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TAX UPDATE

September 2010

These Tax Notes include commentary on the following topics:

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- › Labor Government Proposed Tax Policies
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Rural Community Bank Exempt from Tax - Wentworth District Capital Ltd v Federal Commissioner of Taxation, Full Federal Court

This case concerned the country town of Wentworth, NSW, whose sole bank closed in September 1996. As a result the community of Wentworth travelled a 1 hour round trip to Mildura (Vic) to do their banking. The bank closure had a negative impact on the town's local economy as the locals often did their shopping etc whilst banking in Mildura. Members of the Wentworth community approached the Bendigo Bank for assistance and by March 1999 a community bank was opened in the town. The taxpayer (WDCL) was incorporated to provide premises and staff to a subsidiary of the Bendigo Bank who conducted the banking operations.

The question before the Federal Court was whether WDCL was exempt from income tax as an association 'established for community service purposes'. The company's constitution stated that its dominant purpose was to promote community banking services for the benefit of the community who have a particular need by reason of age, disablement etc.

Explanatory material which aids in interpreting the legislation, noted that the need for certain activities in a community could include the circumstances of living in a remote area. The Court held that the purpose of WDCL was to facilitate the provision of banking services in Wentworth by making it commercially viable for the Bendigo Bank to return to Wentworth. In a town with no face-to-face banking services this provided a substantial real and tangible benefit to the community. Whilst the arrangement with the Bendigo Bank required WDCL to further the interests of the Bendigo Bank it would be unrealistic to suggest that this was the dominant purpose of WDCL. Accordingly the Court concluded that WDCL was entitled to income tax exempt status.

Labor Government Proposed Tax Policies

As Labor has now formed Australia's first minority Federal Government in 70 years, below is a reminder of some of Labour's election tax policies:

- › Businesses that undertake capital works to improve the energy efficiency of their existing buildings - from 2 stars or lower to 4 stars or higher - can apply for a one-off bonus tax deduction.
- › Small businesses can write off assets costing up to \$5,000 from 1 July 2012 and will have a lower company tax rate of 29% from 1 July 2012. Larger companies will access the reduced tax rate from 1 July 2013.
- › Labor will continue to pursue mineral resource tax reform.
- › Labor is committed to deliver the redesigned Research and Development (R&D) tax credit

Also of note is an amendment to the 2010 Federal Budget proposal regarding the 50% tax discount on interest income (for the first \$1,000 of interest income). The application date of the policy will be delayed by a year and it is now proposed to commence from 1 July 2012.

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Foreign Tax Credits Cancelled due to Tax Scheme - Citigroup Pty Limited v Federal Commissioner of Taxation, Federal Court

In this case the Federal Court has upheld the Commissioner's application of Part IVA tax avoidance, to cancel the tax benefit derived by the taxpayer in the form of excess foreign tax credits.

The taxpayer was the Australian head company of Citigroup. In a complex transaction, the taxpayer acquired Hong Kong interest bearing bonds. The interest coupons attached to the bonds were immediately sold for a lump sum payment. In Hong Kong the proceeds of sale were assessed for tax on a gross basis. In Australia however, the income was taxed on a net basis resulting in a significantly lower tax liability than that in Hong Kong. As a result the taxpayer obtained some \$12mil in excess foreign tax credits which was available to be set off against other foreign income.

In determining whether the Part IVA tax avoidance provisions applied to the transactions, the Court considered the factors outlined in the legislation. Of note were the following:

- › Form and substance of the scheme - the scheme was complex. Furthermore, the financial and tax consequences for the taxpayer flowed primarily from what occurred on day one when the interest coupons were sold.
- › The time at which the schemes were entered into - it was relevant that the sale of the interest coupons occurred on the last day of the year of income. This was also the first year in which the taxpayer was required to file an Australian tax return on a consolidated basis (thereby needing to include more foreign sourced income to which the excess foreign tax credits could be applied).

Accordingly, the Court concluded that the taxpayer entered into the bond transactions with the dominant purpose of obtaining a tax benefit, and that "absent the foreign tax credits, the [scheme] did not make sense".

Out of Time to Claim Input Tax Credits - AATA 620 Re Australian Leisure Marine Pty Ltd, Administrative Appeals Tribunal

In this case the client understated their claim to Input Tax Credits (ITCs) in their original June 2005 quarter Business Activity Statement (BAS). Despite becoming aware of the error in 2005, the taxpayer did not lodge a revised BAS until August 2009.

Under the Taxation Administration Act 1953 taxpayers are not entitled to a refund of ITCs, unless they notify the Commissioner of their entitlement within 4 years from the end of the tax period in which the entitlement to the ITCs arose. As the first notice given to the Commissioner was the revised BAS lodged in August 2009, and this exceeded four years since the end of the June 2005 tax period, the AAT confirmed that the taxpayer was not entitled to the ITCs. The AAT was of the opinion that neither the Commissioner nor the AAT have the discretion to extend the 4-year time period.

No share trading business existed - AATA 576, Re Smith, Administrative Appeals Tribunal

In this case the AAT has found in favour of the Commissioner, concluding that the taxpayer (an employee of Babcock and Brown), was not carrying on a business of share trading.

The AAT considered the general principles from established case law. These included:

- › Profit making intention: in the AAT's view, the evidence indicated that the taxpayer did not have the intention of being a share trader, until after his tax returns were lodged. The taxpayer did not take profits when they were available which a share trader would generally do.
- › Repetition and regularity of activities: the length of time that the taxpayer held shares was longer than a share trader would have been expected to and there were long intervals between transactions. Further, the AAT noted that a lot of the shares traded were those held in entities of his employer to which he was subject to trading restrictions which would hamper any regularity of trading.
- › Operating in a business-like manner, records: It was not given significant weight that the taxpayer also had a full time job. The concern for the Tribunal however, was that the taxpayer could not provide an indication of how much time was spent on the share trading activities.

Accordingly the AAT concluded that the taxpayer was an investor with the result that any losses made by the taxpayer were treated as capital losses and not revenue losses.

ATO View Pending High Court Decision on Deductibility of Education Expenses Against Youth Allowance

The ATO has announced that until the High Court decision is made on the case of Federal Commissioner of Taxation v Anstis, it will continue to apply its Ruling TR 98/9 when deciding whether or not self education expenses are deductible.

Previously the Full Federal Court allowed self education expenses of Ms Anstis to be claimed as a deduction as it held they were necessarily incurred in the gaining of assessable income, that being the students Youth Allowance support income. This decision goes against the ATO's established view that self education expenses are not deductible against payments under certain Commonwealth educational assistance schemes.

State Revenue Ruling DA.052 - Lease Provisions - General Application

The Victorian State Revenue Office (SRO) has issued a Revenue Ruling to provide guidance on the operation of the lease provisions of the Duties Act 2000 (Vic). Under the Act, a grant or surrender of a lease can be subject to stamp duty if the lease effectively transfers rights in the underlying land similar to a straight sale/purchase transaction. The Ruling outlines the factors the State Commissioner will consider in applying the lease duty provisions, such as the consideration payable and the term of the lease and any rights/options to purchase the leased land.