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Practice Update

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NOVEMBER 2008

Super funds coming unstuck with loans to members

The Tax Office has reported that, when it comes to the investment restrictions that apply to SMSFs, the most common contravention continues to be loans to members of funds and their relatives.

In addition, many SMSF trustees are claiming their loan arrangements are arm's length loans to non-related parties. However, the ATO has found that, in over 20% of its audit cases, the loan arrangements had not been conducted at arm's length.

Case Study – accessing funds to prop up a business

Editor: The following example provided by the ATO highlights an instance of non-compliance and what they did about it.

The approved auditor of a fund reported a contravention because the fund had made a loan to a related party for the year ended 30 June 2005.

The related party was a company of which the trustees of the fund were also the directors. The company had run into liquidity problems so the trustee lent the money to the trading company. The loan was for \$126,000, which equated to 99% of the fund's total assets.

Attempts were made throughout the case to get the trustees to rectify the contravention, and, earlier this year, the trustees proposed an enforceable undertaking to rectify by June 2010. However, this was not accepted by the ATO as the timeframe was unreasonable, and they proceeded to make the fund non-complying.

Superannuation and Business Real Property

Trustees of SMSFs are generally prohibited from acquiring assets from related parties **and** may only maintain 'in-house assets' (i.e., assets involving dealings with related parties) when their value is less than 5% of the total value of the fund's assets.

An exclusion from both of these requirements applies in relation to 'business real property'.

When considering whether or not a particular property is business real property, most trustees usually need guidance regarding the 'business use test', which requires that the real property be 'used wholly and exclusively in one or more businesses' carried on by any entity.

A new draft ruling released by the ATO to assist trustees contains a number of examples that highlight the importance of understanding business real property, including the following.

Business real property examples

Letting holiday flats – no business

Ms Hend owns two holiday flats, which she lets for short-term accommodation at a popular holiday destination. Ms Hend and her partner manage and maintain the flats, which includes cleaning and repairing the flats, and financial tasks such as banking.

Ms Hend and her partner set up the Hend Super Fund and both become members of the fund. They propose that the Hend Super Fund acquire the flats from Ms Hend.

The elements of repetition and continuity of acts and transactions indicate the possibility of there being a rental property investment business being carried on.

However, the scale of the operation is such that it is not considered to be a business.

As there is no business conducted in respect of the premises, the property is not business real property, and so the Hend Super Fund cannot acquire the flats from Ms Hend (a related party).

Bed and breakfast – business

Dean Lamont owns a house with five bedrooms and two living areas. He uses one of the bedrooms himself. The other four bedrooms are let year-round as part of a bed and breakfast business. One living area is set aside for the exclusive use of guests. Breakfast is included in the room cost and other meals are available by arrangement.

Dean advertises his rooms with Worldwide B&B Internet bookings agency. Dean has a business plan, pays tax, and has three permanent part-time employees. The business has operated since Dean acquired the house 17 years ago.

In this case, a business is being carried on. Dean's non-business use of the property is incidental and relevant to that business. Therefore, the property is used 'wholly and exclusively' in the business and is business real property.

Overseas holidays deductible!

Editor: The following case shows that even unusual claims can be successful, as long as you are able to get your evidence in order, and can show a clear connection between an expense and your income earning activities.

The taxpayer was a sales consultant in a travel agency who undertook domestic and overseas travel during the 2004/05 tax year, including a round the world trip and a trip to the USA.

He claimed a tax deduction for his travel expenses of \$9,985, but the claim was eventually disallowed by the Tax Office after an audit.

The taxpayer's argument

His primary reason for taking the particular flights that he did was because his employer expected employees to travel on their own time. Also, by using a particular round the world ticket offered to his travel agency exclusively, he came to understand its benefits and how to make the ticket "work for customers much better".

After travelling on the ticket and having the knowledge and confidence to recommend it, he said he "sold literally hundreds of them", which provided good bonuses to him.

The Tax Office's argument

The Tax Office conceded that the experience gained on the overseas trips would likely have benefitted the taxpayer to some extent in his occupation as a travel agent. However, the trips undertaken were 'holidays'. Also, while overseas, he did not visit a single travel agency to see how they did business.

The Decision

The Senior Member of the Tribunal stated that the trips clearly assisted the taxpayer in his occupation as a travel agent, that they were not simply holidays, and that he did not need to visit any travel agencies as he was a sales consultant employed to sell holiday related travel products.

In addition, his remuneration increased overall each year, largely because of the receipt of bonuses.

Therefore, "none of (his) overseas travel expenses were of a private nature" (even though he spent three days out of seven in a town in Spain in which he had relatives), but the claim of \$9,985 was reduced to \$8,337 basically due to problems with substantiation (e.g., receipts).

New benchmarks

In addition to the benchmarks released for the painting, roofing, tiling, floor sanding and polishing, and taxi industries, the Tax Office has now issued benchmarks for the concreting industry.

These benchmarks indicate an expected range of income for concreters based on the labour and materials used, and apply to concreters who work directly with household customers.

FBT on laptops and GPS receivers

The Tax Office has confirmed that, after the Government's changes to the FBT laws from 13 May 2008, a GPS navigation receiver provided to an employee can be a 'portable electronic device' and can therefore be exempt from FBT as an 'eligible work related item'.

Also, a laptop provided to an employee can still be 'primarily for use' in their employment, and exempt, even if they sometimes use it for private purposes and the employer has no private use policy.

Please Note: Many of the comments in this publication are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances.