

# sharptax

Grant Thornton periodical  
reporting on taxation issues  
for business owners.

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This edition of **sharptax** looks at the implications of a few recently decided court cases...

## Managed Investment Scheme Update

Following on from last month's news regarding managed investment schemes (MIS), the Commissioner has announced that his existing ruling will remain in place until 30 June 2008, with the new ruling to apply from 1 July 2008, instead of 1 July 2007 as previously announced.

## Indooroopilly Children Services (Qld) Pty Ltd v FCT

ABC Learning Centres Limited (ABC) is a provider of child care services. While ABC holds child care centre licences through a subsidiary, the centres themselves are operated by regional franchisees under sub-licenses. Fees charged by ABC to the franchisees are based upon the net revenue of the child care centres.

Given that child care costs are largely staff-related and given the high staff turnover levels in the industry, ABC had developed a share scheme that applied to the staff of the franchisees. ABC believed it would ultimately benefit from the scheme in the form of higher franchise fees arising from decreased staff turnover throughout its franchisees.

The Carer's Share Plan (CSP), as it was known, was to be a discretionary trust administered by an independent trustee. ABC issued shares to the CSP for no consideration and employees of the ABC franchisees were eligible to receive distributions from the CSP at the discretion of the trustee.

At no stage throughout the planning of the CSP did ABC consult with their franchisees and no consideration was paid by the franchisees to ABC in relation to the CSP.

Prior to the implementation of the CSP, ABC sought a private ruling from the Commissioner seeking to confirm that FBT will not apply to the CSP. The Commissioner ruled that FBT was payable.

The Full Bench of the Federal Court upheld the previous single judge's decision that the issue of shares from ABC to the CSP is not a fringe benefit as the relevant employees are unknown at the time of the issue. The decision of *Essenbourne Pty Ltd v FCT* was sighted as the authority.

Of particular note are the comments by Justice Allsop who was quite dismissive of the Commissioner for disregarding the *Essenbourne* case and other similar authorities.

The Commissioner has subsequently announced that he will not be appealing this case and that Taxation Ruling TR 99/05 will be amended to incorporate the decision of this case. Furthermore, the Commissioner will be reviewing outstanding cases involving employee benefit arrangements that are to be impacted by this case.

Where to from here? This decision provides employers with a clearer path for an employee benefit trust to be implemented without incurring an FBT liability. However, the deductibility of payments made to such a trust needs to be ascertained on a case-by-case basis.

## Guest v FCT

This is another case on the deductibility of post-business cessation interest. In this case the taxpayer held an interest in a blueberry growing venture. The taxpayer entered into the venture during June 1987, financed by a loan that could have been non-recourse against the taxpayer if two particular principal repayments were made on time.

Unfortunately for the taxpayer, the principal repayments were made late and, as a consequence, the non-recourse provision under the loan agreement ceased to have effect. During July 1991, the financier was placed into receivership and the taxpayer ceased involvement with the blueberry project.

Over the next five years, the taxpayer was twice advised by the receivers that he remained liable for the outstanding loan and accrued interest and when the loan was reassigned by the financier in November 1997, the assignee and the taxpayer agreed to a repayment plan. From 1997/98 year onwards, the taxpayer claimed interest deductions on the loan which were subsequently disallowed by the Commissioner.

Following on from previous post-business cessation deduction cases, the Federal Court ruled in the taxpayer's favour, citing that the nexus of the loan was not broken despite the fact that the taxpayer:

- ceased involvement in the project in 1991
- failed to repay the loan by the due date (being March 1992)
- failed to accept an offer put forward by the received in August 1996

There is now a clear line of cases in which post-business cessation expenses can be deducted, but it remains to be seen whether the Commissioner will continue to read down the circumstances in which he considers that expenses are deductible.

## FCT v Slade Bloodstock Pty Ltd

Slade Bloodstock Pty Ltd was incorporated by Mr and Mrs Slade to act as a trustee for a unit trust which undertakes racehorse syndication activities, whereby yearlings would be acquired and then syndicated to investors.

In order to provide for working capital for the venture, Mr & Mrs Slade lent money to Slade Bloodstock on an interest-free, at call basis in accordance with a loan agreement between the parties. Under the loan agreement, Mr and Mrs Slade could request the loan be repaid via the payment of their personal expenses, such as school fees and credit cards.

During 2000, 2001 and 2002, Slade Bloodstock paid for or reimbursed the private expenditure incurred by Mr and Mrs Slade which at the end of each year was offset by journal entry against the balance of the loan. At no time during this period did Mr or Mrs Slade receive salaries from Slade Bloodstock.

The Commissioner sought to treat the private expenses paid as an expense payment fringe benefit.

While the AAT set aside the FBT assessments, the Commissioner appealed to the Federal Court and somewhat surprisingly was successful in doing so. The Federal Court ruled that the AAT erred by concluding that the benefits were provided in respect of the Slades being ultimate beneficial owners, as that in itself does not prevent the benefits from also being provided as an employee.

Furthermore, as the venture had no employees whatsoever Mr and Mrs Slade received the benefits "directly or indirectly" in respect of employment.

From this decision, it seems that loan repayments should be made in cash so that there is no possibility of an expense payment benefit arising. As it stands however, it seems that many private companies that have repaid loans in a similar fashion may unknowingly have triggered FBT liabilities.

It remains to be seen if this case will be appealed or how the ATO and the Government will respond to the case, as it seems unreasonable that the repayment of a loan can give rise to FBT. We will keep you informed of any news in this regard.

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