

Dear Client,

We are pleased to supply you with the November 2007 edition of **The Report**, which contains information on a number of important developments in taxation including:

- **Decision Impact Statement on Trust Deeds** — Tax Office provides more certainty on its view regarding deductibility of contributions made to various employee benefit trusts.
- **Penalty for Incorrectly Claimed Input Tax Credits** — AAT affirms the Tax Office's administrative penalty on a taxpayer for failing to take reasonable care in claiming input tax credits.
- **Overseas Volunteer Work Payments not Assessable** — AAT rejects deduction claims for volunteer work-related travel expenses.
- **Taxpayer's Investment not Anti-avoidance** — Federal Court finds investment in a sandalwood project was significantly commercial and not in contravention of Part IVA.
- **Lump sum Payment Assessable as Income** — AAT confirms that a lump sum compensation payment received by a taxpayer was income.

Please contact us if you wish to discuss how the points raised in **The Report** specifically affect you.

**Melbourne Cup Holiday**

Please note our office will be closed on Tuesday 6<sup>th</sup> November 2007.

Yours sincerely

**GUESTS ACCOUNTING**

# The Report

## tax news / views / clues

### **Decision Impact Statement on Trust Deeds**

Readers will remember the Full Federal Court decision in *Cajkusic v. Commissioner of Taxation* from our February 2007 issue. In response to this decision, the Tax Office has released a Decision Impact Statement indicating its position from the Court's decision.

In that decision, the Full Court held that while contributions made to various employee benefit trusts were not deductible, the default beneficiaries under the trust were not assessable on the resulting increase in taxable net income of the trust.

The Court held the trust's carry forward losses from the previous year were properly applied against current year income. As the prior year losses were greater than the current year income, there was no distributable income in the current year. Therefore, the beneficiaries were not entitled to or assessable on any income of the trust.

In the decision impact statement, the Tax Office indicated that it accepts the decision as an application of conventional tax law principles in determining when a beneficiary of a trust is presently entitled to the income of a trust estate.

However the Tax Office has further indicated that it does not believe the case to be authority for the proposition that the terms of a trust instrument can govern the meaning of income, for tax purposes, of the trust.

The Tax Office does not propose to conduct active compliance targeted at this issue, but will seek to further test the issue in the appellate courts as soon as the opportunity arises.

➤ **TIP:** It is important to carefully consider the wording of each trust deed before the trustee resolves to distribute the income of the trust. This analysis should be undertaken each year, as the income profile of the trust may change from year to year.

### **Penalty for Incorrectly Claimed Input Tax Credits**

In a recent decision, the Administrative Appeals Tribunal (AAT) affirmed the Commissioner's decision to impose a 25% administrative penalty on a property developer for failing to take reasonable care in claiming input tax credits relating to the GST incurred on a land acquisition.

However, the AAT set aside the Commissioner's decision not to remit the penalty and reduced the penalty on the basis that the property developer's advisors played a part in giving rise to the liability.

### **Overseas Volunteer Work Payments not Assessable**

In a recent decision, the AAT dismissed a taxpayer's appeal and held that neither a payment received by the taxpayer from the Rotary Club, nor salary or wages received for employment, were assessable income. Consequently, the taxpayer was also not entitled to a deduction for work-related travel expenses claimed for an overseas trip.

The taxpayer was employed as a physiotherapist and took leave without pay to volunteer in Vietnam. She was offered \$3,300 by the Rotary Club to fund the airfares and accommodation costs, and also received salary and wage income while in Vietnam.

The taxpayer argued that income derived from volunteer work in Vietnam and the payment from the Rotary Club towards airfares and accommodation costs was assessable income. Subsequently, the taxpayer claimed work-related travel expenses against that assessable income.

The AAT did not agree with the taxpayer's treatment of the income on the grounds that the payments received did not constitute assessable income. As a result, deductions claimed by the taxpayer would not be an allowable deduction, as the deductions were not incurred in gaining or producing assessable income.

## **Taxpayer's Investment not Anti-avoidance**

In a recent decision in *Lenzo v. Commissioner of Taxation*, the Federal Court found that a taxpayer's investment in a sandalwood project in Western Australia was not a tax avoidance scheme.

The taxpayer entered into an arrangement to invest in a sandalwood plantation in Western Australia with the sole aim of accumulating wealth for the taxpayer's retirement.

The taxpayer had undertaken a review of several similar projects before deciding to invest in Tropical Forestry Services Ltd (TFS). As part of the project, the taxpayer was required to make certain payments to the project managers for management and administration of the project. He also made loan repayments to the financial institution from which he borrowed the funds for the investment.

The taxpayer claimed a tax loss for respective tax years in which he was involved in the project, which represented project maintenance fees, rental, interest and bank fees, and indemnity fees, all of which were associated with the taxpayer's involvement in the project.

The Commissioner sought to apply the tax anti-avoidance provisions to deny the deductions the taxpayer claimed in relation to his investment in the project.

In this case, the Court concluded that overall the project had a commercial nature. The management fees were paid for a service to be provided by TFS and the loan repayments made by the taxpayer were as prescribed by the loan agreement in place.

As a result, the Court upheld the taxpayer's claim that there was no suggestion that any of the agreements entered into by the taxpayer were contrived. While a tax benefit was derived from the project, it could not be concluded that this benefit was the sole or dominant purpose for entering into the arrangement.

➤ **TIP:** Taxpayers considering entering into an investment project such as a plantation, should seek independent tax advice.

## **Lump sum Payment Assessable as Income**

In a recent decision, the AAT held that a lump sum compensation payment received by a taxpayer was income.

The taxpayer was a life tenant under four trusts. Under this arrangement, the taxpayer was entitled to the income of the trusts for her lifetime. Her son, the remainderman, was entitled to the assets of the trust after her death.

The taxpayer entered into a deed of release whereby she gave up her rights under the trusts. She received a lump sum payment as well as the income of the trusts.

The taxpayer argued that the payment was received due to a breach of the duties of the trustee. She claimed that the trustee had been focused on the capital growth of the assets of the trust and did not balance this with her entitlement to income. The taxpayer was not entitled to any capital growth of the trust.

The Commissioner assessed the lump sum payment as a receipt of income, and the AAT upheld this assessment.

The AAT considered the rules regarding lump sum receipts where the nature of the receipt is determined by looking at it in the hands of the recipient taxpayer. As the taxpayer in this case was only entitled to income of the trust, any amount of compensation that she received for the loss of that income must also be income.

## **GIC and SIC Rates Released**

The Tax Office has released updated general interest charge and shortfall interest charge rates for the October to December quarter 2007, which are as follows:

<b>Rate</b>	<b>Annual</b>	<b>Daily</b>
GIC	13.75%	0.03767123%
SIC	9.75%	0.02671233%

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.

