

Anti-avoidance Rules Applied to Wash Sale Arrangements

The Tax Office recently released Draft Taxation Ruling TR 2007/D7 regarding the application of the anti-avoidance rules to arrangements known as 'wash sales'.

'Wash sale' is an expression used to describe a transaction in which an asset is sold where there is no intention on the part of the seller to cease final ownership of the asset (e.g. the seller is still exposed to the economic risks of owning the asset). The Tax Office considers that such a transaction may come within the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936).

Part IVA is a general anti-avoidance provision that gives the Commissioner discretion to cancel all or part of a tax benefit which has been obtained in connection with a scheme put in place for the purposes of providing that benefit.

The ruling deals with arrangements put in place that give rise to a loss which is to be offset against a gain that has already been derived or is expected to be derived. The ruling also describes the circumstances in which the Tax Office may form the view that the sole or dominant purpose of entering into the wash sale arrangement was to obtain a tax benefit. These include:

- the manner in which the scheme was carried out seems out of the ordinary, contrived or complicated as compared to how the disposal of an asset to a third party is usually undertaken;
- the form of the scheme involves the disposition of an asset which creates a capital loss or allowable deduction for tax purposes, however the taxpayer continues to economically own or benefit from the same or similar asset;
- the timing of the transaction, including where the timeframe over which the scheme was carried out is short, and timing of the scheme matches the derivation of the capital gain or assessable income. In addition, there are no other related events which might explain the timing of the scheme and disposal;
- the result of the transaction is the creation of a capital loss and therefore a reduction in the amount of tax payable either through a reduction in capital gains or ordinary income, and an ultimate reduction in income tax payable; and
- the taxpayer disposes of the asset to persons who are controlled or influenced by the taxpayer, or have a family connection to the taxpayer.

The ruling indicates that under these circumstances, the Commissioner is likely to exercise his ability under section 177F of ITAA 1936 to either cancel the tax benefit or determine that the whole or part of the loss or deduction was not incurred by the taxpayer.

To read the full text of Draft Taxation Ruling TR 2007/D7: *Income tax: application of Part IVA of the Income Tax Assessment Act 1936 to 'wash sale' arrangements*, visit the ATO website at:

<<http://law.ato.gov.au/pdf/tr2007-d007.pdf>>.

Car Fringe Benefits — Operating Cost Method

The Tax Office recently released Interpretative Decision ID 2007/140, which outlines that where the operating cost method is used, a journey which is not business-related, and provides a small exempt benefit which increases the business use percentage, will be treated as business use.

Background

The taxable value of a car fringe benefit can be determined in one of two ways, either by the statutory formula method or the operating cost method.

Broadly, the statutory formula method seeks to apply a statutory fraction to a specially determined car value, where the fraction varies with the kilometres travelled by the car. This method is the default method of determining the value of the benefit if the employer does not express a choice about which method to use. It is also the default method where it provides a lower value, even if the employer has chosen to use the operating cost method.

The operating cost method seeks to determine the taxable value of a car fringe benefit based on the operating costs of the car during the period in which the benefit arises. Under this method, the taxpayer is required to keep a logbook recording use of the car for a continuous 12-week period to determine the business use of the car. The operating costs are then apportioned between the business and non-business use of the car for the period, and that portion which relates to the non-business use of the car represents the taxable value of the benefit.

The value of a car fringe benefit under the operating cost method is determined via the following formula:

$$[C \times (100\% - BP)] - R$$

C: is the operating cost of the car during the holding period.

BP: is the percentage of business use over the holding period.

R: is the amount of the recipient's payment attributable to the holding period.

Holding period

The holding period relates directly to the FBT year during which the employer held the car for the purpose of providing the fringe benefit.

Operating cost

The operating cost generally consists of the car maintenance and running costs, and includes items such as the registration, servicing and fuel costs for the car.

Business percentage

The business percentage component is the percentage of the total distance travelled by the car over the holding period that relates to business use. The business percentage is calculated by dividing the total business kilometres driven by the total number of kilometres driven, and displayed as a percentage. However, when calculating the taxable value of the car fringe benefit, the calculation of taxable value does not allow for adjustments relating to minor benefits.

Decision

The Tax Office has indicated that non-business travel which results in a minor benefit for FBT will still be treated as business use for the purposes of calculating the taxable value of the fringe benefit. By including this minor exempt benefit as business travel, the effective result is an increase the ratio of business kilometres to total kilometres of the car, and hence an increase in the business use percentage.

The interpretative decision concludes that minor travel should be included as business travel, therefore increasing the business use percentage, resulting in a reduction in the taxable value of the car fringe benefit.

For more information about Interpretive Decision ID 2007/140: *Car Fringe Benefits: Operating cost method — calculating taxable value when minor benefits that are exempt benefits are provided*, visit the ATO website at: <<http://law.ato.gov.au/atolaw/view.htm?docid=AID/AID2007140/00001>>.

Superannuation Contributions

The Tax Office recently released Interpretative Decision ID 2007/144, regarding whether a private company could claim a deduction under section 82AAC of ITAA 1936 for superannuation contributions made for the benefit of the directors, where the private company was in the business of passive investment. The interpretative decision indicates that a deduction can be claimed in relation to the superannuation contributions, provided that the directors are entitled to be paid for their services.

For more information on Interpretive Decision ID 2007/144: *Superannuation: Deductibility of superannuation contributions made for directors of a passive investment company*, visit the ATO website at: <<http://law.ato.gov.au/atolaw/view.htm?docid=AID/AID2007144/00001>>.

GST on Packaged Supplies

In a recent decision in *Food Supplier and Commissioner of Taxation* [2007] AATA 1550 (16 July 2007), the Administrative Appeals Tribunal (AAT) decided in favour of the Commissioner concerning the supply of promotional items given away with the sale of food products.

In this case, the entity was a food supplier that supplied products like instant coffee. Occasionally, the food products were supplied with non-food products such as alarm clocks, radios and cricket balls. Both items were branded with the entity's name, packaged together and sold as one item for the same price that the food would normally be sold for.

As the supply of food is GST-free in accordance with the GST law, the entity claimed that the supply of the packaged products was not for consideration on that basis, and because the food product was GST-free, no GST was payable.

The primary question was whether the promotional items attracted GST. The AAT concluded that there was consideration for the supply as a whole, including the promotional item. As the promotional items were not GST-free, the consideration should be apportioned, with GST applied to the non-food component. The AAT based its decision on the following elements.

Composite and mixed supplies

The AAT held that the supply was a mixed supply (i.e. it consisted of a supply of two separate items) and that the promotional item was supplied for consideration (even though it was marketed on the basis that it was being given away for 'free'). The AAT was not persuaded otherwise by the fact that the promotional package was being sold for the same price as that for which the food would normally sell without the promotional item. It noted that the 'promotion items have intrinsic value, will not be consumed with the food and are mostly unconnected with the food'.

The AAT held that the issue was not whether there was a mixed or composite supply but whether the promotional item was being supplied for consideration. There must be consideration for a taxable supply to exist.

Consideration

According to the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), a 'taxable supply' exists when there is a supply and the supply is made for consideration, 'except to the extent that it is GST-free'. Consideration includes 'any payment, or any act of forbearance, in connection with a supply'.

The entity claimed that the consideration was for the food and not the promotional items as they were 'free'. Based on the facts, the AAT held that the promotional items were being supplied for consideration even though they were marketed as being 'free' and the purchaser was making a payment 'in connection with' the supply as a whole. The AAT rejected the view that the promotional item was free and the package as a whole was being sold for the same price as that for which the food product would normally sell for without the promotional item. In deciding this view, the AAT noted that 'the promotional items could only be acquired in packages with the food products. The taxpayer would not supply them free of charge alone.' It was further pointed out that it is dangerous to associate the word 'free' with the lack of consideration.

Calculation of GST

While the AAT did not decide conclusively the basis on which the GST should be calculated, it concluded that the GST should be calculated in accordance with section 9–80 of the GST Act. In applying section 9–80, the Commissioner looked at the cost of the promotional item to the taxpayer, and calculated the amount of GST from the proportion which that amount represented of the price of the total package. The AAT indicated that in their 'tentative opinion' this approach was reasonable.

Commissioner's Discretion on Shareholder Loans

The Tax Office recently released Practice Statement PS LA 2007/20, which outlines how the Commissioner will exercise his discretion in relation the application of Division 7A of ITAA 1936 to shareholder loans.

Where a private company makes a loan or a payment to a shareholder or associate, Division 7A may operate to deem that the amount of the loan or payment is a dividend. However, where a deemed dividend arises, the Commissioner has the discretion to disregard the deemed dividend.

The statement outlines the circumstances in which the Commissioner may consider exercising his discretion in relation to shareholder loans, including where:

- it is clear in the Commissioner's view that the taxpayer has made a genuine mistake or inadvertent omission;
- the taxpayer has sought corrective action prior to 30 June 2008;
- the deemed dividend from the shareholder loan occurred between 30 June 2001 and 30 June 2006; and
- the taxpayer's income tax returns lodgments are up-to-date.

The Commissioner advises in the practice statement that his discretion will apply to any taxpayer who has a shareholder loan issue and satisfies the four points above.

In the practice statement, the Commissioner outlines the circumstances in which he considers that 'corrective action' has been undertaken by the taxpayer including, for example:

- where a deemed dividend has arisen as a result of a shareholder loan, the taxpayer has put in place a loan agreement which is in accordance with the section 109N of ITAA 1936. The loan agreement must be made in writing and satisfy the following criteria:
 - a loan has a benchmark rate of interest as set out by the Tax Office; and
 - if the loan is secured by a mortgage over real property, the maximum term is 25 years, or seven years if the loan is unsecured; and
- the taxpayer has made a payment or payments which equate to the minimum yearly requirement as set out by the loan agreement.

For more information about Practice Statement PS LA 2007/20, visit the ATO website at:

<http://law.ato.gov.au/pdf/ps07_020.pdf>.

STS Taxpayers

The Tax Office has released two publications relating to accessing the simplified tax system, specifically relating to calculating STS group turnover and the 25% entrepreneur's tax offset.

For more information on the 25% entrepreneur's tax offset, visit the ATO website at: <<http://www.ato.gov.au/businesses/content.asp?doc=/content/67700.htm>>.

For more information about STS group turnover, visit the ATO website at: <<http://www.ato.gov.au/businesses/content.asp?doc=/content/23950.htm>>.

The publications indicate that this will be the last year in which the STS will operate in its current format. New changes have been introduced making further amendments for small business taxpayers.

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