



**A National Tax Publication**

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## Tax Office Compliance Program released

As reported in BDO's August Client Alert on this topic, the Tax Office released its Compliance Program for the 2006-07 tax year. This 82-page document outlines the Tax Office's main areas of focus for the coming year and details the tax risk areas. As mentioned in the Client Alert, the Compliance Program is ostensibly part of the Tax Office's policy of providing a more open and transparent approach to the administration of tax collection.

The Program is divided into six market segments: individuals, micro-business, SME's, large business, non-profit and government organisations. This is then followed by a discussion of three global "key issues"—aggressive tax planning, evasion and fraud, and international tax issues. Much of what was said in the Program is similar to previous years. However, new topics such as the stated focus on high net wealth individuals and promoters of tax schemes have been added.

The SME segment is one of the larger business segments and includes (in Tax Office parlance) all businesses with turnovers between \$2 million and \$100 million. It accounts for 21% of all corporate income tax collections, 35% of GST collections and 21% of FBT collections. The Tax Office's approach to this segment is to ensure that the taxpayers have information necessary to comply with the tax laws, and to then come down hard on non-compliers. While the tax forgone by a single taxpayer in this segment might not be as high in dollar terms as in other segments, the sheer number of businesses within this segment means that the Tax Office needs

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to "encourage" compliance. This "encouragement" takes the form of seeking greater penalties for non-compliance as a deterrent to others.

The Tax Office recognises a number of issues concerning SME's including:

- high wealth individuals (a common theme throughout the Program following the success of Operation Wickenby);
- capital gains tax, which the Tax Office views as a particular problem in this segment, especially in the area of non-reporting of transactions;
- capital management;
- service trusts;
- phoenix arrangements;
- the property, building and construction industry;
- international tax;
- employer obligations;
- GST;
- participation in the cash economy;
- aggressive tax planning;
- superannuation funds, particularly self-managed superannuation funds; and

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- excise, particularly the misunderstanding of obligations by taxpayers in this segment.

One area of particular concern for the Tax Office with regard to SME's is tax losses. Due to misunderstandings or downright evasion, the Tax Office opinion is that tax losses should be subject to special scrutiny. Areas that will be scrutinised by the Tax Office are:

- inappropriate or inflated deductions;
- under-reporting of income;
- profit shifting (that is, transfer pricing);
- recouping losses without taking into account changes in ownership;
- misclassifying losses as revenue or capital;
- loss creation arrangements;
- using related party losses outside of a group; and
- misuse of the consolidation rules to create or inflate losses.

As with previous years, the "Aggressive tax planning" key issue section of the Program outlines matters such as detection of schemes, product rulings, dealing with promoters, GST schemes, arrangements to reduce personal income tax, and financial products. Aside from the new focus on promoters, made possible by the promoter penalties legislation enacted earlier this year, there is little that is new in this section of the Program.

**BDO comment:** The BDO Client Alert discussing the Compliance Program outlines key risk areas that should be reviewed by all readers, to determine if they should



put their house in order. One of the big differences with the current document over past documents is the large amount of Tax Office resources devoted to high net wealth individuals. This group came to the forefront of the Tax Office's view due to the success of Operation Wickenby, and the additional funding given to the Tax Office in the May Federal Budget specifically earmarked to combat non-compliance by such individuals. The review of high net wealth individuals is mentioned in most sections of the Program. We are likely to see the affairs of many medium and high profile persons reviewed by the Tax Office in the near future.

## Tax Office assault on tax evasion

Following on from the discussion of the Compliance Program, there have been a number of cases and announcements that demonstrate that the Tax Office is shifting up a gear with its compliance activities. In one of the cases, *Cachlios and Commissioner of Taxation* [2006] AATA 676, the Administrative Appeals Tribunal confirmed an amended assessment and a 75% penalty in respect of tax evasion by the taxpayer. The taxpayer had failed to disclose any business income from her medical supply business for a three-year period but claimed that she had business expenses to offset the income. This claim was given short shrift by the Tax Office and the Tribunal.

The second case, *Commissioner of Taxation v Tang* [2006] SASC 252, concerned the Tax Office secrecy provisions. However, it arose in respect of documents created by the Tax Office alleging tax fraud by the taxpayer in relation to its restaurant business. The

SA Supreme Court held that the documents were covered by the secrecy provisions, even though they had had been created using information from documents obtained by the Federal Police using (what were later held to be invalid) search warrants.

In addition, there have been a number of announcements indicating that the Tax Office will run data-matching exercises to fight evasion. In the Commonwealth Gazette on 2 August 2006, the Tax Office notified that it would run data-match checks on the fishing industry. One of the more innovative data-match exercises was announced in the Commonwealth Gazette on 23 August 2006, when the Tax Office advised it will data-match aircraft purchases from Civil Aviation Safety Authority, from Recreational Aviation Australia Inc and from the Australian Sports Rotorcraft Association, to find persons that spend more than their declared income.

## BDO National Tax Seminars

BDO conducts a series of bi-monthly seminars around the country, focusing on issues topical within the tax world. September's seminar will feature a discussion of "Superannuation: What do the changes mean?". The BDO National Tax Group is host and presenters of this event. If you would like to attend or would like more information about upcoming seminars in the series, please contact your local BDO office.



## Super issues

On the superannuation theme this month, there have been two recent cases handed down in August, while the Tax Office also finalised a Ruling. The first case, *Thompson v Leigh* [2006] NSWSC 540, concerned the beneficial ownership of certain landholdings for bankruptcy purposes. The registered proprietor of the property was a bankrupt who claimed that he held the property as trustee for his superannuation fund. As there was no trust deed, the bankrupt had to run a technical argument based on "resulting" or "implied" trusts. The trustee in bankruptcy disagreed and sought to gain access to this property. The NSW Supreme Court also disagreed, citing lack of evidence that any trust existed.

The second super case, cited as *Confidential and Commissioner of Taxation* [2006] AATA 733, concerned whether the taxpayer could obtain a deduction for "controlling interest superannuation contributions". This refers to arguments that have been raised over the years that are based on a technical reading of the rules relating to deductions for superannuation contributions: the definition of "employer" includes a controller of an employer and, technically, a controller of a company that employs that controller might be seen as that person's own employer. Such a reading of the deduction provisions has been rejected over the last few years and this case was no exception.

Taxation Ruling TR 2006/7, which had previously been issued as draft Taxation Ruling TR 2006/D1, concerns the concept of "special income" of a superannuation. Such income includes distributions from discretionary trusts as well as some distributions or dividends from private companies or trusts, particularly where the shares were acquired on a non-arm's length basis. Also included is certain non-arm's length income. This income is

taxed at the highest marginal rate rather than at the concessional 15% rate and, therefore, it is imperative for a superannuation fund to ensure that it does not receive any of this income. The Ruling discusses the matters that the Commissioner will take into account when considering whether a transaction is arm's length. It also provides a number of useful examples.

**BDO comment:** Due to the concerns of the ageing population and the lack of Australia's saving base, the Government provides various incentives to encourage people to save for their retirement. The main incentive is the superannuation fund, an investment vehicle in which both contributions and earnings are taxed at a concessional rate. The Budget announcements of both 2005 and 2006 make this vehicle even more attractive by removing both the superannuation surcharge and by heralding the amendments that will make all benefits paid by superannuation funds to persons over 60 tax-free.

One of the main concerns with such a vehicle is to ensure that it is not inappropriately exploited; that it is only used to save for retirement and not to provide a tax shelter for high-wealth taxpayers. It is for this reason that there are a number of regulations on the use of these vehicles, limitations on the available tax benefits, and tax implications when a fund is misused. The two cases represent situations where, arguably, the fund is being misused to protect assets from the trustee in bankruptcy and to gain a deduction without any contributions tax. The Court and Tribunal looked unfavourably on this apparent misuse. The Ruling outlines a third scenario where the misuse of a fund will be looked on unfavourably. As long as a superannuation fund is used correctly, it will be a useful, concessional-taxed entity. However, where it is misused, the consequences can be severe.



## Losses lost

In *Weyers v Commissioner of Taxation* [2006] FCA 818 the Federal Court disallowed trust losses that the taxpayers attempted to utilise over a seven-year period. The trust-loss entity had been acquired as a part of a complicated tax minimisation scheme, and the trust had later loaned sums to the taxpayers. The Federal Court held that the trust losses were not actually deductible, as the loans that purported to give rise to the losses were not entered into for income producing purposes. Additionally, the loans to the taxpayers were considered to be distributions of trust income.

In another case concerning losses, *Hall and Commissioner of Taxation* [2006] AATA 360, the Commissioner invoked the “non-commercial loss provisions” to quarantine deductions incurred in respect of an olive-growing venture. When asked to

exercise his discretion to not apply those rules, the Commissioner refused. The Administrative Appeals Tribunal upheld this refusal and the olive-growing losses were not deductible.

**BDO comment:** There are many schemes, arrangements and products which seek to reduce a person’s taxable income by generating real or notional loss, or by utilising the unutilised losses of another. This has led to several arguments and court cases, as well as amendments to the tax law, regarding the validity and commerciality of such losses. These cases represent two scenarios where losses are unlikely to be deductible: when trust loss entities are acquired (although the facts in *Weyers* were more complicated than that and pre-dated the trust loss rules), and where a non-commercial venture or hobby is entered into. If any readers are presented with arrangements that purport to utilise these kinds of losses, they should treat the arrangement with caution.

## Land tax and strata title

Moving away from income tax, the case of *McKinney v Commissioner of State Revenue* [2006] WASAT 216 demonstrates that the timing of the lodgment of a strata plan is exceptionally important for land tax purposes. The taxpayer intended to subdivide its land but had not lodged its strata plan as at 30 June 2005. Therefore, at that date, the land still constituted an undivided lot and was exempt from land tax as a residential unit. This case demonstrates that owners of land should seek advice as to the timing of any action in relation to land, as this could have serious ramifications. The landholder in this case was lucky that he had not lodged the strata plan earlier.



## Practice statements released

Also on the compliance theme this month, the Commissioner issued two Practice Statements. PS LA 2006/8 discusses the policy for the remission of shortfall interest charges and general interest charges for shortfall periods, while PS LA 2006/7 discusses “alternative assessments”, being those that assess a similar gain or transaction but only apply if another assessment is held to be incorrect.

PS LA 2006/8 is interesting as it outlines various situations where interest charges will be remitted, for instance, where there is a delay in commencing or completing an audit.

Additionally, as the “general interest charge” (which applied for periods prior to 30 June 2004) was higher than the “shortfall interest charge” (the current interest rate applied), the Commissioner would in many circumstances remit the general interest charge to the shortfall interest charge rate.

Both Practice Statements are useful insights into the Tax Office’s policy and procedure on various issues. If readers would like further details in regard to either documents, please contact your local BDO office.



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