

# Rundles Report

tax news | views | clues

March 2014

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## Business sale earn out arrangements back in spotlight

The Coalition government has decided that it will proceed with a long-standing proposal to improve the current tax treatment of earnout arrangements.

Earnout arrangements are a common way of structuring the sale of a business. Under a standard earnout arrangement, business assets are sold for a lump sum plus a right to further payments that are contingent on the performance of the business for a specified period following the sale.

The earnout right typically reflects the uncertainty surrounding profitability, the value of goodwill and cash flow projections. Under the current rules, the calculation of the tax on the sale is based on the lump sum as well as the estimated value of the earnout right, which means the seller could end up paying tax on an amount not yet received. The proposed changes aim to resolve this, as well as other tax issues.

The government has indicated that it intends to pass legislation to implement this proposal during 2014.

**TIP: Although the tax changes would not apply until changes to the law are formally passed, the ATO has released details of administrative treatment that allows a transitional approach for certain cases. Contact our office for further details.**

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## ATO administration of valuations under review

The Inspector-General of Taxation, Mr Ali Noroozi, is reviewing the ATO's administration of valuation matters.

"Australia's tax and superannuation laws are increasingly relying on concepts such as market value", Mr Noroozi said. Valuations may be required for a variety of assets, transactions, businesses and liabilities for taxation purposes. For example, market valuations may be required in order to access the capital gains tax concessions for small businesses.

"Whilst there may be sound economic reasons for using such concepts, their use has resulted in a growing need for taxpayers to undertake significant valuation work", Mr Noroozi said. The Inspector-General said the main source of taxpayer concern is the compliance burden associated with valuations. He said that, "critically, valuations are inherently subjective and can be a source of significant uncertainty leading to ATO disputes which can be frustrating, time-consuming and costly".

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## ATO data-matching targets bank card sales

The ATO has announced that it will request and collect data relating to credit and debit card sales of merchants for the periods from 1 July 2012 to 30 June 2014 from various financial institutions, including the four major banks in Australia: Australia and New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation.

The ATO says the data acquired will be matched with certain sections of its data holdings to identify non-compliance with various tax obligations, including under-reporting or omitting business income. Records relating to 900,000 merchants are expected to be matched under the program.

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## Motel business refused GST tax credits

A motel business has been mostly unsuccessful before the Administrative Appeals Tribunal (AAT) in a dispute with the ATO concerning claims for input tax credits.

Following a tax audit, the Tax Commissioner refused the taxpayer's input tax credit claims of around \$88,500 for the quarterly tax periods from 1 January 2007 to September 2010. This was on the basis that there was a lack of documentation to substantiate the claims. The Commissioner had sought documentation from the taxpayer on various occasions, including sampling documentation for the June 2010 quarter.

However, the representative of the motel business was unable to produce all of the relevant documentation. He argued that a substantial amount of the records sought were lost due to flooding of the motel office in December 2008 and that he had been unable to respond to the requests for information as he was overseas.

Based on information provided before the proceedings, the Commissioner accepted that the taxpayer was entitled to some \$16,000 of the original claim. The AAT found that this was acceptable in the circumstances. However, it affirmed the Commissioner's stance on the balance of the claim. The AAT also rejected the taxpayer's additional input tax credit claim of around \$28,000. The AAT said the taxpayer had been given "every opportunity to produce documentation or other evidence to support his claims for imputation credits". It further noted that the taxpayer was unable to produce documents or other evidence that demonstrated that the credits that the Commissioner had allowed were insufficient.

**TIP: It is essential for small businesses to have adequate record-keeping practices. A key consideration is to make sure that records can be understood by more than one person. Another consideration is to document how records are kept (ie paper records or electronically), what records are maintained and where they are located, and how back-up records are managed.**

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## Tax changes following mining tax repeal

The Coalition government late last year introduced a Bill into Parliament to repeal the mining tax. A number of other tax measures and concessions associated with the mining tax are also proposed to be repealed or revised.

Under the changes, the small business instant asset write-off threshold will be reduced from \$6,500 to \$1,000. This means that, with effect from 1 January 2014, small business entities (ie generally, those with an aggregated turnover of less than \$2 million) will be able to claim a deduction for a value of an eligible depreciating asset that costs less than \$1,000 (rather than \$6,500) in the income year in which the asset is first used or installed ready for use. If implemented, this proposed change will return the threshold to the level it was prior to changes made by the previous Labor government. The special rules allowing accelerated depreciation for motor vehicles will also be discontinued with effect from 1 January 2014.

The Coalition government also proposes to delay the phased-in increase in the superannuation guarantee charge percentage to 12% by two years. This means that the superannuation guarantee rate would:

- pause at 9.25% for the years starting on 1 July 2014 and 1 July 2015;
- increase to 9.5% for the year starting on 1 July 2016; and
- gradually increase by half a percentage point each year until it reaches 12% for years starting on or after 1 July 2021.

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## Local government payments in ATO sights

The ATO has previously sought from local government council and shire authorities throughout New South Wales, Victoria, Queensland, and Tasmania details of entities who provided contractor services in the 2011 and 2012 financial years. The ATO says it will now acquire details of entities receiving taxable payments from local government council and shire authorities throughout the country covering the 2011 to 2014 financial years.

The ATO says it will electronically match the information collected with its own data holdings to identify instances of non-compliance with tax lodgement and payment obligations. Records relating to 20,000 to 40,000 individuals are expected to be matched under the program.

**TIP: Be aware of the ATO's use of electronic data-matching to check tax compliance. According to the ATO, most people are willing to meet their tax and superannuation responsibilities. However, the ATO says it uses a range of measures, including electronic data-matching, to identify the small minority of taxpayers who do not fully meet their responsibilities.**

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## Tax bill for transfer of land to joint development trust

A taxpayer (the trustee of a trust) has been unsuccessful before the Federal Court in arguing against a capital gains tax bill following a transfer of land it owned to a "joint venture trust". The transaction took place in August 1998 and the amount in dispute totalled some \$7.6 million. The joint venture trust was set up to facilitate commercial development of the land owned by the taxpayer as well as adjacent land owned by other owners.

The taxpayer argued that there was no change in the beneficial ownership of the land and that there should therefore be no tax liability on the transfer. However, the Court held that the transaction was taxable and that the exceptions to the tax liability as argued for by the taxpayer did not apply in the circumstances. The Court also affirmed the Tax Commissioner's decision to impose an administrative penalty at the rate of 25% of the tax shortfall.

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## Forestry managed investment scheme losses refused

An individual has been unsuccessful before the Administrative Appeals Tribunal (AAT) in a matter concerning losses claimed in tax returns for the 2006 and 2007 income years.

The individual had invested in a forestry managed investment scheme and the losses from that investment, which amounted to \$1 million over the two years, had been claimed on the basis that he was a member of a partnership. During an audit of the taxpayer's affairs, the taxpayer disclosed to the Tax Commissioner that the partnership losses should not have been claimed and that the 2007 return had been lodged by his tax agent without his authority. The Commissioner refused the claims for losses and issued amended assessments. However, the Commissioner also treated the taxpayer as a person who had made a voluntary disclosure and he decided to reduce the shortfall penalty originally imposed by 80%.

The taxpayer objected to the amended assessments and penalty on the basis that an ATO officer had led other taxpayers to understand that the investment he had made in the scheme could be made. However, the AAT affirmed the Commissioner's decision. It held, among other things, that the returns had been lodged by the taxpayer's tax agent with his authority and that he had failed to discharge the onus of showing that the scheme had not been entered into or carried out for the sole or dominant purpose of the individual obtaining a "scheme benefit". This meant that in the circumstances, the Commissioner could, under the tax law, refuse the losses claimed and issue the amended assessments.

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## Property rental deduction claims mostly refused

An individual has been mostly unsuccessful before the AAT in challenging the Tax Commissioner's decision to refuse a variety of deductions relating to rental properties. The individual, who worked full-time as an industrial chemist, owned rental properties with her husband and had done so for many years. In the 2003, 2004 and 2005 income years, they owned nine rental properties. The taxpayer declared a net rental loss for those years, arguing that she carried on a business of letting rental properties.

The AAT agreed that the taxpayer was carrying on a business of letting rental properties and allowed some claims, including part of her telephone, computer and other work-related expense claims.

However, it refused most of the other disputed expenses, which included car expenses, travel expenses, repair and maintenance costs and the costs of investment courses and seminars. The AAT refused the claims, saying they either lacked the necessary connection with the individual's income-producing activities, or there was insufficient evidence to support the claims.

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## **Brothers in business together, but not a partnership**

The Supreme Court of Western Australia has found that two brothers were not in a partnership. The two brothers had spent some 30 years in business together – their businesses included an accounting practice, property development, share dealings, corporate consulting and farming. However, the Court heard that their relationship deteriorated and culminated in a dispute as to whether they were in a partnership in those years – one brother (referred to by the Court as John, who was an accountant and tax agent) said no, while the other brother (referred to by the Court as Tony, who was not an accountant) said yes.

The Court said thousands of documents were filed, but none of them were a partnership agreement between the two brothers. It said the various deeds of settlement establishing trusts presented in evidence provided proof of the brothers' intentions to trade exclusively through corporate entities and trusts and not to trade as partners. At the time of writing, it is understood that one of the brothers (Tony) is seeking an appeal against the decision.

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## **Daughter found to be "puppet director" of company trustee**

A married couple has been successful before the AAT in a matter concerning access to the capital gains tax concessions for small businesses. The key issue in dispute concerned a trust (in respect of which the couple were beneficiaries) and the trust's entitlement to the concessions in connection with a capital gain made on the sale of assets by the trust in the 2008 income year. Specifically, the main issue was whether the trust was controlled, either alone or with others, by the couple's daughter.

The Commissioner argued that the daughter was a controller of the trust and that, therefore, the trust was connected with other entities controlled by the daughter, with the result that the trust breached the eligibility requirements for any of the capital gains tax concessions sought by the couple. However, the AAT found that the husband alone was the person who controlled the trust for the purposes of the small business concessions. Therefore, entities connected with the daughter, who was found to be a mere "puppet director" of the company trustee, did not have to be taken into account in determining the trust's entitlement to the concessions claimed by the couple.

In finding that the husband alone controlled the trust, the AAT noted, among other things, that the trust was not accustomed to acting in accordance with the daughter's wishes independently of her father's wishes in circumstances where her wishes and directions were actually her father's.

**TIP: The tax law provides four concessions to reduce eliminate and/or provide a roll-over for a capital gain made on an eligible asset that has been used in a small business. These concessions include the "15-year exemption", the "50% reduction", the "retirement exemption" and the "roll-over" concession.**

**The availability of the concessions is subject to satisfying a range of conditions, and these rules can be tricky to apply in practice – improperly claiming the concessions can have devastating consequences. Please contact our office for further information.**

# Noel's News



## ***Film Review – by Maria Marson***

***Need for Speed*** - Starring: Aaron Paul (star of *Breaking Bad*),  
Domenic Cooper, Imogen Poots

I recently saw the movie “**Need for Speed**” with my 14 y.o. son Scott and his school friend James. It was not the movie we intended to see at first but in the end we walked out of the cinema pumped.

If you love fast exotic cars like the Shelby Mustang, Testarossa, Bugatti, Lamborghini, just to name a few, this movie is a must see for all petrol heads and it won't disappoint. A slick and intense movie filled with chases, crashes, jumps and a high octane adventure.

The movie is about a young man, Tobey Marshall, a motor mechanic and street car racer framed for a manslaughter he didn't commit by NASCAR driver, Dino Brewster. On his release from prison, Tobey is set on revenge with plans to beat Dino in the high stakes De Leon cross country speed race and save his struggling garage business.

With his loyal crew, Tobey defies the odds and proves that the underdog can still finish first.

A quote that sums up this movie is ..... *“I feel the need, the need for Speed”*



## ***Restaurant Review – by Mark Lisle***

### ***Bistro Thierry – 511 Malvern Rd, Toorak***

If you don't like French cuisine, don't read any further.

You can't get any more French than *Bistro Thierry*. Once you arrive at the restaurant, there is no mistaking that it is French. Once you enter, the ambience is even more obviously French. The décor is French, the waiters are all French and the menu is classically French. All the classic French dishes are there... French onion soup, escargots, steaks with classic French sauces, French fries, soufflé, crème brulee, etc. I think the steaks are top class and the meal sizes are generous, which is always a winner with me.

There are plenty of French wines on the wine list of course, but there is also a good sprinkling of quality Australian wines. For the champagne lovers, there is a wide variety of French champagnes on offer at varying prices.

Overall, I think *Bistro Thierry* is reasonably priced, considering the quality of the food and service, and well worth a visit.



## ***Sporting Predictions – as seen by Brad Roach***

### **AFL**

The 2014 AFL season has kicked off with a few upsets already in the first round. My top 8 at the opening of the season is Fremantle, Hawthorn, West Coast, Sydney, Geelong, Richmond, Essendon and North Melbourne. The grand final will be played out again by Hawthorn and Fremantle with Fremantle winning their first AFL premiership. Looking ahead to the Brownlow Medal, the top three vote getters will be Joel Selwood, Nathan Fyfe and Jobe Watson.

### **GOLF**

The next major golf championship is the US Masters to be held at Augusta. The Australian golfers are again well placed to win this tournament after Adam Scott won this event last year, the first time by an Australian. Will an Australian win again this year? I think so, this time it will be Jason Day by a shot with Rory McIlroy and Adam Scott tied for second.

### **SOCCER – A LEAGUE**

The A-League finals are about to commence for the 2013-2014 season. Brisbane Roar will be the A-League premiers over the Western Sydney Wanderers.

### **TWENTY20 WORLD CUP**

The Twenty20 World Cup is currently under way in Bangladesh. Australia lost their first round match to Pakistan which will make it difficult to progress to the finals. I expect the final to be played out between India and Sri Lanka with India being crowned the 2014 World Twenty20 Champions.

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