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Client Information Bulletin

Re-structure may save tax

The reduction of the corporate tax rate to 30% from 1 July opens an 18.5% gap between the highest marginal rate and the corporate rate.

A number of clients are taking the opportunity to review the entities in which they hold interests in businesses and other assets to ensure they are legally paying the minimum tax rate.

'The reduction of the corporate tax rate to 30% from 1 July opens an 18.5% gap between the highest marginal rate and the corporate rate.'

In some instances, we are advising clients not to hold assets such as investment properties in a corporate structure. The further drop in the Company tax rate may now make this more attractive.

There are other considerations, such as capital gains tax and dividend streams. For instance, if shareholders require an income stream from the investments, the effective tax rate will not change. The personal marginal rate, less the franking credit, will be paid upon receipt of the dividend.

Government's Tax Election Policies

The election is over! We have summarized the major points to taxation matters as announced during the election campaign.

1. No increase in the rate of GST, no roll back.
2. The introduction of a First Child Tax Refund for children born after 1 July, 2001.
3. Increase the fully deductible superannuation amount to \$5,000 for self-employed people.
4. Reducing the 15% superannuation surcharge to 10.5% over 3 years.
5. Allow superannuation contributions of up to \$1,000 per annum to be made for minors.
6. Allowing couples who are members of accumulation funds to split their superannuation contributions.
7. Requiring superannuation contributions to be made quarterly.
8. Extending the tax concessions for the venture capital sector, by providing venture capital limited partnerships with flow-through tax treatment from 1 July, 2002.
9. Enhancing the tax exemption for certain foreign source income of expatriates who are resident in Australia for less than four years.
10. Reviewing the capital gains tax treatment for departing residents.

Dismissal of Casual Employees

Until recently, regulations prohibited casual employees with fewer than 12 months service from making an unfair dismissal claim.

The Federal Court has declared this law invalid.

This means casual employees engaged for only a short period can sue the employer for unfair dismissal.

'Until recently, regulations prohibited casual employees with fewer than 12 months service from making an unfair dismissal claim.'

The Industrial Relations Commission will no doubt explain how it will deal with the implications of the case. It is likely that the Federal Government will step in with new legislation to address the decision.

In the meantime, employers need to be aware that they don't presently have the luxury of dismissing casual staff without the potential for repercussion and, therefore advice should be obtained when planning to dismiss such an employee.

Loan decision creates interest

The Federal Court recently ruled that interest is tax deductible after a business has ceased operation and the business loan is refinanced.

The Court overruled a previous decision and found that interest paid on a business loan was tax deductible not only after the business ceased, but also after a subsequent refinancing of the original loan.

In this case, the taxpayer operated a business in partnership with her husband until her husband's death.

The taxpayer continued to repay the partnership loan after the business had ceased, and the loan was subsequently refinanced. She claimed tax deductions for all interest payments made on both loans.

The Court found that there was still sufficient nexus between the interest tax deduction and the obligation to repay the principal and the interest incurred whilst operating the business.

An important point was that the taxpayer refinanced to secure a lower interest rate and would have otherwise struggled to repay the original loan.

This case contrasts with earlier decisions in which interest on loans refinanced in similar circumstances was considered non-deductible after the refinancing.

Please note that the Australian Tax Office have indicated that they will appeal this decision.



Bonuses not deductible until paid

The Federal Court has recently ruled that employee bonuses accrued at year end are not tax deductible to the employer until paid the following year.

The key facts of the case were as follows:-

- bonuses were paid to employees at the discretion of the company;
- bonus estimates were accrued monthly but not settled until the following year;
- employees were not advised whether they would receive a bonus until the following financial year;
- no employee had a legal entitlement to be paid a bonus, through there was a clear *expectation*, understanding and commitment, and bonuses were a significant component of remuneration; and,
- bonuses were actually paid in the following year.

The Court held that even through there was a *commercial certainty* that an amount would be paid, this was distinct from a *legal liability* to pay. In addition, it was also ruled that the deduction was not available at year end, because at the stage, the amount was incapable of being calculated.

Renouncing Trust Interest

This is topical at the moment, particularly for recipients of Centrelink benefits, who are beneficiaries in Trusts.

A Tax Office Draft Determination has highlighted the CGT consequences of a beneficiary renouncing their interest in a discretionary trust. An interest is renounced, for example, when a beneficiary abandons or refuses to accept their interest or entitlements.

The Draft Determination provides that beneficiaries with no interest in the trust before exercise of any discretion by the trustee (say, to distribute income or capital), are unlikely to make a capital gain or renunciation.

However, a capital gain may arise where an interest is renounced after the trustee has exercised its discretion in favour of a beneficiary, or where a beneficiary has a default interest. In such cases, the interest will have a value.

Renunciation will result in a disposal of the interest for no consideration, but the CGT provisions could deem market value consideration, resulting in a capital gain.

It may be argued that the Draft Determination takes a rather technical position, which could produce potentially harsh and inequitable outcomes.



GST – Bad Debt Write-off Time

It's been over 12 months since the introduction of the GST and it's now time for entities to consider whether or not they have any GST adjustments relating to bad debts.

Some time ago, the Tax Commissioner issued a ruling relating to the application of GST to bad debts. Leaving aside the 12-month provision, the Commissioner considers there is an ability to write off a debt as bad if:

- the debtor, if incorporated, is in liquidation with insufficient funds to pay the debt; or,
- the supplier is unable to trace the debtor, and objective examination of all the facts indicated there is little or no likelihood of recovering the debt

Under the bad debt provisions the supplier has a decreasing GST adjustment, and the acquirer has an increasing GST adjustment for a tax period if:-

- a taxable supply or creditable acquisition was made;
- the whole or part of the consideration for the supply has not been received or provided;
- the supplier writes off the whole or part of the debt, or a part of the debt has been overdue for 12 months or more;

and,

- the supplier has previously remitted GST on a BAS. In the case of the acquirer, the increasing adjustment will result from a previously claimed input tax credit.

The adjustment is 1/11th of the amount written off or overdue by 12 months or more. The adjustment can only relate to that part of the debt arising from a taxable supply.

Where a debt that was the subject of a previous adjustment is recovered in part or in full, the supplier and acquirer must reverse the adjustment (either in total or in part, as the case requires). The reversal is made in the tax period the debt is recovered.

Be sure to leave a Will!

An interstate Estate is risky.

The Statute Law Amendment (Relationships) Act 2001 will come into effect soon. This Act significantly amends the Administration and Probate Act by altering the order of distribution where a person dies intestate (i.e. without a valid will).

The amendments address the discriminatory treatment of defacto partners of persons who die intestate. Under the present statutory scheme of distribution that applies where a person dies without a Will, defacto partners do not receive any distribution from their deceased partner's estate. The estate is instead distributed to the deceased's spouse, and/or nearest next of kin in accordance with a statutory formula.

However, the amendments will introduce a degree of uncertainty and potential litigation that previously did not exist. The amendments may also in certain circumstances create inequitable outcomes.

A key aspect of the amendments to the statutory scheme of distribution is the replacement of "spouse" with "partner". "Partner" is defined to include a spouse and a "domestic partner".

The act defines "domestic partner" to be either someone who was living with the deceased at the time of his or her death "...as a couple on a genuine domestic basis..." for a continuous period of two years prior to the deceased's death; or someone who was living with the deceased at the time of his or her death, "...as a couple on a genuine domestic basis..." irrespective of the time involved, provided they are a "parent" of the deceased's child and that child is under the age of 18 years at the time of deceased's death.

"Parent" is defined to include a domestic partner who has "...day to day care and control of the child and with

whom the child is ordinarily resident..." This definition of a partner would appear to open the door to claims for distribution from short term domestic partners at the expense of the deceased's children. It is also not clear whether a person still qualifies as a "domestic partner" if he or she no longer acts as a "parent" after the partner's death.

The act also contemplates the co-existence of a spouse and a domestic partner and provides for an apportionment of the share that presently is distributed to the spouse. The act does not, however, contemplate the existence of more than one domestic partner, nor does it provide for an apportionment between two domestic partners.

The uncertainty present in the definition of "domestic partner" may delay the Grant of Probate and the grant of letters of administration (i.e. Permission to take control of the property of the deceased). The Registrar of Probate may refer such applications to the Court.

This will greatly add to the cost of administering the estate of a person who dies without a Will.

These amendments reinforce the message that everyone should have a current Will in order that their Estate is distributed in accordance with their wishes.

Travel expenses disallowed

A recent High Court decision confirmed the Taxation Office disallowance of deductions claimed by a taxpayer travelling between two places of unrelated income earning activity. The case involved travel between a taxpayer's farm (where he resided and also conducted a deer farming business) and Sydney Airport (where he reported to work as a pilot). The Commissioner of Taxation disallowed the deduction claimed for expenses incurred in

travelling between the farm and the airport.

The Court held that the taxpayer was not entitled to a deduction for travel between two places of work because the expenses were not related to deriving income from either activity.

The taxpayer's expenditure was not incurred in the course of his employment as a pilot, nor in the course of his deer farming business. The travel occurred in the intervals between the two income producing activities. In this respect, they are no different from expenses incurred in travelling from home to work, which is not deductible.

The Federal Treasurer has indicated that an amendment will be made to legislation to "maintain deductibility for relevant expenses incurred in travelling between two places of unrelated income earning activity to accord with the Commissioners long held views as expressed in published rulings and Taxpack".

The amendment will retain deductibility for expenses incurred in traveling:-

- directly from one job to a second job.
- from usual workplace to an alternative workplace, and
- between the alternative workplace and home.

Christmas Office Hours

Our office will be closed 24, 25, 26, 31 December and 1 January 2002.

Disclaimer:

The contents of this publication are general in nature and we accept no responsibility for persons acting on information contained herein without first consulting us