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PSI Test — Separate Business Premises

Personal services income (PSI) is included in an individual's assessable income if it is mainly derived from an individual's personal exertion, whether the income is received directly by the individual or by an interposed entity. However, this does not apply to income derived by a personal services business (PSB).

There are several tests to determine whether a PSB exists, one of which is the 'business premises' test.

In a recent decision, the Federal Court found that the Administrative Appeals Tribunal (AAT) made an error of law in finding that the business premises test had been satisfied on the basis of exclusive use of premises which were physically separate from premises used for private purposes in a case where areas of the property such as the driveway and gate were shared between the business and home.

The taxpayer company conducted a business from a separate two storey building on the same land that the private dwelling of the controller of the taxpayer was also situated. The controller was employed by the taxpayer entity and provided business-consulting services to the taxpayer's clients.

The taxpayer had successfully argued to the AAT that the business premises were separate

from the controller's residence and hence the taxpayer was operating a PSB and not merely deriving PSI.

The Federal Court found that the AAT failed to reach a clear position concerning whether the business had 'exclusive use' of a shared garage, and that the required physical separation of the premises had been met.

Accordingly, the AAT's earlier decision was overturned, and the Commissioner's original assessment was upheld.

Part IVA Applied to Tax Effective Investment Scheme

In two recent decisions, the AAT disallowed deductions claimed by two taxpayers in relation to a tax effective investment involving a eucalyptus oil project.

During the 1998 and 1999 tax years, the taxpayers claimed various deductions for costs associated with their participation

in the project. The Commissioner sought to amend the taxpayers' returns for those years to disallow certain deductions claimed, applying Part IVA to the scheme.

The taxpayers appealed the assessment to the AAT on the basis that the scheme was not entered into with a sole or dominant purpose of obtaining a tax benefit.

The Commissioner argued that the specific benefit derived from entering into the scheme was the availability of tax deductions that ensured a positive cash flow position for the investor, regardless of the performance of the project.

The AAT held that the scheme in question exhibited the characteristics of a scheme with the sole or dominant purpose of obtaining a tax benefit, through the availability of tax deductions not otherwise available to the taxpayers.

- **TIP:** The Tax Office (and courts) have increasingly applied Part IVA when an obvious tax benefit arises that outweighs the commercial benefits. It would be prudent to consider tax effective investments on which the Tax Office has issued a product ruling to avoid any unexpected tax implications.

Capital Gains Tax and Trust Cloning

In TR 2006/4 the Tax Office has previously outlined in detail its view of all of the key aspects that must be identical under two trusts for a taxpayer to be able to transfer assets between the trusts without triggering a capital gain in certain circumstances.

The Tax Office recently released ATO ID 2006/318, which indicates that this will not apply where the meaning and effect of the trust deeds are not the same, even if the wording of the two deeds is identical.

The example provided concerns two trust deeds that were identically worded, with both having a clause that excluded the settlor from taking any benefit under the trust. Each trust had a different settlor who established the trust by contributing the initial trust property or capital.

In this case, when a piece of property was transferred from one trust to the other, capital gains tax applied as the two trust deeds, while worded identically, did not have the same meaning and effect. This was because a different settlor was excluded from benefiting under each trust.

- **TIP:** When drafting trust deeds, great care should be taken to ensure that the two trusts are considered identical if it is likely that assets may be transferred between the trusts in the future.

GST-Free Exports

The GST legislation provides that exported goods are GST-free. This applies where they are exported within 60 days from the earlier of the issue of the invoice or the first receipt of any consideration. If this deadline lapses, it is possible for a taxpayer to apply for an

extension to maintain the GST-free status.

The Tax Office recently released PS LA 2006/16, outlining the circumstances in which a GST-registered entity can obtain a time extension.

The practice statement informs exporters of the information that they need to provide to the Tax Office in order to make an extension request, as well as the factors that the Tax Office will consider in reviewing the application. It also provides useful practical examples that illustrate the general application of the principles explained in the practice statement.

Trustee Determines Distributable Income of Trust

In a recent decision, the Full Federal Court has found that beneficiaries were not presently entitled to income of a trust for the current year due to the existence of prior year losses.

The taxpayers were beneficiaries of a family trust which carried on a business. In the 1997 and 1998 income tax years, the trust claimed deductions for contributions made under an employee benefit trust arrangement.

The Commissioner disallowed these deductions and amended the taxpayers' assessments arguing that the deductions represented distributable income of the trust on which the beneficiaries should be assessed.

The Court, in allowing the taxpayers' appeal, held that losses incurred in one year must, in the absence of any further direction given by the trust deed, be made up out of profits of

subsequent years and not out of capital, such that no profits are distributable until all past losses are recouped.

As the trust had a negative distributable income on that basis, there could be no present entitlement to any income of the trust. The Court thus found that the income of the trust was properly assessable to the trustee.

The Commissioner has sought leave to appeal to the High Court.

CGT — Life and Remainder Interests

The Tax Office recently released TR 2006/14, which deals with the tax consequences of creating life and remainder interests in property.

Broadly, a life interest is a right to use an asset or enjoy the income from an asset during a person's lifetime. The asset passes to the holder of the remainder interest on the death of the life tenant.

The ruling deals with the potential tax implications of:

- the creation of life interests under a will;
- the death of a life tenant;
- the granting of life interests between taxpayers; and
- the disclaimer of a life interest.

The ruling outlines the Tax Office's position on a range of aspects, which will now provide greater clarity in this area that taxpayers often find complex.

- **TIP:** Effective estate planning will require individuals to carefully consider the issues discussed in the ruling around life and remainder interests.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.