

### TAX OFFICE TARGETS WEALTHY AUSTRALIANS

On 7 April 2008, the Federal Commissioner of Taxation announced the release of a booklet titled '*Wealthy and wise: a guide to managing your taxation obligations*' which is aimed at people who control \$30m or more in net wealth.

The Commissioner indicated that the ATO will be undertaking 200 risk reviews as well as commencing 40 audits during this financial year. The Commissioner also noted that the HWI Taskforce has increased in numbers to 181 people.

The booklet outlines issues likely to attract ATO attention, including:

- (a) tax performance that varies substantially from business or economic performance;
- (b) significant variations in tax payments that are inconsistent with economic indicators;
- (c) unexplained losses;
- (d) a history of aggressive tax planning by individuals or their adviser;
- (e) tax outcomes that are inconsistent with the intent of newer law;
- (f) discrepancies between lifestyle and reported income;
- (g) private assets treated as business assets;
- (h) non-disclosure or lack of transparency in offshore dealings, especially involving tax havens, banking secrecy and low tax jurisdictions;
- (i) distortions and inconsistencies in market valuations.

The ATO has indicated that high net wealth individuals are being identified by:

- (a) state land titles offices;
- (b) property sales databases;
- (c) Australian Securities Exchange and commercial share registry data;
- (d) annual investment income reports from investment institutions;
- (e) overseas revenue authorities and financial institutions;
- (f) state government registration authorities and insurance companies; and
- (g) other federal agencies such as AUSTRAC, ASIC & the Department of Immigration & Citizenship.

**Argyle Comment:**

***It is important to understand that the ATO is targeting HWI based on unusual patterns identified. Advisors need to ensure that High Wealth Individuals fully understand the need to ensure that their taxation affairs are in order, and that where unusual patterns as set out above do exist, they can be explained with documentary evidence and relative ease.***

### ATO TARGETING RENTAL PROPERTY BORROWING EXPENSES

The ATO is focusing on errors in relation deductions for borrowing expenses.

Ordinarily, deductions in relation to borrowing expenses are spread over 5 years or the loan term (if the loan term is less than 5 years).

Common issues identified by the ATO include:

- (a) Stamp duty: Stamp duty in connection with the purchase of the property is not a borrowing expense, but rather forms part of the cost base of the property for CGT purposes.
- (b) Borrowing expenses: Only when the borrowing expenses are \$100 or less can they be claimed in full in the year that they are incurred.

**ATO TARGETING RENTAL PROPERTY BORROWING EXPENSES** continued

(c) Apportionment problems: The problem here is that borrowing expense deductions are claimed in full where a loan used to purchase a rental property is also partly used for private purposes. Borrowing expenses can only be claimed in respect of the part of the loan that relates to the investment, and not the private portion used for other purposes.

**Argyle Comment:**

***The three areas set out above have been identified by the ATO quite easily. Errors can quite often be determined quite easily determined reviewing settlement statements provided at the time of purchase of a property. Advisors should ensure that these documents are obtained from clients on purchasing property, and subsequent refinancing of loans.***

**WASH SALES - TAXPAYER ALERT 2008/7**

Following the release of TR2008/1 earlier this year, dealing with Wash Sale arrangements, the ATO has on 18 April 2008 issued Taxpayer Alert 2008/7 titled 'Application of Part IVA to Wash Sale Arrangements'. The type arrangements this alert covers is where a taxpayer disposes of, or otherwise deals with a capital gains tax (CGT) asset to generate a capital or revenue loss, but where in substance, there is no significant change in the taxpayer's economic exposure in the asset.

Examples of mechanisms to carry out wash sale arrangements covered by this Taxpayer Alert and where Part IVA might be relevant are discussed in paragraph 4 of TR 2008/1 which sets out the ATO view in relation to wash sales.

Aside from the application of Part IVA to disallow a tax benefit, the ATO states that any entity involved in the arrangement will be considered a promoter of a tax exploitation scheme.

**Argyle Comment:**

***Advisors need to ensure that clients engaging in what may potentially be considered a wash sale, are clearly informed of the risks associated with doing so where the objective is to avoid tax. Similarly where it is possible that a genuine transaction may be considered a wash sale, it is important that minutes of meetings as well as other documents are all in order, properly documenting the purpose of such a transaction.***

**DRAFT SMSF RULING 2008/D2 - ACQUIRING ASSETS FROM RELATED PARTIES**

The Draft explains how the prohibition on a SMSF trustee acquiring assets from a related party applies to the contributions of assets to an SMSF by a member or related party. Section 66(1) of the SIS Act, provides that a trustee or investment manager of an SMSF must not intentionally acquire an asset from a related party of the fund unless one of the exceptions applies to the acquisition (i.e., market value acquisitions of business real property, listed securities or an in-house asset under 5%).

A "related party" is defined in section 10 of the SIS Act to include a member or Part 8 associate of either a member or a standard employer-sponsor. A Part 8 associate includes a relative and entities that are majority owned or controlled by a member or a standard employer sponsor, partners and relatives. The Draft states that whether a trustee intentionally means to acquire an asset from a related party is a matter that either requires direct proof or may be established by drawing an inference from the relevant circumstances.

The Draft also explains that the arrangements discussed need to be considered in the context of the other relevant SIS provisions, including:

- (a) the sole purpose test (section 62);
- (b) the prohibition on lending money to a member or relative (section 65);
- (c) prohibition on placing a charge over a SMSF asset (SIS regs 13.14);

**DRAFT SMSF RULING 2008/D2 - ACQUIRING ASSETS FROM RELATED PARTIES** continued

(d) prohibition on borrowing (section 67);

(e) arm's length dealings (section 109); or

(f) in-house asset rules (section 71).

**Argyle Comment:**

***As taxpayers and trustees of SMSF's become more excited contributing to SMSF's, advisors need to ensure that potential investments and contributions do not breach the related party rules. This is a major focus area of the ATO in relation to contributions and investments, particularly now with the new section 67(4) of the SIS Act.***

**SMSF BORROWING MONEY - TAXPAYER ALERT TA 2008/5**

The ATO has now released TA 2008/5 which is concerned with arrangements under which the trustee of a SMSF enters into certain limited-recourse borrowings, which may not meet the conditions in subsection 67(4A) of the SIS Act and/or related rules and regulations.

The ATO states that arrangements which exhibit one or more of the features set out below may give rise to taxation and superannuation regulatory issues, including whether:

- Monies advanced by a member or related party at zero or less than a commercial rate of interest could be characterised as a contribution to the SMSF. This may result in the trustee/member having to pay excess non-concessional contributions tax.
- Monies advanced by a member or related party at greater than a commercial interest rate of interest may result in:
  - a breach of the sole purpose test outlined in section 62 of the SIS Act, on the basis that the excessive interest rate may mean that the SMSF is not being maintained solely for the purpose of providing superannuation benefits, and/or
  - the trustee breaching paragraph 65(1)(b) of the SIS Act, which prohibits the trustee from giving financial assistance to a member of the SMSF or to a relative of such a member using the resources of the SMSF.
- Interest capitalised may result in the arrangement failing to meet the requirement that the money borrowed is or has been applied for the acquisition of an asset under paragraph 67(4A)(a) of the SIS Act.
- A personal guarantee of the type may result in recourse being made to the assets of the SMSF other than the asset acquired (or any replacement) in the event that the guarantee is enforced against the trustee as the principal debtor, contrary to the intent that the exception in subsection 67(4A) of the SIS Act only applies to limited recourse borrowings.
- An asset of the type prohibited by trustees of acquiring may result in breaches of the SIS Act or SIS Regulations.

The ATO has also confirmed that existing fund assets cannot be placed into a limited recourse borrowing without breaching the SIS regulatory requirements.

**Argyle Comment:**

***Advisors need to ensure that Taxpayers and Trustees fully understand that requirements in entering into arrangements of this nature. The ATO has made it very clear that they are focusing on a number of key points.***

### SMSF DETERMINATION SMSFD 2008/2 CALCULATING THE MARKET VALUE RATIO OF AN SMSF'S IN-HOUSE ASSETS

Draft SMSFD 2007/D3 now replaced with this determination states that it is not permissible for a SMSF, when calculating the market value ratio of in-house assets for the purposes of s 75 of the SIS Act, to value its assets at historical cost.

It replaces Draft SMSFD 2007/D3 and is essentially the same in its conclusions, except that it deals with all potential in house assets that may be held by a SMSF.

An SMSF must not acquire an in-house asset (to which an exception does not apply) if the market value ratio of the SMSF's in house assets exceeds (section 83 of the SIS Act) 5%, or would exceed 5% if the asset was acquired. It adds that the valuation of in-house assets is also relevant to section 82 of the SIS Act, which requires trustees to dispose of in-house assets if, at the end of a year of income, the market value ratio of the SMSF's in-house assets exceeds the 5% limit.

The general formula for working out an SMSF's market value ratio of in-house assets in s 75(1) requires working out the "Number of whole dollars in value of in house assets of the fund" and "Number of whole dollars in value of all the assets of the fund". The Tax Office says s 10(1) defines "value" to mean market value. An SMSF is therefore required to value all assets of the SMSF at market value whether in-house assets or not.

#### **Argyle Comment:**

***This Determination serves as a reminder to Trustees and advisors to Trustees of SMSF's that current market values must be considered at the end of each income year where a trustee is relying on the 5% rule for non excepted in house assets.***

### SMSFR 2008/D3 - SMSF'S: BUSINESS REAL PROPERTY FOR THE PURPOSE OF THE SIS ACT

The ATO has released a draft ruling which provides guidance on the definition of the term 'business real property' for the purposes of the SIS Act.

Sub-section 66(5) of the SIS Act defines business real property as:

- any freehold or leasehold interest of the entity in real property; or
- any interest of the entity in Crown land, other than a leasehold interest, being an interest that is capable of assignment or transfer; or
- if another class of interest in relation to real property is prescribed by the regulations for the purposes of this paragraph - any interest belonging to that class that is held by the entity;

where the real property is used wholly and exclusively in one or more businesses (whether carried on by the entity or not), but does not include any interest held in the capacity of beneficiary of a trust estate.

The draft provides that an interest can only be business real property if the underlying land satisfies the business use test. The business use test requires the real property be used wholly and exclusively in one or more businesses, whether or not that business or those businesses are carried on by the relevant entity. The Draft states that in general, the character of the real property's use determines whether the business use test is satisfied. This will depend on questions of fact and degree. A holistic assessment of all facts and circumstances relating to the use of the property is made when working out whether the test is satisfied.

The status of an interest in real property as business real property must also be determined at a particular point in time. The ATO notes that paragraph 66(2)(b) of the SIS Act provides that the question must be considered at the time when an SMSF acquires an eligible interest in real property from a related party.

### SMSFR 2008/D3 - SMSF'S: BUSINESS REAL PROPERTY FOR THE PURPOSE OF THE SIS ACT continued

#### **Argyle Comment:**

***Trustees and Advisors need to be careful in determining whether a particular property comes within the definition of Business Real Property when acquiring real property from related parties. It is extremely important that proper records are kept as proof of use of a property in circumstances where a property is not necessarily commercial in nature, but for the purposes of the SIS Act satisfies the definition of business real property.***

### TD 2008/8 - DIVISION 7A REQUIREMENTS FOR THE PURPOSES OF SECTION 109N OF THE 1936 ACT

This TD which was previously issued in draft form as TD 2007/D19 is increasingly relevant as the self correction deadline for Division 7A loans approaches (i.e., 30 June 2008). It explains that the entire agreement between the parties must be in writing including:

- the names of the parties;
- the loan terms (that is the amount of the loan and the date the loan amount is drawn,
- the requirement to repay the loan amount, the period of the loan and the interest rate payable);
- that the parties named have agreed to the terms; and
- when the written agreement was made, for example the date it was signed or executed,

for the purposes of paragraph 109N(1)(a) of the 1936 Act.

The TD explains that an agreement that is partly oral and partly in writing is not an agreement in writing for the purposes of this paragraph. It explains that if a formal written loan agreement between the parties does not contain all the essential elements, the requirement of paragraph 109N(1)(a) may still be satisfied provided there is supporting written evidence of the remaining elements of the agreement between the parties.

#### **Argyle Comment:**

***Advisors need to identify Division 7A issues and ensure that their clients take advantage of the self correct deadline which is approaching. Going forward Advisors also need to ensure that relevant documentation is in place as required by section 109N of the 1936 Act.***

### DIXON ATF THE DIXON HOLDSWORTH SUPERANNUATION FUND v FCT FINANCIAL DETRIMENT NOT RELEVANT TP REMISSION OF PENALTIES

#### Facts

The Full Federal Court has allowed an appeal by the Commissioner from an AAT decision in which the Tribunal varied down to 25% a penalty imposed on a taxpayer for the wrongful claiming of a input tax credit by the trustee of a superannuation fund on the purchase of commercial property that was sold as a going concern.

The initial BAS lodged by the Taxpayer did not seek to claim an input tax credit for the purchase of the property. At a later stage, the taxpayer engaged a new tax agent to lodge an amended BAS which incorrectly claimed an input tax credit of \$171,491. The Commissioner detected the error before the payment of the ITC & imposed an administrative penalty of 50%.

The taxpayer objected to the penalty. The Commissioner disallowed the objection and the taxpayer applied to the AAT. The Tribunal concluded that the penalty imposed was harsh in the circumstances because no loss of revenue to the Commissioner arose and decided in favour of the taxpayer.

The Commissioner then appealed to the Federal Court which set aside the AAT decision. The taxpayer then appealed to the Full Court.

## DIXON ATF THE DIXON HOLDSWORTH SUPERANNUATION FUND v FCT FINANCIAL DETRIMENT NOT RELEVANT TP REMISSION OF PENALTIES continued

### Decision

The Full Court stated it was irrelevant that the false or misleading statement had been detected before payment by the ATO, & that the discretion to remit penalties is not dependant on financial detriment suffered by the Commissioner as GIC normally accounts for that.

## AAT CASE, RE CHALMERS AND THE LYNTON CHALMERS SUPERANNUATION FUND AND FCT PENALTY UPHELD FOR CLAIMING INPUT TAX CREDIT WHERE VALID TAX INVOICE NOT HELD

The AAT has upheld a penalty imposed by the ATO against taxpayers who claimed an input tax credit without holding a valid tax invoice.

### Facts

In June 2005, the taxpayers entered into a contract to acquire a unit in Perth with the intention of using it as an office. Clause 18.2 of the Contract provided that '*unless otherwise expressly agreed in the contract, the seller must not apply the margin scheme on the purchase price*'. It was agreed in the Contract that the seller could apply the margin scheme.

The taxpayers sought a tax invoice from the Vendor who maintained that the property was purchased as a residential apartment, and that on that basis it would not issue a tax invoice. The taxpayers relied on Contract, in particular assuming that the Vendor would not apply the margin scheme to the Purchase Price in breach of contract. The taxpayers took the view that the margin scheme had not been applied.

In April 2006, the taxpayers lodged a BAS for the period 1 January 2006 to 31 March 2006, claiming the ITC in respect of the property purchase, whilst not having obtained a tax invoice from the Vendor. The Commissioner subsequently imposed a penalty for the making a false or misleading statement, resulting in a GST shortfall of \$48,182.

### Decision

The AAT said that, while it may be the case that the election by the Vendor to use the margin scheme was a breach of the contract relating to the Property, that was a matter between the parties and not the ATO. In the Tribunal's view, the Taxpayers did not provide a valid basis for claiming the ITC's in relation to the Purchase of the Property. It noted that the taxpayers had made no attempt to ascertain whether the margin scheme had been applied and claimed the ITC as if they held a valid tax invoice in respect of the supply.

The Tribunal found that the imposition of the penalty of 25% of the shortfall amount was appropriate.

### **Argyle Comment:**

***The case highlights a number of issues when acting for a purchaser:***

- ***the need to carefully review a contract for sale of land prior to exchange of contracts;***
- ***the need to check the ABR register to ascertain that a Vendor is registered for GST prior to both exchange and settlement of a purchase;***
- ***the need to insist on receipt of a valid tax invoice from a Vendor on settlement and not assume it will be provided after settlement; and***
- ***the importance of insisting that Taxpayers hold a valid tax invoice prior to claiming ITC on capital acquisitions.***

## ATO TP DATA MATCH ASX SECURITIES RECORDS

The ATO has announced that it will request and collect identity and transaction details pertaining to securities held in all ASX listed entities for data matching purposes. The ATO aims to identify non-compliance with CGT, income tax and GST obligations. Whilst the ATO has indicated that approximately 2.8m individuals will be affected by the program, it is expected that administrative action will be taken on a very small percentage (less than 1%).

### GOVERNMENT CHANGING FOREIGN INVESTMENT RULES FOR VACANT COMMERCIAL LAND 12 MONTH HOLDING PERIOD TO BE CHANGED TO 5 YEARS

The Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Chris Bowen MP, recently announced that the Rudd Government will change the foreign investment policy to extend the timeframe for the development of vacant commercial land from 12 months to 5 years.

The Minister indicated that the change recognises the reality facing commercial land purchasers that 12 months is not enough time for completing all the statutory and commercial processes required to enable development to commence. The Government believes that a 5 year limit strikes the right balance between encouraging competition while preventing foreign investors from land banking and speculating.

### ASIC DISQUALIFIES DIRECTORS AFTER COMPANIES FAIL OWING TAX DEBTS

ASIC has advised that, during March 2008, it disqualified 3 directors from managing corporations following their involvement in failed companies which had outstanding tax debts.

One director was disqualified from managing corporations for 3 years. ASIC reports that there were 15 failed companies and that the majority of the companies failed owing money to employees for superannuation in addition to significant sums to the Tax Office and the OSR. ASIC reports that in relation to the majority of the companies, the director failed to ensure that the companies maintained proper books and records and failed to provide same to the liquidator of the companies.

In another case a director was disqualified from managing corporations for 2 years. In this case, the company owed a significant debt to the ATO and it was found that the director failed to properly inform herself of the financial position of the companies as required by a director in her position and that she allowed the company to trade while it was insolvent.

In another case, ASIC disqualified a property developer from managing corporations for 18 months. ASIC reports that he hampered the winding up of the Companies which he managed by failing to provide reports about the companies affairs to the liquidators.

#### **Argyle Comment:**

***Advisors and directors need to be aware that it is not just repeat offenders that may be chased by ASIC on winding up a company. Directors also need to be aware that whilst commencing winding up action within the required timeframe may prevent a director from becoming personally liable under a '222 Notice (DPN)', ASIC and the ATO have powers to go beyond the recovery of directors penalties in certain circumstances.***

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