

Tax News, Views and Clues

No deduction for franchisee fee

In a recent decision, the Administrative Appeals Tribunal (AAT) disallowed deductions for the payment of an initial upfront fee to participate in a franchisee arrangement.

A group of taxpayers were involved in an arrangement whereby they would pay an upfront amount to secure franchise rights. They also paid legal and administration fees in respect of the franchise.

These outgoings were claimed as a deduction by all taxpayers, in their income tax returns.

The franchise business involved marketing financial services to accounting firms in certain areas throughout Australia.

The Commissioner amended the taxpayers' assessments for the periods in question, disallowing the deductions for the franchise fee and administration fees on the basis they were outgoings of a capital nature.

The taxpayers objected to this decision arguing that the payments were made in the course of carrying on a business and were

therefore deductible as an outgoing of a revenue nature.

The AAT upheld the Commissioner's position. It indicated that there was no business being conducted and the expenses were not incurred in the production of assessable income. Instead the AAT held that the taxpayers had made a capital investment.

➤ **TIP:** Broadly, a tax deduction will be available where it can be shown that the expense is incurred in carrying on a business to produce assessable income, as opposed to acquiring a capital or investment asset.

Personal services income

In a recent decision, the Administrative Appeals Tribunal (AAT) held that consultancy income derived by a company was personal services income (PSI). The income was earned by the company for the provision of the services of an engineer, who was also the sole director of the company.

The taxpayer consulted as an electrical engineer through his company. Over several contracts the company derived income for

the provision of engineering services.

Readers may remember that the PSI rules apply where the income is derived mainly as a reward for the individual's personal efforts or skills.

In such circumstances, the income represents the individual's PSI, irrespective of whether or not that income is derived in another entity, such as a company.

The Commissioner attributed the company's income to the taxpayer directly.

In his view, the taxpayer was not operating a personal services business and therefore the PSI rules should apply.

Broadly, the taxpayer argued the company satisfied two of the four tests required for a personal services business. These tests were:

- the results test — where at least 75% of the personal services income derived is for producing a result; and
- the unrelated clients test — where a taxpayer derives personal services income from at least two entities which are not associates of each other.

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THE REPORT (Cont.)

The AAT held that the Commissioner had correctly attributed the income of the company to the taxpayer as personal services income and that a personal services business did not exist in the circumstances of the case.

Deductions disallowed for scheme

In a recent decision, the Federal Court has upheld the Commissioner's decision to disallow deductions in relation to management fees, license fees and marketing fees paid by investors.

A partnership of individuals and a company were established to invest in a business which provided an information product to travel agents.

As part of their involvement in this business, each partner was required to pay license fees, management fees and marketing fees. These fees were largely funded by limited recourse loans.

Broadly, under the limited recourse loan arrangement, the lender only had access to 50% of the gross income from exploiting the licenses in overseas territories (after deducting certain expenses for recovery of the loan).

The Tax Office's position on limited recourse finance is that deductions are only available for amounts actually paid.

Amounts not ultimately incurred as a result of the limited recourse nature of the loan will not be deductible.

In this instance, the taxpayers claimed a deduction for the entire amount of the license fee, management fee and marketing

fee paid as part of their investment, despite the fact that they were largely funded by limited recourse loans.

The Commissioner amended each of the taxpayer's assessments and applied Part IVA of ITAA 1936 to each taxpayer.

He argued that the sole or dominant purpose of entering into the arrangement was to obtain a tax benefit. He indicated that this argument was based on the overall size of the management fee paid relative to the income earned and the fact that the scheme lacked commercial substance.

In conclusion, the Federal Court held that the taxpayers had entered into a scheme for the sole benefit of obtaining a tax benefit as the deductions claimed were far in excess of any funds each of the taxpayers actually contributed.

Each taxpayer's deductions were disallowed to the extent that they exceeded their actual cash outlays.

➤ **TIP:** Taxpayers should be wary when entering into arrangements that involve limited recourse debt and should seek advice as to the availability of deductions.

Penalties for recklessness in preparing BAS

In a recent decision, the Administrative Appeals Tribunal (AAT) has set aside a decision regarding shortfall penalties of approximately \$134,000 imposed on the taxpayer for recklessness in preparing two business activity statements (BASs).

The taxpayer claimed to misunderstand the advice given to them by the Tax Office and indicated that he did not have an intention to mislead or avoid any payment of GST.

As the relevant law and the calculation of the liability was complex, the AAT held that, under the circumstances, reasonable care was taken by the taxpayer in relation to the BASs.

Tax Office Compliance program

The Tax Office has released their compliance program for the 2007/2008 financial year, indicating their tax priorities for the year include the following issues:

- reviewing whether taxpayers have correctly accounted for CGT on the disposal of assets;
- work-related expenses, specifically regarding tourism workers, travel consultants, fitness and sporting industry employees, construction industry employees, mining employees and guards and security employees;
- company executives with remuneration in excess of \$1 million who aren't fully reporting income;
- rental income and expenses with a specific focus on unusual patterns of rental claims; and
- aggressive tax planning where taxpayers are creating losses through the acquisition of prepaid warrants, and through new financial products.

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