

## ATO Tackles Wash Sales

A common year-end tax planning technique is under attack from the Australian Tax Office (ATO).

The ATO has released a tax ruling and a taxpayer alert to confirm its view regarding “wash sales” i.e. schemes involving the disposal and purchase of the same, or substantially the same, asset within a short period.

The schemes that the ATO are concerned about are those that are driven by the sole and dominant purpose to create a capital or revenue loss to offset a taxable gain. Under this type of “wash sale” arrangement, the interest in the asset disposed of is substantially reinstated by the taxpayer and there is no significant change in the taxpayer’s economic exposure in the asset. In other words, the scheme is devised to create an artificial loss for the purpose of obtaining a tax benefit.

The ATO considers this type of arrangement to infringe upon the general anti-avoidance provisions in Part IVA.

### Example

The following example describes a typical wash sale scheme:

Mr. A derives a capital gain in an income year. In order to reduce the tax payable on the gain, he decides to sell his non-performing shares in ABC Limited to realise a capital loss in the same income year. Almost immediately after the disposal of the ABC shares (original shares), Mr. A buys another parcel of shares in ABC Limited at substantially the same price as he sold the original shares for.

The ATO would consider that Mr. A has artificially realised a loss to reduce the tax payable on the capital gain he made in a separate transaction.

This is only one example of a “wash sale” that may fall foul of the ATO ruling.

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### Period between Sale and Acquisition

In the above example, the assets are sold and repurchased immediately but the ruling considers that a longer period between sale and repurchase may still be a problem if it is apparent that the taxpayer’s exposure to fluctuations in the value of the asset between these times was minimal.

### Transfers to or between Trusts

The ruling also has examples of disposals of assets between two trusts that are controlled by the same person and with similar terms. Where the disposal has the dominant purpose of creating a loss that can be offset against a taxable gain there may be a problem.

### Transfers to Associates

The ruling indicates that the disposal of assets to associates will generally not be seen as offensive provided the associate benefits in substance from the asset. The ruling indicates that the associate will not substantially benefit from the

assets where the assets are virtually worthless or where there is an understanding that the original holder of the assets will reacquire the assets. This is a reversal of the ATO's position in previous rulings that have now been withdrawn.

## Revenue Losses

The tax benefit obtained through a "wash sale" is usually a capital loss. However, it may also be a tax deduction if the asset is held on revenue account, for example, shares held by a day trader as trading stock.

However, as a day trader is able to revalue their stock at year-end, thereby obtaining a deduction for any reduction in market values of their shares, they will not need to conduct wash sales to realise the loss on their trading stock. This does not mean day traders are excluded from the operation of Part IVA in terms of wash sales.

## Substantially the Same Assets

The ruling will not only apply where the assets sold and repurchased are the same assets but can also apply where the assets acquired are substantially the same as the assets sold.

Reference: TR 2008/1

# 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 similar 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.

## 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

### Capital Protected Loans

The Attractiveness of capital-protected loans has been reduced after the recent budget announcement increasing the non-deductible portion of the interest on the capital-protected loan.

The deductible benchmark interest rate applicable for capital-protected loans entered into from 13 May 2008 will be reduced to the Reserve Bank of Australia's (RBA) indicator variable rate for standard housing loans. Interest in excess of this level will be treated as the cost of capital protection and not deductible if on capital account.

The current law, which applies the RBA indicator variable rate for personal unsecured loans, will continue to apply to existing arrangements for the shorter of five years or the life of the product.

### Family Trusts – reversal of concessions

The Government will 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 it to 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 will be 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 that 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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