

Have you considered buying a boat?

If the answer is “yes”, then the reasons why you want to buy the boat may be very important. If the boat will be used to hire out for private charters, you should consider the way in which you conduct your boat activities.

Are you carrying on business?

If your boat activities amount to carrying on of a business you may be entitled to a tax deduction for the expenses incurred in hiring the boat for private charters. You may also be entitled to a GST credit for the cost of acquiring the boat.

There are a number of factors that need to be considered in determining whether your boat activities amount to carrying on a business. If some or all of these factors are not present in the manner in which the boat activities are conducted, you risk having your tax deductions and GST credit disallowed.

For example, two recent Tribunal cases relating to boats acquired for business purposes were disallowed by the AAT on the basis that the boat activities were not carried on in a businesslike manner. The nature and extent of the activities conducted by the taxpayers were not sufficient for the taxpayers to be considered to be carrying on a business.

These cases illustrate the fact that there are a number of important factors that need to be evidenced before boat activities can be determined to be carrying on business.

Reference: Re Hatrick AATA 301; Drysdale AATA 393

ATO focus on main residence

Under normal circumstances a person who purchases a home with the intention of living in it may be eligible for the main residence exemption provided:

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1. They move into the home “by the time it was practicable” to do so after acquiring it; and
2. They have proved that they had occupied the home as their main residence.

However, the outcomes of two recent Tribunal cases have suggested that the above principles need to be clearly established before the main residence exemption can be applied.

Delay in moving into home

As it usually takes time to move into a home, the law recognises that certain delays in moving into the home may be acceptable. For example, where there is a delay in moving in because of illness or other reasonable causes. However, are delays in moving in until it is convenient for the taxpayer to do so an acceptable situation?

Holiday Apartments and Small Business CGT Concessions

The generally accepted understanding that the receipt of income for holiday accommodation is not rent is in doubt following a recent tax case.

The Administrative Appeals Tribunal (the Tribunal) held that the holiday unit was not an active asset for the purpose of small business CGT concessions for two reasons:

1. The exclusion of rent deriving properties from active assets, and
2. Holding of one holiday apartment is not considered to be carrying on a business.

While the second of these reasons is generally accepted, the first reason goes against an ATO ruling and in fact, it was not argued by the ATO in the case (they only put the second reason to the court).

What is Rent?

The ATO ruling has examples where the income from holiday apartments is not considered to be rent and therefore is not affected by the rent exclusion in the definition of active asset. In one of the examples, a block of six holiday apartments operated similarly to a motel were considered active assets because the income derived from the operation of these units was not considered rent.

The key determining factor in the ruling example in relation to whether the rent exclusion applied was the occupants did not have the right to exclusive possession of the premises, and therefore, there was no landlord/tenant relationship.

In comparing the taxpayers' circumstances with those in the ruling example, the Tribunal was satisfied, in this instance, that the occupants had the right to exclusive possession of the taxpayers' holiday unit during their stays; hence, the relationship between the occupant and the taxpayers was a tenant/landlord relationship. The Tribunal concluded the main use of the property in question was to derive rent. However, the Tribunal gave little justification for this distinction apart from saying the occupier would consider themselves to have rented the apartment and to have exclusive possession.

This question was considered in a recent Tribunal case and the answer was "no". Here the taxpayer purchased a property with the intention of moving in immediately after settlement. However, due to a request from the previous owners, the property was rented back to them by the purchaser for a period of six months. At the end of the six months the taxpayer rented the property to another tenant. Consequently, the taxpayer did not move into the home until it became convenient for him to do so.

The taxpayer's delay in not moving into the home at "the time it was first practicable" caused him to lose the benefit of the main residence exemption for the period prior to him moving in.

Establishing your main residence

There are many things that a person can do to establish that they have moved into the main residence. This may include moving your belongings into the home, changing the address on the electoral roll, changing the address to which your mail is delivered and ensuring services such as telephone, electricity and gas have been connected. In the second case, the taxpayers had to pay capital gains tax on their family home because they failed to establish that their house was their main residence. Among other things, they only moved in the bare-essentials such as bedroom furniture, a TV and some furniture. They did not move in the fridge, washing machine or the microwave and they did not use the kitchen cooking facilities. Furthermore, they could not establish that they had changed the address on their driver's licence, car registration, electoral roll or bank accounts.

Tax Office Audits

The Tax Office has indicated that one of their main focuses on CGT reviews will be the main residence exemption. Taxpayers selling their main residence, where they have had some periods of absence or where they have conducted a business or other income producing activity at the home should, ensure they obtain professional tax advice in relation to the disposal.

Reference: Re Chapman AATA 421; Erdelyi and Erdelyi AATA 1388

Ramifications for holiday accommodation businesses

Although this conclusion did not ultimately affect the outcome of this case, it may have serious ramifications for cases where the taxpayers are carrying on business of holding holiday units and/or houses.

The issue turns on the meaning of the word “rent” in the context of the small business CGT concessions. It is hoped that the ATO will issue a statement soon clarifying the status of its comments in its existing ruling about the definition of the word “rent”.

Reference: Re Carson AATA 156; TR 2006/78

Can a Shed be a Main Residence?

The answer to this question is apparently “yes” according to the Tribunal’s decision in a case where the taxpayer sought to apply the main residence CGT exemption to the sale of her property that included a builder’s shed in which she lived.

Whilst most people may regard the conditions of the shed uninhabitable, the Tribunal was satisfied that the shed was the taxpayer’s main residence during the time she lived in it. In making this decision, the Tribunal took into account the taxpayer’s unique living habits. The Tribunal ruled that the taxpayer was allowed the main residence partial exemption on the gain she made from selling the land.

The Meaning of Main Residence

Generally speaking, a main residence can be a residential building, a houseboat, a caravan or a mobile home. The Tribunal’s decision in this case seems to suggest whilst the form of the dwelling is important in deciding whether this dwelling is the taxpayer’s main residence, the meaning of main residence is subjective and is to be decided on a case by case basis.

Reference: Re Summers AARA 152

Travel Expenses Deductible for Teacher

In a recent Tax Case a history teacher obtained a tax deduction for his overseas travel costs, even though the travel was not at the direction of his employer.

In order to seek promotion, the teacher travelled extensively with a view to develop his knowledge in world history. During his trips, he also collected valuable teaching materials for his department. He was later promoted to the head of his faculty department.

The Tribunal allowed the deductions with an adjustment for the private component of his trips.

Travel was not a job requirement

Although it was not a job requirement for the taxpayer to travel, he was allowed a deduction because his travel was mainly for the purpose of furthering his profession.

Reference: Re Lenten AARA 281

ATO Focus on Restaurants

The ATO is currently reviewing businesses in the restaurant, catering and takeaway industry to identify those who do not accurately record and report their business transactions.

To assist in the review process, the ATO will use industry sales data and other third party information.

Federal Budget Announcements

Fringe Benefits Tax

The following four popular salary sacrificed fringe benefits tax concessions have been amended to reduce their benefit to employees. All these changes will apply from 7:30 pm EST 13 May 2008:

- Exemption for work related items limited to one a year and it must be used primarily for work purposes (includes mobile phones, laptop computers, personal digital assistants and tools of trade);
- No income tax depreciation deduction for employees on FBT exempt items (e.g. packaged laptop);
- Salary sacrifice of interest payments on jointly held investments – otherwise deductible rule will only apply to employee’s proportion of the legal entitlement to the investment; and
- Meal cards and other meal benefits provided for consumption on the employer’s business premises – these benefits are FBT exempt but from 13 May

2008 the exemption will not be allowed where the benefit has been salary sacrificed.

Family Trusts – reversal of concessions

The Government has reverse two of the family trust changes introduced by the previous Government.

The definition of family in the family trust election rules will be changed to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse. This change will have effect from 1 July 2008.

Family trusts will also be prevented from making a once off variation to the test individual specified in a family trust election (other than in relation to a marriage breakdown). This change will have effect from the 2007-08 income year.

Both of these changes reduce the scope for family trusts to utilise tax losses to lower income tax.

Other changes to the Family Trust rules that were introduced by the previous Government will **not** be reversed, including; allowing variations in the family group that may arise as a consequence of death or marriage breakdown and allowing family trust elections to be revoked in circumstances where the original elections were not actually required. The current Government will retain these amendments.

Small Business CGT Concessions Extended

The Government will increase access to the small business CGT concessions via the \$2 million Aggregated Turnover

Test. Effective for the 2007-2008 income year, the small business CGT concessions will be extended for taxpayers owning a CGT asset used in a business by a related entity and for partners owning a CGT asset used in the partnership business.

Currently the small business entity \$2 million test requires that the relevant taxpayer carry on a business, and therefore does not apply to business structures where the CGT asset is owned by an entity that does not carry on business but is used in a related entity that carries on the business.

Depreciation of computer software

The statutory effective life on in-house computer software for tax depreciation purposes have been increased from two and a half to four years for expenditure incurred on or after 7.30 pm AEST on 13 May 2008.

This means that taxpayers will now be required to write off computer software for tax purposes at an effective rate of 25% on a straight-line basis rather than the pre budget rate of 40%. A four year depreciation period for expenditure on in-house software is the same period as the Commissioner's safe harbour effective life for computer hardware.

In-house software is computer software, or the right to use computer software that is acquired, developed or developed by someone else and is mainly used by the taxpayer in performing the functions for which the software was developed i.e. used as a business tool rather than developed for sale.

Should you require assistance additional information, **contact your PKF tax adviser** or:

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