

## Loss Not Deductible on Sale of Land

In a recent decision in *Price Street Professional Centre Pty Ltd v. Commissioner of Taxation* [2007] FCA 345, the Federal Court upheld a ruling handed down by the Administrative Appeals Tribunal (AAT), finding that a loss arising on the sale of land purchased as a capital asset was not deductible.

The applicant, a shelf company, came to be beneficially owned by a non-resident businessman, with the shares held on trust by his Australian solicitor.

The businessman had previously purchased a parcel of land in Queensland with the intention of developing the land to provide accommodation to overseas students. As the businessman was a non-resident, he was required to seek approval from the Foreign Investment Review Board to develop the land, which was subsequently granted, subject to the land being developed within 12 months.

In 1992, the businessman transferred the parcel of land to the taxpayer for \$1,450,000. Shortly after acquiring the land, the taxpayer entered into a lease of the dormitory with a third party. In the 1993 income year, the taxpayer decided to sell the land to a third party and in doing so created a large loss. In the 1994 income year, the businessman instructed the solicitor to wind up the company.

The income tax return lodged for the taxpayer company for the 1993 year originally disclosed an accumulated trading loss and a capital loss.

Some time later, a new accountant suggested that an error may have been made in the income tax return and advised that the loss should be treated as a revenue loss and not a capital loss. By this stage, the solicitor owned the company and he instructed that an amendment be lodged. In 1999, the company was selected for a Tax Office audit and an amended assessment was issued for the years in which the revenue loss was carried forward and, in addition, a penalty was imposed.

The applicant objected to the amended assessments on the grounds that the activities which gave rise to the revenue loss, were indeed activities in relation to a profit making scheme. In addition, the losses satisfied the continuity of ownership test, as at all times, the solicitor remained beneficial owner of the shares in the company. The AAT disagreed with the applicant on both counts. It found firstly that the land was a capital asset, and also found that both the continuity of ownership and same business tests had been failed in relation to the losses.

On appeal the Federal Court considered the following issues:

- were the losses incurred by the applicant allowable as deductions; and
- if they were, did the applicant satisfy the continuity of ownership test, or the same business test, to recoup those losses?

The applicant argued that the AAT, in coming to its decision, referred to the incorrect test in finding that the loss was referable to the sale of a capital asset. The applicant submitted that the AAT should have focused on whether or not the asset was acquired with a purpose of making a profit by sale and not whether the land was trading stock and the gross proceeds were on revenue account.

The Commissioner responded that the key issue was whether the loss incurred had the necessary connection with the applicant gaining or producing assessable income. The Commissioner argued that the mere realisation of an asset does not represent income, even if the realisation is carried on in an enterprising way. This is distinct from a gain or loss made in the operation of a business by carrying out a profit making scheme, which would prima facie give rise to income.

The Federal Court agreed with the AAT in principle that the loss incurred was of a capital nature. The Court noted that the land was purchased and used for the purposes of constructing student accommodation which generated rental income, which bore all the hallmarks of a capital asset. This fact did not change merely because the applicant in question was a corporate entity. Nowhere could it be found in evidence that either the businessman or the applicant held the land with the purpose of profit making by resale. In agreeing with the AAT's decision, the Court did not need to consider the issue of satisfying the continuity of ownership or same business tests.

The appeal was dismissed and penalties were upheld. The applicant has sought leave to appeal this decision to the Full Federal Court.

## **Timing of Asset Depreciation**

Taxation Determination TD 2007/5 provides guidance in relation to when a depreciating asset is considered to begin its decline in value. To read TD 2007/5, visit the ATO website at: <<http://law.ato.gov.au/pdf/td2007-005.pdf>>.

## **Change in Extent of Creditable Purpose**

Immediately prior to the end of each financial year, entities registered for GST need to consider the issue of adjustments for GST purposes. The Commissioner has recently released GST Ruling GSTR 2006/4, which outlines his position on the meaning of 'creditable purpose' and 'extent of creditable purpose' in the context of claiming the correct amount of input tax credits.

Ordinarily, if a registered entity makes an acquisition or importation and utilises the acquisition or importation solely or partly for a creditable purpose, it is entitled to claim an input tax credit. To claim input tax credits, the entity must estimate the 'extent' to which the acquisition or importation is for a creditable purpose. This implies that it is the planned use of an item at the time it is acquired that is significant when calculating the amount of input tax credits that can be claimed.

Division 129 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) affirms that the extent to which an acquisition or importation is for a creditable purpose affects the amount of the resulting input tax credit. However, when the extent of creditable purpose is changed by later events, and the actual use of an acquisition for a creditable purpose is different to the planned use at the time of acquisition, adjustments may need to be made. For example, where there is a change in the percentage of creditable use, the entity may be required to make an increasing/decreasing adjustment, consequently altering the amount of input tax credits first claimed upon acquisition.

In order to determine whether Division 129 operates, entities need to make sure they maintain accurate records of acquisitions and importations, including the value of acquisitions and importations and whether they relate to making taxable supplies. It is also important to track the business use of the acquisition.

Adjustment periods generally occur once a year and establish the timing of the adjustments for a change in creditable purpose. An adjustment period starts at least 12 months after the end of the tax period in which the attribution of the acquisition/importation is made and ends on 30 June each year. The value of the acquisition and whether the acquisition relates to making taxable supplies determines the number of adjustment periods. The number of adjustment periods for an acquisition that is related to making taxable supplies is as follows:

<b>Value</b>	<b>Number of adjustment periods</b>
\$1,000 – \$5,000	2
\$5,001 – \$499,999	5
\$500,000+	10

For example, an entity purchased video equipment for \$5,500 on 16 September 2004 for use in making taxable supplies. The acquisition is attributable to September 2004 as the entity accounts for GST on a monthly basis. At this time, the entity plans to use the acquisition solely for a creditable purpose. On the basis of the value of the expenditure and the above table, there are 5 adjustment periods. The first adjustment period is 30 June 2006, as this is 12 months after the end of the tax period in which the acquisition was made (30 June 2005). The remainder of the four adjustment periods will end on 30 June in subsequent years.

In relation to the first adjustment period, if the actual use for a creditable purpose is different to the planned use at the time of acquisition, the full input tax credit that could have been claimed on acquisition (assuming the acquisition was solely for a creditable purpose) is adjusted by that difference.

If the actual creditable use is greater than the planned creditable use, the entity has a decreasing adjustment, and it can claim a further amount of input tax credit on the acquisition. If the actual creditable use is less, the entity has an increasing adjustment. In other words, the Tax Office will take back some of the input tax credits previously claimed by the entity.

With the second and subsequent adjustment periods, actual creditable use for the entire period since acquisition is compared with the percentage creditable use at the end of the previous adjustment period. After the number of adjustment periods applicable to an acquisition have run their course, no further adjustment is required even if there is a change in creditable use.

There are many complications in the Division 129 adjustment provisions and it is advisable for entities to substantiate both the tracking and calculation of Division 129 prior to the year end Business Activity Statement (BAS) being lodged.

To read GST Determination GSTR 2006/4, visit the ATO website at: <<http://law.ato.gov.au/pdf/gstr2006-004c1.pdf>>.

## **Small Business CGT Changes**

These amendments to the small business CGT concessions received Royal Assent on 12 April 2007, and were largely unchanged from when they were first reported. To read the amendments to small business CGT concessions in the Tax Laws Amendment (2006 Measures No 7) Act 2007, visit the Commonwealth Law website at: <[www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/framelodgmentattachments/9B9347CFB00DDFECCA2572C100043DE4](http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/framelodgmentattachments/9B9347CFB00DDFECCA2572C100043DE4)>.

## **Loan Repayments Held to be Fringe Benefits**

In a recent decision in *Commissioner of Taxation v. Slade Bloodstock Pty Ltd* [2007] FCA 188, the Federal Court held that loan repayments made by a company to its owners were in fact in respect of their employment and were fringe benefits under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA).

The taxpayer, Slade Bloodstock Pty Ltd, was in the business of purchasing race horses and then forming syndicated partnerships for potential investors in each respective horse. The company was run and managed by Mr and Mrs Slade, who were also the sole shareholders. As with most start up operations, the company had become reliant on significant cash injections, which were contributed by Mr and Mrs Slade and booked as credit loan balances.

Periodically, Mr and Mrs Slade would draw down on the credit balances for their own day-to-day affairs as neither of them received a salary from the business, let alone any other distribution. Each amount drawn from the company for private expenses was treated as a repayment of the loans. The Commissioner disagreed with this treatment and sought to assess the periodical draw down of cash as a fringe benefit, upon which fringe benefits tax (FBT) applied and for which FBT returns should have been lodged.

Broadly, in accordance with section 136(1) of the FBTAA, a fringe benefit is defined as a right, privilege, service or facility which is conferred to an employee, or an associate of an employee which is in respect of the employee's employment. The taxpayer contended that the payments made were not in respect of an employer/employee relationship, but were simply a repayment discharging the company of its loan obligations. The taxpayer further contended that Mr and Mrs Slade were not employees as defined by the FBTAA.

The AAT initially concluded that no employment relationship existed between Slade Bloodstock and Mr and Mrs Slade. The AAT found that they would have been entitled to the repayment of the loan contributions to the company regardless of their employment relationship. The Federal Court overturned the AAT's decision agreeing with the Commissioner that a fringe benefit had indeed been provided, in accordance with section 136(1) of the FBTAA.

The Federal Court held that the AAT had erred in its decision in finding that a mere casual relationship existed between the company and Mr and Mrs Slade. The Court described that without their efforts as the sole employees of the company, no business would exist. In addition, the periodic drawing down of funds from the company was to discharge personal obligations of the employees including their mortgage payments and school fees. Therefore, the personal expenses of Mr and Mrs Slade were either paid directly by the company or by their own private credit cards which were subsequently reimbursed by funds transferred from the company.

The Court concluded that the decision of the AAT should be set aside, and the Commissioner should be allowed to assess Slade Bloodstock on the benefit provided to Mr and Mrs Slade.

This decision is on appeal to the Full Federal Court.

## **2007 Motor Vehicle Claims**

The updated rates for motor vehicle expense claims on a per kilometre basis for the 2006/07 income year are available at: <[www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/frame lodging attachments/C70DD69AFD5970AACA2572A6007F90BF](http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/frame lodging attachments/C70DD69AFD5970AACA2572A6007F90BF)>.

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