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THE REPORT

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Tax News, Views and Clues

Contributions to Super Fund Denied As Deductions

The Federal Court has ruled in favour of the Tax Office and denied a company \$2 million in deductions for amounts contributed to an offshore non-complying superannuation fund.

The company took part in a scheme that involved making contributions to a New Zealand resident superannuation fund.

Broadly, the proposal provided that the taxpayer could obtain an unlimited deduction for superannuation contributions made to an offshore superannuation fund. In addition, the contributions would not be taxed in the fund and Fringe Benefits Tax (FBT) would not apply.

The Commissioner denied the deductions on the grounds that the sole purpose of the contributions was not to provide superannuation benefits for its eligible employees, but rather to provide a tax effective way to remove funds from the company.

The Court agreed with the Commissioner and denied the deduction for the contributions. The Court also found that the taxpayer was liable for FBT on the value of the contributions.

Please contact us for further information.

Joint Ventures for GST

The Tax Office has released a draft ruling setting out what it regards as the necessary characteristics of a joint venture for GST purposes, as opposed to a partnership or other arrangement. Under GST law, a joint venture is not an entity unless it is approved by the Tax Office as eligible to register and pay GST as an entity separate from each of the participants.

An approved GST joint venture permits transactions between the joint venture partners to be exempt from GST. Only when the transactions are made with outside parties does GST apply.

The Tax Office regards the following characteristics as essential for a joint venture to exist:

- joint control;
- a specific economic project;
- a sharing of costs by the participants;
- a sharing of product not of profit; and
- a contractual agreement between the parties.
- **Tip:** If you are planning to enter into a joint venture with another party, it will be necessary to plan the structure to be used and obtain approval to register as a joint venture prior to the commencement of the project.

Please contact us for further information.

Scheme Promoters Face Civil Penalties

The promoters of aggressive tax avoidance and tax evasion schemes face the prospect of civil penalties under proposed measures designed to curb such activities. The measures, introduced by the Federal Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, aim to deter would-be promoters and consequently reduce the availability of such schemes.

Under present tax law, penalties may only be imposed upon scheme participants as no civil or administrative sanctions apply to persons found to be selling, designing or promoting schemes. As a result, the development and marketing of new schemes has continued to grow.

The new measures will enable the courts to impose a maximum penalty of either \$550,000 or an amount equal to double the total consideration received by the promoter from the scheme.

Persons such as financial planners, tax agents, accounting or legal practitioners who only provide advice on such arrangements will not be caught under these measures as their actions do not represent active promotion.

The Government will release draft legislation for review. The new measures will apply to schemes that are first offered to investors on or after 1 July 2004.

- **Caution:** Before entering into schemes that purport to be 'tax effective', taxpayers should seek independent professional advice.

ATO Decisions On Partnerships

No Deduction for Payment of Partnership 'Salary'

A recent Tax Office Interpretative Decision (ID) has stated that for the purposes of determining the net income of a partnership, the payment of 'salaries' to partners in a partnership is not an allowable deduction.

Under the law, net income of a partnership is calculated by subtracting all allowable deductions from the partnership assessable income. Each partner is then required to include their share of the partnership net income or loss in their individual income tax returns.

The courts have adopted the view that a payment of 'salary' to a partner only constitutes an advance or drawing against the partnership profits and not a payment made in respect of employment. This view is based on the fact that a partnership is not a separate legal entity and, as a result, it has been held that a partner cannot be an employee and a partner at the same time.

Accordingly, the payment of a partner's 'salary' cannot be classified as a cost of the business and will not constitute an allowable deduction in determining the net income of the partnership.

Excess Partnership 'Salary' Not Assessable If Repaid

The Tax Office, in a recent Interpretative Decision considers the assessability of drawings of partnership income where there are insufficient partnership profits to cover the drawings and the partnership agreement requires a repayment of the excess.

The ID provides that the amount repaid is non-assessable as it constitutes a repayable advance rather than a taxable share of partnership net income.

Partnership to Company: Rollover Relief for Assets Transferred

In another recent Interpretative Decision, the Tax Office considered a case where a partnership transferred assets held in a low-value pool to a company wholly owned by the partners.

The ID provides that in such a case, capital gains tax rollover relief is available on the transfer.

The effect of the rollover is that any capital gain or loss made by the partners on the transfer of the assets is disregarded.

Taxpayers should be alert to the fact that this relief does not extend to any depreciation balancing adjustment that may arise.

Please contact us for further information.

Taxation of Compensation Receipts

The Tax Office has recently stated its position regarding the taxation of payments received by individuals as a consequence of suffering a personal injury.

Compensation payments which are a replacement or a substitute for income are considered to be ordinary income and are therefore assessable at the taxpayer's marginal tax rate. This is based on the notion that a compensation payment bears the same character as the replaced income.

On the other hand, a compensation payment received as a reimbursement for medical expenses is considered to be private in nature and consequentially not assessable for income tax.

Also, if a taxpayer receives a lump sum compensation payment in consequence of a 'wrong, injury or illness' that the taxpayer has personally suffered, the capital gain is disregarded and accordingly, the payment is potentially tax free.

Please contact us for further information.

A Higher General Interest Charge for March 2004 Quarter

The Tax Office has advised that the General Interest Charge (GIC) for the March 2004 quarter will be 12.32%. This is a 0.5% increase on the previous rate.