

# sharptax

Grant Thornton periodical  
reporting on taxation issues  
for clients in business.

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This edition of Sharp Tax brings you updates and a reminder of the consequences of entering into arrangements that **‘shift value’**.

## Service entity arrangements

At the end of April the Australian Taxation Office (ATO) released the final information relating to service entities, being Taxation Ruling TR 2006/2 and the accompanying guidance booklet.

The Ruling is not too dissimilar from its draft in that it requires the examination of the particular facts and circumstances to determine whether service fees paid are deductible under general provisions, or whether the fees have been incurred for some other non-deductible purpose. The ATO position is that excessive fees may have been incurred at least in part for a non-deductible purpose.

The ATO provides various benchmark rates for different services provided by service entities, which are significantly lower than what many taxpayers have considered to be reasonable. However, to depart from these ATO indicative rates would require detailed benchmark studies to support the rates utilised.

The response to the new guidelines has been mixed. Some welcome the shift in the ATO benchmarks, while others believe that they are still unrealistic.

Taxpayers have until 30 April 2007 to review their arrangements.

After this date they may be at risk of an audit if their arrangements are not in line with the ATO rates as provided. However, high risk cases may be the subject of further ATO scrutiny in the period up to 30 April 2007.

## Be cautious when undertaking sale and leaseback arrangements

The ATO has released Draft Taxation Ruling TR 2006/D5, which addresses the ATO's views in relation to the taxation treatment of various sale and leaseback arrangements.

The ATO states that usually the vendor of a depreciating asset will have a balancing adjustment event which will either give rise to assessable income or an allowable deduction for the vendor. The vendor will also be entitled to claim deductions for lease payments. The lessor will be assessable on the lease back income, but can claim deductions including the decline in the asset's value. Should it sell the asset upon termination of the lease then it too will have a balancing adjustment event.

The ATO then notes that the tax law contains special provisions addressing hire purchase arrangements. It notes that where the contracts contain a repurchase clause, the arrangements may be more appropriately reclassified as a hire purchase arrangement, thus the lessee will be entitled to depreciation and interest deductions and the lessor will be assessed on interest received.

The ATO also note that the terms and conditions of some arrangements may constitute a sham or call for the application of general anti tax avoidance provisions of our law and deny tax benefits arising.

If you are considering a sale and leaseback arrangement to finance transactions or other business undertakings, we strongly recommend you seek taxation advice before doing so.

## Value Shifting

Value Shifting is a taxation issue that is often overlooked in the reorganisation or succession planning for privately owned companies or trusts.

A value shift can occur in a number of ways and the tax laws have rules for two categories of shifting value, being:

- direct value shifting; and
- indirect value shifting.

A direct value shift occurs where there is a decrease in the market value of an equity interest or a loan in a company or trust and that movement in market value is attributable to anything done under a "scheme" (that is very widely defined). It also requires that the entity in which there is a shift in value to have a controller.

Common examples of when a direct value shift arises include the following:

- issuing new shares or interests at a discount to market value
- changing voting rights attached to shares
- buying back shares or other interests

Where a direct value shift occurs, and the shift in value is more than \$150,000, a capital gain may arise to the party that has given up value, or a cost base adjustment may arise.

An indirect value shift arises where economic benefits are transferred between entities, usually on a non-arm's length basis or for less than market value. An indirect value shift requires some form of ultimate common ownership of the entities and can arise from the transfer of any form of goods or services between the entities.

However, there are a number of exemptions that can apply for indirect value shifts from which you may benefit (including where the value of the shift is less than \$50,000). Where certain conditions are satisfied, the indirect value shift results in adjustments to the tax cost bases of the interests of the shareholders in the entities involved.

Whilst the above may indicate whether or not a direct or indirect value shift may have occurred, the precise facts and circumstances of each situation must be reviewed to determine whether the value shifting laws apply and, and if so, whether there are any material tax consequences as a result.

As noted above, value shifting is often a material tax issue whenever interests in family owned entities are varied in order to pass on the benefits of ownership to relatives or related parties.

## Sporting clubs not considered tax exempt

In a recent AAT Case, AAT Case [2006] AATA 265 Re South Sydney Junior Rugby League Club Limited and FCT, the AAT has reconfirmed the position that a licensed club associated with a sporting team is not a tax exempt entity like a sporting club. A similar position had previously been adopted in Cronulla-Sutherland Leagues Club v FCT (1990) 21 ATR 300.

In this case, the licensed club had a very large membership and offered a range of activities, facilities and entertainment, with an emphasis on gambling income. It was found that the support or encouragement of rugby league was not a main object or even an object equal to that of the licensed club itself.

## Government seeks to reduce compliance costs

Recently the Federal Treasurer announced an interim response to the Report of the Taskforce on Reducing the Regulatory Burden on Business. A final response is due to be released by the end of July 2006. However, this interim response dealt with the following compliance measures:

- the FBT exemption threshold for minor and infrequent benefits is to increase from \$100 to \$300 from 1 April 2007;
- the FBT reporting threshold is to increase from \$1,000 to \$2,000 from 1 April 2007; and
- the incorporation fee for companies has been reduced from \$800 to \$400.

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