

BUSINESS TAX & GST III

EXAM NOTES

SMALL BUSINESS ENTITY SYSTEM

- Eligibility: Subdivision 328-C of ITAA97: Turnover threshold of \$2million per year
 - Aggregate annual turnover of \$2mil or less if following are satisfied
 - Aggregated turnover for the previous income year is less then \$2m
 - Aggregated turnover for the current year likely to be less then \$2m or;
 - Aggregated turnover for the current income year is less then \$2m
 - Business will have to include details of all entities connected with it; entities it controls
- Capital allowance rules for SBE system
 - Immediate write off for items costing less then \$20,000 as per s 328-180(2)
 - Pooling of other depreciable assets as per s 328-185
 1. General SBE pool (for items with effective life <25 years) = 30% and 15% in the first year of acquiring the asset
 2. Long Life SBE pool: items with effective life >25 years= 5% and 2.5% in the first year

PERSONAL SERVICES INCOME

- **Definition: Ordinary or statutory income that is derived mainly as a reward for the personal efforts and skill of an individual: s 84-5(1)**
- Not PSI if income is from the use of assets (dividends, rent etc)
- Are they being awarded for a personal skill?

Examples:

- (1) A taxpayer owns a semi-trailer and is the only person who drives it, paid for transporting items with this truck
 - a. Income of the truck is not PSI- income is produced mainly by using the truck and so is not a reward for the personal services of the taxpayer
 - (2) Taxpayer provides a computer programming service but she uses the client's equipment and software to do the work
 - a. Yes this income is PSI, is a reward of her personal efforts and skills
- Personal services entity or an individual is considered to be carrying on a **Personal Services Business** if:
 - It meets the results test or;
 - It receives less then 80% of its PSI from one source and it is able to satisfy one of 3 PSB tests
 - **Results Test:** an individual or personal services entity satisfies this test, if, in relation to at least 75% of the individuals or entity's PSI during the income year as per s 87-18(1)
 - the income is for producing a result (outcome paid on performance not hours worked)

- the individual or entity is required to **supply the plant, equipment or tools** necessary to perform the work
- the individual or entity is **liable for the cost of rectifying any defective work**
- **80% Threshold**
 - If results test is not passed then there is an 80% threshold to be applied
 - If 80% or more of an individual's PSI is from the same entity then the entity will require a Personal Services Business determination from the commissioner: s 87-15(3)
 - If less than 80% of the PSI is from any one source, entity can self assess against the remaining 3 PSI tests, and if it passes one of those tests, the income of the individual or PSE will not be subject to the PSI rules
- **Unrelated Clients test: s 87-20**
 - Will be satisfied in an income year if:
 - The individual or PSE gains or produces income during the income year from providing services to 2 or more non-associated entities and
 - The services are provided as a direct result of advertising or otherwise offering the services to the public at large or to a section of the public
- **Employment Test**
 - Satisfies the employment test in an income year if:
 - He or she engages 1 or more entities to perform work and
 - The market value of the principal work performed is at least 20% of the individual's or PSE's principal work for that year; s 87-25 (1)
 - An individual or PSE will also satisfy this test if it has an apprentice engaged for at least half of the income year: s 87-25(3)
- **Business Premises Test: s 87-30(1)**
 - Satisfied if the individual or PSE maintains and uses business premises at all times during the year, which are:
 - Owned or leased by the contractor
 - Mainly used (more than 50%) for PSI producing activities
 - Exclusively used by the entity or individual contractor; and
 - Are physically separate from the individual's or associate's residence (must be detached and not have any internal access; cannot work at home)
 - *Dixon Consulting* (2007) ATC 2550: held that a building consisting of an office and a garage adjacent to residential premises occupied by a director of the taxpayer: did not satisfy the business premises test because taxpayer did not have exclusive use of the garage

→ If the tests are failed then this will not classify as personal services income and it will be considered salary and wages and withhold the correct amount of PAYG withholdings. The income will then be included in the individual's assessable income.

NON-COMMERCIAL LOSSES

Division 35 of ITAA97

-Rules prevent an individual (or partner in a partnership) offsetting losses from '**non-commercial' business activities** against other assessable income in the year the loss is incurred.

-loss gets carried forward cannot be claimed in that year; s 35-10

-do not apply to companies or trusts

-'business activities'

4 Commerciality Tests (any one needs to be satisfied)

1. **Assessable income Test:** assessable income from the activity for the income year is at least \$20,000 or would reasonable be estimated to be at least \$20,000 if the activity were carried on for the whole year: s 35-30
2. **Profits Test:** the activity has made a profit (for tax purposes) in at least 3 of the past 5 years, including the current year, s35-35. In the case of a partnership, it is the taxpayer's share of the partnership net income that is taken into account.
3. **Real property Test:** total value of real property, or interests in real property, used on a continuing basis in carrying on the activity is at least \$500,000; s 35-40. The higher of market value or reduced cost base is taken into account and is calculated at the end of the income year. In a partnership, only count the partner's individual interest in the partnership real property.
4. **Other assets test:** total value of other assets (except cars, motorcycles and similar vehicles) used on a continuing basis in the activity is at least \$100,000; s35-45. (The value depends upon the type of asset; eg. WDV if a depreciating asset.)The value of any real property or other assets partly used in carrying on the activity is apportioned; s35-40.

Exemptions

→ rules in Division 35 do not apply to losses from a primary production or professional arts business where assessable income for the year from other sources (eg.salary and wages) is less than \$40,000; s 35-10(4).

-Primary production: FARMING

-Professional Arts Business: authors, playwrights, artists and sculptors

→ Special circumstances outside taxpayers control: natural disasters; e.g drought, flood, or bushfire; something not due to ordinary economic or market fluctuations

OR

→nature of the business activity is such that there is a lead-time between the activity commencing and the production of assessable income

INTEREST DEDUCTIBILITY

- General test adopted by the courts: *FCT v Munro* (1926); *Ure v FCT* (1981); *Fletcher v FCT* (1991); "The use to which the borrowed money is put" eg. The purpose of the

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loan. (What the person has done with the borrowed money determines if interest is deductible.

- If assessable income from the loan is greater than the interest expense: no need to inquire about taxpayer's subjective purpose
- IF assessable income is LESS than the interest expense then it may necessary to consider the taxpayers subjective purpose: as per *Fletcher*
- Before income produced: Interest deductions allowed in *Steele v FCT*, where the taxpayer borrowed money to acquire land upon which she expected to build a motel; but no assessable income from the project as motel was never built
- After business ceased: *FCT v Brown* (1999); allowed as a deduction the taxpayer's shares of interest on a bank loan to purchase a delicatessen business in relation to years of income after the business had ceased. Business purchases in 1988 and ceased 1990; interest paid until 1995; court held that amount of time between the cessation of the business and the interest being incurred was still sufficiently proximate and so was deductible. This position also adopted in *FCT v Jones*; where interest on both original loan and refinanced loan were deductible even though the business had ceased operating.
- Interest expenses are not always deductible: In *P&G Rocca Pty Ltd v FCT*; the taxpayer was not entitled to a deduction for interest paid on the borrowings that it on-lent interest free to a related entity. The related entity used the money to buy a property that was to be used for its business. Court held: insufficient nexus between the interest payments and the production of the taxpayer's income.
 - *Spassked Pty Ltd v FCT* (2005); Full Federal court also held that interest expenses were not deductible to the taxpayer as they were out of all proportion to the income expected to be derived.
Interest=\$888 million Income received= \$44million
- Where the loan is made to associates, then the amount of interest deductions is limited to the amount of income derived; *Ure*: because it is accepted that there are likely to be more than one purpose involved in the lending.

FRINGE BENEFITS TAX (FBT)

As per Fringe Benefits Tax Assessment Act 1986 (FBTAA)

→ Paid by employers on the 'taxable values' of all benefits provided to employees in respect of their employment

→ FBT YEAR= 1 April to 31st March

Defined in s 136(1) in FBTAA:

- A benefit (defined: any right, privilege, service or facility)
- Provided by an employer (or someone on the employers behalf)
- To an employee or an associate (family member) of the employee
- At some time during the FBT year
- In respect of the employment of the employee

Gross-up factors:

- Type 1 factor: 2.1463 (for goods where GST is included or assumed to be included)
- Type 2 factor: 1.9608 (for goods with NO GST)

CAR FRINGE BENEFITS

-arises where a care is made available to an employee for private use and the vehicle is owned or leased by the employer

-includes: passenger cars, station wagons, mini-buses, panel vans and utilities (something designed to carry fewer than 9 passengers). NOT motorcycles (give rise to residual benefit)

-'private use' defined: s 136 (1): any use not exclusively in the course of producing assessable income of the employer

VALUATION METHODS: (use the method that gives them the lower liability)

- Statutory formula method as per s 9(1)

$$\frac{ABC}{D} - E$$

- A=base value of the car; cost price of the car as per s 9(2) including expenditure incurred in acquiring the car, including delivery costs and GST. Registration and stamp duty are not INCLUDED. Reduced by 1/3 in the 5th year of ownership.
- B= Statutory fraction as per s 9(2)(c)= 20% for FBT year ending 31 March 2016
- C= the number of days during the year in which the car was privately used or available for private use
- D= number of days in the FBT year of tax= 365 or 366 for leap year
- E= the amount of the recipient's payment; amount of consideration paid by the employee to employer as consideration for use of that car, eg. Petrol