test case, *Long and Commissioner of Taxation* [2007] AATA 1269 (30 April 2007), the AAT held that an eligible termination payment (ETP) paid to an employee, who was also a director of the company, was a bona fide redundancy payment.

Broadly, an eligible termination payment is made where an individual's employment is terminated. Upon redundancy, part of the an employer payment can qualify as bona fide redundancy payment, and is excluded from the ETP where it satisfies certain criteria in accordance with the provisions set out in section 27F of the *Income Tax Assessment Act 1936* (ITAA 1936).

A payment is considered to be a bona fide redundancy payment where:

- it is made to a taxpayer as the consequence of termination of employment by way of bona fide redundancy;
- if paid after 1 July 1994, the payment is not from an eligible superannuation fund;
- the termination of employment occurred prior to the 65<sup>th</sup> birthday of the employee;
- in the case of the relationship not being at arm's length, the payment does not exceed an amount that could be reasonably expected to be paid to an employee who is at arm's length; and
- there is no agreement between the employer and employee for employment of the employee after the termination.

Where a bona fide redundancy payment is made, section 27A provides that a base amount plus an amount per completed year of service will be tax-free.

The individual (along with her husband and son) was a director of a company that installed and maintained satellite dishes under contract with another company. This was the only business activity conducted by the company. When this contractual arrangement was terminated, the business effectively ceased to exist. As a result, the individual, her husband and son were paid out their salary and a redundancy payment, which was equivalent to the maximum tax-free amount.

The Commissioner contended that because the taxpayer was a director of the company, the payment was not considered to be a redundancy payment as it was not paid in consequence of her dismissal on the basis of bona fide redundancy. He considered that the payment was made as a result of a voluntary decision made by the taxpayer, as director of the company, to terminate her own employment.

In addition, the Commissioner argued that the taxpayer and the company were not dealing at arm's length, and the payment exceeded what was reasonable as the amount was higher than that paid to arm's length employees of the company.

The taxpayer objected to the Commissioner's amended assessments and the AAT concurred, finding that the dismissal was not a voluntary action of the taxpayer, as it was clear there was no longer any work. The AAT also held that the amount paid to the taxpayer was not excessive as the taxpayer's role within the company was that of a senior employee, and that this amount could reasonably be expected to be paid to any other employee working in this capacity.

The Commissioner sought to use this case as a test case in determining whether or not an employee who is also a director is eligible to receive a bona fide redundancy payment. The AAT determined that this case could not set such a precedent, as each case has different circumstances that need to be examined when determining whether a particular payment is a bona fide redundancy. The AAT concluded that in this case the payment was a bona fide redundancy payment, and was therefore tax-free as it was within the relevant thresholds.

## **Capital Allowances — Black Hole Expenditure**

The Tax Office has recently released three ATO Interpretative Decisions, ATO ID 2007/87 to ATO ID 2007/89, in relation to business related costs referred to as 'black hole expenditure'. In particular, the ATO IDs cover the concepts of what are business-related costs and the possible exclusions applying in relation to depreciable assets and CGT assets.

### **Background**

Broadly, under section 40–880 of ITAA 1997, an entity may deduct certain business-related expenditure over five income years where, for example, that expenditure is not specifically deductible, included in a CGT cost base or specifically excluded under another provision. This residual deduction is often referred to as black hole expenditure.

Under section 40–880(2), the expenditure must be in relation to the following:

- the business;
- a business that used to be carried on;
- a business proposed to be carried on;
- the liquidation or deregistration of a company of which the entity was a member;
- the winding up of a partnership in which the entity was a partner; or
- the winding up trust that carried on business of which the entity was a beneficiary.

Subsections 40–880(3) to 40–880(9) provide exceptions and limitations in relation to the deductibility of business-related costs. In particular, these exceptions provide that a deduction is not available under section 40–880 to the extent that the expenditure:

- forms part of the cost of a depreciating asset that the entity holds, used to hold or will hold; or
- could be taken into account in the calculation of a capital gain or loss an entity may make.

### **Position taken in ATO IDs**

In each of the ATO IDs, the Tax Office looks at a different aspect of a situation involving a sole trader conducting a bus charter business. In the course of carrying on this business, the taxpayer sought to purchase a second hand bus for his fleet. The taxpayer incurred expenditure relating to airfares to view the bus and on the purchase of replacement tyres for the bus. Upon further inspection of the bus, the taxpayer decided not to purchase it. The taxpayer then sought to claim a deduction under section 40–880 in relation to the airfares and tyres.

In order to ascertain whether or not the expenditure undertaken by the taxpayer is deductible, it is necessary to first consider whether this expenditure (i.e. the taxpayer’s out of pocket expenses) qualifies as business-related expenditure within section 40–880(2). In particular, whether this expenditure is expenditure in relation to the business carried on by the taxpayer.

The extrinsic materials supporting section 40–880 provide guidance as to the interpretation of the statement ‘in relation to’ a business, and this includes expenditure on the profit yielding structure of the business.

The Commissioner concluded that activities in relation to acquiring buses were a necessary part of the trading operations of the taxpayer’s bus charter business. Further, the airfares and tyres were an essential step in the process of purchasing the bus. Accordingly, this expenditure qualified as expenditure in relation to the taxpayer’s business under section 40–880, irrespective of the final decision of the taxpayer not to purchase the bus.

Following the above analysis, once satisfied that the expenditure is in relation to the business carried on, it is necessary to consider the possibility of any limitations or exclusions applying. For example, taxpayers should consider whether one of the following exclusions (amongst others) may apply:

- the item forms part of the cost of a depreciating asset that the entity holds, used to hold or will hold; or
- the item could be taken into account in the calculation of a capital gain or loss an entity may make.

#### ***Depreciation exclusion***

In relation to the example above, although a bus falls within the definition of a depreciating asset, the above exclusion would not apply in respect of the airfares and tyres as the taxpayer did not ultimately hold the depreciating asset. In arriving at this conclusion the Commissioner determined that the tyres on a stand-alone basis would not constitute a depreciable asset as they are merely a component of the bus.

#### ***CGT exclusion***

In relation to the example above, a bus also falls within the definition of a CGT asset and ordinarily expenditure on airfares to purchase a CGT asset would be included in the cost base of the asset. However, as the taxpayer did not proceed with the purchase, the exclusion would not apply in relation to the airfares.

The tyres purchased by the taxpayer are a CGT asset, and expenditure on the purchase of these tyres would form part of the cost base of the tyres. Further, upon making the decision to abandon the tyres purchased, a CGT event will be triggered. The expenditure on the tyres would be considered in calculating a capital gain or loss from this event. Accordingly, the exclusion would apply to deny a section 40–880 deduction in relation to the expenditure on the tyres.

### **Conclusion**

In conclusion, the Commissioner held that the airfares and tyres were both expenditure in relation to the taxpayer's business. However, he held that because the expenditure on the tyres could be excluded from a deduction under section 40–880 on the basis that it could be taken into account in a CGT cost base, only the airfares were deductible over five years under section 40–880.

### **Additional information**

For a copy of ATO ID 2007/87: *Income Tax — Capital allowances: business related costs — in relation to your business* visit the ATO website at:

<<http://law.ato.gov.au/atolaw/view.htm?docid=AID/AID200787/00001>>.

For a copy of ATO ID 2007/88: *Income Tax — Capital allowances: business related costs — limitation to deduction — cost of depreciating asset* visit the ATO website at:

<<http://law.ato.gov.au/atolaw/view.htm?docid=AID/AID200788/00001>>.

For a copy of ATO ID 2007/88: *Income Tax — Capital allowances: business related costs — limitation to deduction — taken into account for capital gains tax (CGT) purposes* visit the ATO website at:

<<http://law.ato.gov.au/atolaw/view.htm?docid=AID/AID200789/00001>>.

## **Entitlement to an ABN — Assessment to be Made at Time Business is Commenced**

In a recent decision in *Applicant for an Australian Business Number and Registrar of the Australian Business Register* [2007] AATA 63 (20 February 2007), the AAT set aside a decision of the Registrar of the Australian Business Register to retrospectively cancel an entity's Australian Business Number (ABN).

In this case, the applicant applied for an ABN in May 2000 and specified in the ABN application that his business would conduct activities in 'metal products, steel pipes, bars, RHS to retailers and wholesalers'. The application was successful and the business was allotted an ABN. The applicant began to develop lathes as part of the new business.

By 2004, the applicant had decided not to pursue the activities of manufacturing lathes as it was not profitable. Accordingly, when the lathe manufacturing business was abandoned, it was replaced with a new proposed business. This business was associated with manufacturing art and decorative frames. The applicant's intention as part of the proposed business was that he would create paintings on the art frames, which would be framed by the decorative frames. He hoped to establish a very profitable business that would eventually involve the exhibition of these paintings. He commenced these activities by initially advertising for artists to make line drawings on canvas frames, on which he would complete paintings. These, in turn, would then be placed in the decorative frame and eventually displayed. However, this did not occur. A few of the artists that had responded to the applicant's advertisement displayed interest in purchasing the art frames from the applicant in the course of pursuing their own artistic activities and therefore the applicant sold a number of these frames to the artists.

The applicant also had a few other projects being conducted at the same time. One of the projects involved the marketing of a processed material and another project involved the use of a number of identical vehicles for the delivery of fine wine. This project did not proceed and the vehicles were sold.

The Registrar of the ABN register had determined that the applicant was not carrying on an enterprise because the applicant did not have a reasonable expectation of profit or gain, and decided to cancel the ABN for the period from July 2000 to the end of 2004. As a consequence of cancelling the ABN, the applicant would not have been entitled to input tax credits which he claimed in the sum of approximately \$25,000.

According to section 8 of *A New Tax System (Australian Business Number) Act 1999* (the Act), an entity is entitled to an ABN if the entity is 'carrying on an enterprise in Australia'.

Section 38 of the Act states:

- (1) An enterprise is an activity, or series of activities, done:
  - (a) in the form of a business; or
  - (b) in the form of an adventure or concern in the nature of trade...
- (2) However, enterprise does not include an activity, or series of activities done:
  - (b) as a private recreational pursuit or hobby; or
  - (c) by an individual... without a reasonable expectation of profit or gain.

Accordingly, although the applicant's proposed projects were unsuccessful or never launched, the AAT held that the applicant did continue to carry on a core business, which involved the manufacture and sale of products. In doing so, he used premises in the nature of a factory or workshop for which a substantial amount of rent was paid. Consequently, the applicant did have a business with respect to which there was a reasonable expectation of profit or gain, although that profit was not realised.

The AAT also held that the correct time for assessing the potential expectation of profit and gain is at the time the business commences and not with hindsight when a business subsequently does not become profitable. The AAT held that, on the facts, the applicant was carrying on an enterprise as evidenced by sales recorded on his Business Activity Statement. The AAT set aside the decision of the Registrar, and substituted a decision cancelling the ABN from 31 December 2004.

## **Superannuation Rates and Thresholds**

For more information on the rates and thresholds that apply from 1 July 2007 in relation to:

- superannuation contributions and benefits;
- employment termination payments;
- the superannuation guarantee; and
- co-contributions,

please visit the ATO website at: <[www.ato.gov.au/print.asp?doc=/content/60489.htm](http://www.ato.gov.au/print.asp?doc=/content/60489.htm)>.

## **Other Key Issues**

### ***Shortfall interest charge***

To read a Tax Office factsheet relating to the application and calculation of the shortfall interest charge (SIC) please visit the ATO website at: <[www.ato.gov.au/taxprofessionals/content.asp?doc=/content/67127.htm](http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/67127.htm)>.

### ***CGT improvement threshold***

The Tax Office has released Taxation Determination TD 2007/19: *Income tax: capital gains: what is the improvement threshold for the 2007/08 income year under section 108–85 of the Income Tax Assessment Act 1997?*, which outlines the changes to the CGT improvement threshold for the 2007/08 income year. To read the determination, visit the ATO website at:

<<http://law.ato.gov.au/atolaw/view.htm?docid=TXD/TD200719/NAT/ATO/00001>>.

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