

TAX UPDATE

October 2010

These Tax Notes include commentary on the following topics:

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- › Increased assessment for income tax and excise duty - Sogo Duty Free Pty Ltd v Commissioner of Taxation, Federal Court
- › Part IVA Tax Scheme – RCI Pty Ltd v Commissioner of Taxation, Federal Court
- › Scheme Failed to Transfer CGT Liability – AATA 724, Re MacMahon, Administrative Appeals Tribunal

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Bills Reintroduced to Parliament

The following tax related Bills which lapsed prior to the election, have been reintroduced to Parliament:

- › Tax Laws Amendment (2010 Measures No 4) Bill 2010: this Bill is substantially the same as it was pre-election except for updates to the list of Deductible Gift Recipients named in the Bill. The Bill also includes GST and third party payment adjustments, CGT scrip-for-scrip rollover alignment to takeovers covered by the Corporations Act 2001, an increase to the medical expenses tax offset claim threshold from \$1,500 to \$2,000. The proposed amendments have various application dates.
- › The package of R&D Bills has been reintroduced and contains some minor changes from their original form. The changes clarify that the new R&D incentive supports experimental activities for the purpose of generating knowledge in the applied form of new or improved materials, etc. The new R&D tax incentive provides eligible entities with a tax offset for expenditure on eligible R&D activities. The rate of the tax offset and whether it is refundable depends primarily on the aggregated turnover of the R&D entity.

Draft Legislation – First Home Saver Accounts

Treasury has released for comment, draft legislation that will increase the flexibility of First Home Saver Accounts (FHSA).

Under the current legislation, if an individual with a FHSA purchases a house within 4 years of opening the FHSA, the balance of any funds in the account is transferred to their superannuation fund. The proposed amendments will allow individuals in this situation to retain their FHSA and will allow for the funds to be paid into their approved mortgage after the end of the 4 year minimum qualifying period.

Comments on the draft legislation are due by the 4th of November.

Income Derived on Receipt of Property – Tagget v Commissioner of Taxation, Full Federal Court

In this case the taxpayer has been unsuccessful in their appeal to the Full Federal Court regarding the amount of income derived upon the transfer of land.

In 1998 the taxpayer had an agreement with a property developer to provide services in return for a parcel of land which was to be transferred after certain conditions had been met. Following litigation, the taxpayer received a parcel of land in September 2005. As it was received as remuneration for services, it was common ground that the land received was on revenue account and was assessable on a cash receipts basis.

The taxpayer argued that the value of land to be included in his income should be the value of the land at the date of entering into the 1998 agreement as that was the date he received a valuable right. The Court rejected this argument as the right to receive the land was subject to the achievement of subsequent conditions. For a taxpayer using the cash basis of returning income, the point at which income is derived is the date that cash or property in kind, is received.

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Trustee in Liquidation not Entitled to be Indemnified from Trust Assets - Commissioner of Taxation v Bruton Holdings Pty Limited (In Liquidation), Federal Court

In this case, the corporate trustee of a trust entered voluntary liquidation on February 2007. After that date the Commissioner issued a Notice of Assessment on the trust for income tax payable of some \$7.7mil. The Commissioner also issued a notice to a creditor of the trust requiring the creditor to pay its account directly to the Tax Office as opposed to the trust.

The trustee in liquidation commenced proceedings against the Commissioner and was eventually successful in the High Court where it was held that the Commissioner could not issue a notice to the creditor when the trustee was in liquidation.

During the current proceedings the Commissioner contended that the trustee in liquidation has no right to be indemnified from the trusts assets, for the costs it incurred in the litigation.

The general principle is that a trustee is entitled to be indemnified out of the assets of the trust for debts incurred in the course of performing its duties as trustee. However, in this case the company was a former trustee, not a 'serving' trustee. This is because the company ceased to be a trustee when it went into liquidation. Instead the company was a bare trustee, with limited duties and rights. As bare trustee, the legal proceedings were not part of its duties. Accordingly the Federal Court held that the company had to bear all the costs of the litigation. As a result there will be more funds available in the trust to satisfy the Commissioner's income tax assessment.

The corporate trustee has lodged an appeal against this decision.

Increased Assessment for Income Tax and Excise Duty - Sogo Duty Free Pty Ltd v Commissioner of Taxation, Federal Court

In the Federal Court the taxpayer has lost their appeal in relation to increased assessments of income tax and excise duty.

The taxpayer's business involved selling duty free products, including cigarettes to prospective overseas travellers. The invoices in question related to sales of some 46,017,670 cigarettes to the crews of visiting ships. The Commissioner claimed that the sales were made domestically and the prices shown on the invoices were understated, the reasoning being that:

- › the invoices were dated with dates for which the relevant ship was not in port in Australia; and
- › the invoices were made out to crew members who were not listed as crew members of the relevant ship.

The Commissioner amended the income tax payable by the taxpayer based on the quantity of the cigarettes sold as per the invoices and published recommended wholesale prices.

In order to supply the goods excise free the legislation requires a number of conditions to be satisfied. The Court held that the taxpayer failed to discharge its onus of proof regarding who the cigarettes were sold to and at what price. Accordingly the sales were deemed to have been delivered for home consumption and therefore subject to excise duty, and the Commissioner's method in determining the understatement of income was appropriate.

Part IVA Tax Scheme – RCI Pty Ltd v Commissioner of Taxation, Federal Court

The Federal Court has confirmed the Commissioner's application of Part IVA to cancel the tax benefit obtained by the taxpayer on transactions involving its sale of a US subsidiary.

The Australian taxpayer (part of the James Hardie Group) owned 100% of a US subsidiary. The taxpayer sold the shares in the US subsidiary to another US member of the group, but prior to the sale, the US subsidiary paid a \$318mil dividend (exempt from tax in Australia) which significantly reduced the market value of the shares in the US subsidiary. The shares were then transferred at their reduced market value.

The taxpayer argued that the two transactions were not a single scheme and that their dominant purpose for the dividend was to make the Australian operations more profitable and for the share sale, to restructure their business in the US market.

The Court held that the two transactions were part of a single scheme and if that scheme had not been entered into, the taxpayer would nonetheless have disposed of the shares in the subsidiary as part of the restructure, which would have resulted in a significant CGT liability. In finding the dominant purpose of the scheme was to obtain a tax benefit, the Court noted that the payment of the dividend took place at a time when the plan to restructure the operations into the US was well underway. Further the US subsidiary had to borrow significant amounts from another group member in order to fund the dividend payment.

Scheme Failed to Transfer CGT Liability – AATA 724, Re MacMahon, Administrative Appeals Tribunal

In this case the Tribunal found in favour of the Commissioner, confirming that the arrangement entered into by the taxpayer did not affect his liability to Capital Gains Tax (CGT).

The taxpayer agreed to sell his shares in a technology company to a third party on the basis that he would be retained as an employee. Unbeknown to the purchaser, the taxpayer arranged for the equitable interest in his shares to be first transferred to a related unit trust while he retained legal title to the shares. The taxpayer was entitled to a sign on fee and salary from the purchaser which he directed be paid to a 'Stichting' (an entity formed under Netherlands law). The Stichting advanced funds to the taxpayer via a credit card from a bank in the Cayman Islands.

The Tribunal held that the trust arrangement had no affect. As such the taxpayer remained the legal and beneficial owner of the shares, and that no relevant CGT event was triggered by the transfer of shares to the trust. The CGT liability on ultimate disposal of the shares to the third party purchaser therefore, remained with the taxpayer.

Even if they were to conclude otherwise, the Tribunal stated that Part IVA tax avoidance provisions would clearly apply. The amounts received under the employment arrangement were held to be assessable income as the taxpayer's direction to have the amounts paid to the Stichting did not change their status. In addition the taxpayer did not provide sufficient proof that the funds advanced via credit card were true loans and therefore the funds were held to be assessable income.