

# client alert | explanatory memorandum

September 2005

## Priority Private Binding Rulings

The Tax Office has released Practice Statement PS LA 2005/10 — Priority Private Binding Rulings (priority PBR), with the aim of delivering private rulings in a time frame that is consistent with applicant taxpayers' business needs.

Previously, the Tax Office would generally take at least six weeks to process a PBR application. This has resulted in many taxpayers choosing not to seek a PBR on the basis that the relevant tax situation required urgent resolution and the six-week time frame was too long. The Practice Statement recognises that by granting priority to appropriate ruling applications and processing them in a much shorter time frame, the Tax Office can work more closely with taxpayers and have a greater understanding of how tax law is being applied to major commercial transactions.

The Practice Statement outlines that a transaction requires the following characteristics to be classified as a priority PBR:

- a prospective transaction;
- of major commercial significance, and requires consideration of a company's board;
- time-sensitive;
- the tax outcome is critical; and
- the transaction involves a complex application of the law.

The applicant taxpayer is required to notify the Tax Office that they wish to apply for a priority PBR and must set out in the application the following documents:

- a full brief of the proposed transaction and all issues identified;
- all relevant information;
- a draft ruling;
- both the FOR and AGAINST positions fully argued; and
- time frames identified.

In order to speed up the processing of the priority PBR application, the Tax Office will assign a case manager to each application that meets the criteria as outlined. The case manager will be the Tax Office's representative and will deal directly with the taxpayer. As a result, the case manager has the responsibility to identify which areas of the Tax Office's expertise are required in processing the application and making sure those resources and specialists are readily available to work on the application.

The case manager and the taxpayer will meet in a pre-lodgment meeting and determine if a priority PBR is appropriate to the proposed transaction as described. Once deemed appropriate, the case manager will prepare a case plan outlining the steps that are required to be completed by each party, and appropriate milestones. Once all the relevant issues have been identified, the case manager and the taxpayer will agree to an expected completion and issue date.

For further information, and the actual process of applying for a priority private binding ruling, please review PS LA 2005/10 — Priority Private Binding Rulings at:

<<http://law.ato.gov.au/atolaw/print.htm?find&docid=PSR/PS200510/NAT/ATO/00001>>.

## Taxpayer's Burden of Proof

In *Samba v. Commissioner of Taxation* [2005] FCA 798, the federal court has dismissed a taxpayer's appeal on the grounds that the taxpayers didn't credibly prove that the Tax Office's amended assessments for the 1996, 1997 and 1998 income years were excessive.

The taxpayers, Mr and Mrs Samba, objected to the amended assessments on the grounds that the assessments were excessive. The taxpayers ultimately appealed and the matter was brought before the Administrative Appeals Tribunal (AAT). The AAT held in favour of the Tax Office on the grounds that Mrs Samba had not provided a satisfactory explanation of the circumstances in which she had received and expended cash sums over and above the monies declared in her lodged income tax returns. The taxpayers appealed on the basis that the AAT had made three errors at law in reaching its decision and the case went to the federal court.

Mr and Mrs Samba were a husband and wife with a history in horse training and trading. Mr Samba retired from horse training in 1995 and lodged personal tax returns up to the year ended 30 June 1995. Mrs Samba derived income as a part-time receptionist and disclosed this income in her lodged personal income tax returns for the income years ending 30 June 1996, 1997 and 1998.

The Tax Office began an audit of Mr and Mrs Samba in August 1997 to investigate their involvement in the buying and selling of horses. The purpose of the audit was to establish whether the taxpayers had access to a source of funds that had not been disclosed in their tax returns and, if so, whether these funds were assessable income.

Throughout its investigation, the Tax Office obtained information from the National Crime Authority (NCA), various state horseracing authorities, blood stock agents, horse trainers and banks. The Tax Office traced the cash spent by the taxpayers on horses and other items (credit card payments, travel expenses, investments etc.) in each year of the audit, and compared these amounts with disclosed funds.

At the conclusion of these investigations in March 2001, the Tax Office submitted that the taxpayers had an undisclosed source of funds totalling \$1,277,856 for the period 1 July 1995 to 30 June 1998. The undisclosed amount pertaining to each year is listed below:

Year	Amount
1996	\$378,961
1997	\$662,563
1998	\$236,332

The Tax Office considered that the undisclosed funds were assessable income derived jointly by the two taxpayers. The Tax Office subsequently issued amended assessments for Mrs Samba, assessing her on one-half of the undisclosed amount pertaining to each year.

In response to the investigations, the taxpayers submitted that the source of those funds was the winnings from Mr Samba's gambling on horses. The Tax Office suggested to Mr Samba in October 1997 that he maintain a record of his betting transactions. Mr Samba did not accept the suggestion at the time, but in July 2001, he provided a limited account of his betting activities from October 1997 to June 1998. Mr Samba provided evidence of cash deposits in accounts described as gambling wins, bookmakers' cheques and a record of his betting transactions for a nine-month period.

The AAT found many anomalies in the evidence, such as incorrect race meeting dates, incorrect race locations and some bets purportedly made during a time Mr Samba was overseas. In addition, a record of the names of outlets where the betting tickets were purchased was not provided.

As an alternative argument, Mrs Samba submitted that in the event that the AAT held that she and her husband carried on a business involving the purchase, upkeep, training and sale of horses, the amount shown in the audit report should also constitute allowable deductions representing cost incurred in carrying on that business.

Contrary to both of the taxpayers' arguments, the AAT held that the undisclosed funds were not the result of gambling activities or a horse-trading business but rather were obtained from an undisclosed 'joint enterprise' carried on by the taxpayers. The AAT held that the evidence provided in regard to the gambling records lacked credibility and did not convincingly identify the source of the funds.

In regard to the taxpayer's carrying on business argument, the AAT held that the expenditures identified in the audit report were not expenditures on the activities undertaken to generate the undisclosed source of funds but rather that the expenditures showed how the undisclosed funds were spent. The AAT held the taxpayer provided no additional evidence to show why the expenditures were allowable deductions against the undisclosed income.

Consequently, the AAT held that the undisclosed funds were assessable, as they were substantial, they were available for Mr and Mrs Samba's daily use and they were available throughout the audit period and were apparently replenished throughout that period. In addition, the AAT held that since the taxpayer had chosen not to identify the source of the funds, nor to contend the findings of the investigation, she was not in a position to dispute the assessability of the undisclosed funds.

The federal court reviewed the AAT hearing and considered the taxpayer's grounds to establish an error of law. Under section 14ZZK of the *Taxation Administration Act 1953*, if a taxpayer wishes to appeal against an assessment, the taxpayer has the burden of proving that the assessment was excessive. The taxpayer argued that the AAT required more than a satisfactory explanation for the source of the funds. However the federal court dismissed this argument and held that the AAT had found correctly that the taxpayer had not discharged the burden of proof to show that the assessments were excessive.

For further information please review *Samba v. Commissioner of Taxation* [2005] FCA 798, at:

<[http://www.austlii.edu.au/au/cases/cth/federal\\_ct/2005/798.html](http://www.austlii.edu.au/au/cases/cth/federal_ct/2005/798.html)>.

## **GST: Security Deposits**

The Tax Office has released draft GST Ruling GSTR 2005/D1 concerning the application of GST to deposits. The draft Ruling provides the Tax Office's views on the meaning of a deposit, the difference between a deposit and part-payment and the meaning of the forfeiture of a deposit.

Under current GST law, GST does not apply to deposits until the deposit is either forfeited or it forms part of the taxable supply (that is when the deposit ceases to be a deposit and becomes payment for a supply of services or goods).

Of clear importance to taxpayers is the Tax Office's view of when a deposit is considered not to be a deposit but, rather, a part-payment. Under current GST laws, a taxpayer is required to account for the full GST on a transaction (taxable supply) when either of two things occurs. The first is the receipt of part or full payment for the taxable supply and the second is when an invoice is issued. However, the taking of a deposit should not trigger any GST implications unless the deposit is forfeited, it forms part of the consideration for a taxable supply or the deposit is not a true deposit.

The Tax Office has advised in its draft Ruling that a deposit must be reasonable in terms of 'size'. That is, an amount considered to be too high for a deposit will be considered to be a part-payment and therefore trigger GST obligations. For example, if an electrical goods retailer takes a deposit of \$1,000 from a customer for goods with a sale value of \$3,000, under Tax Office policy the retailer will be required to account for the full GST on the transaction, being \$300, when in the mind of the retailer no GST transaction has actually occurred.

The Tax Office considers that, generally, a deposit of 10 per cent is reasonable and that parties who seek deposits of greater than 10 per cent must be able to show that they are at risk of significant losses in order to justify taking an amount higher than 10 per cent.

The factors that may be taken into account in considering what is reasonable are:

- unusual sale items that may be very difficult to sell (customer ordered, one-off items);
- use of specialised raw materials being applied to 'customised' transactions which cannot be used in other transactions;
- the supplier having to acquire specialised equipment in order to perform the service or make the goods;
- the length of time of the contract (the longer the time, the more chance and risk of default); and
- other extraordinary conditions of the contract.

Where conditions of these types apply, taxpayers could potentially seek to justify a larger deposit, without incurring a GST liability.

### **Implications for Taxpayers**

Many taxpayers take deposits of varying amounts. It is important to keep in mind that, in some cases, deposits of greater than 10 per cent may trigger a GST liability.

In such cases, the taker of the deposit is required to fund the GST on the full sale price even though they have not received the full amount. This may put a strain on the seller's cash flow. In such cases, a higher deposit may need to be taken in order to cover any GST liabilities which may arise.

One important thing to remember, however, is that the deposit must be a true security deposit in terms of the GST legislation. If the amount is in fact a part-payment for supplies made, then even if it is less than 10 per cent it will still trigger a GST supply in that tax period.

For further information, please review draft GST ruling GSTR 2005/D1 — Goods and Services tax — deposits held as security for performance of an obligation, at:

<<http://law.ato.gov.au/atolaw/view.htm?find&docid=DGS/GST2005D1/NAT/ATO/00001>>.

### **Simplified Rules for 'At Call' Loans**

The federal government has recently announced changes to simplify the rules in relation to 'at call' loans for small business. This will make it easier for small businesses to comply with complex debt/equity rules, reduce compliance costs and provide greater certainty.

For further information please review the press release 'At Call Loans to Small Business to be Treated as Debt' from the Minister for Revenue and Assistant Treasurer, at:

<<http://assistant.treasurer.gov.au/mtb/content/pressreleases/2005/063.asp>>.

### **CGT: Right to Use Property before Title Passes**

In ATO Interpretative Decision ID 2005/216, the Tax Office considered whether CGT event A1 (section 104–10 of the *Income Tax Assessment Act 1997*) or event B1 (section 104–15) occurs when the right to the use and enjoyment of a property is passed on to another entity before the transfer of title.

Broadly, CGT event A1 happens if you dispose of a CGT asset. CGT event B1 occurs if you enter into an agreement with another entity under which:

- the right to the use and enjoyment of a property you own passes to the other entity; and
- title in the property will, or may, pass to the other entity at or before the end of the agreement.

In the case described, the taxpayer purchased a residential property and entered into an agreement with another entity (their children) under which the other entity would use the property and meet all obligations for the property. It was also agreed that the taxpayer would transfer title to the property in five years.

When such an agreement is entered into, CGT event B1 would occur at the time the other entity begins using the property.

As no proceeds would have been received at that time, the proceeds will be taken to be the market value of the property at that time (section 116–30(1)).

When title passes to the other entity, CGT event A1 will also occur; however, in the situation where two CGT events are triggered, section 102–25 permits that the CGT event used is the one that is most specific to the situation.

CGT event B1 would be the most specific to this situation.

### **Exceptions**

The capital gain or loss calculated under CGT event B1 is disregarded if the title to the property does not pass to the other entity at or before the end of agreement. If this happens, the taxpayer must submit an amended assessment in the year that the agreement ended.

In the case described above, the title passed within the five years agreed and the gain or loss calculated under event B1 was relevant to the taxpayer’s situation.

### **Author Comment**

In this case, if the taxpayer parent acquires the property and provides immediate use and enjoyment to their children, (resulting in a disposal at market value as discussed above) no gain or loss should arise if there is no change in market value between the time of acquisition and the effective disposal to the children.

The ID does not consider the calculation of any gain or loss, or the potential impact of other amounts included in the cost base, such as stamp duty.

For further information please review ATO ID 2005/216 — CGT event B1: Right to use property before title passes at:

<<http://law.ato.gov.au/atolaw/print.htm?find&docid=AID/AID2005216/00001>>.

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