

the Spry Roughley report

explanatory memorandum

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CURRENCY: This issue takes into account all developments up to and including 15 February 2012.

Wrong property valuations can be costly

Property valuations are relevant in many tax contexts, including CGT and GST. A disagreement with the Australian Tax Office (ATO) on a valuation can materially alter the tax consequences of a transaction eg see the recent decision in AAT Case [2011] AATA 857, *Re M & T Properties Pty Ltd v FCT*, where the taxpayer failed the maximum net asset value test because of a valuation issue.

The ATO has now released an issues paper highlighting what it says are recurring issues concerning valuations of property in relation to the application of the GST margin scheme provisions. The ATO notes that many valuations are referred to the Australian Valuation Office (AVO) for evaluation, particularly as to whether or not the valuation specifies a value that is within a range that is reasonable. Often, when certain elements of a valuation are outside an acceptable range, the ATO says the ultimate valuation is higher than it should be resulting in a lower margin and less GST payable. The paper was prepared in collaboration with the Australian Property Institute and the AVO.

The paper sets out the main issues regarding non-complying valuations identified by the ATO and its position when those issues occur. Some highlights from the paper are summarised in the following table.

Issue	ATO position
Profit and risk ratios: When valuing a property on the basis of a hypothetical development approach, the anticipated profit and risk margins are determined after consideration of the level of risk associated with a project as at the date of valuation. In many cases, the ATO says profit and risk ratios are not supported in the valuation report and appear to be well below what could reasonably be expected.	Valuers need to determine profit and risk ratios that are reflective of the characteristics and condition of the subject property at the valuation date. These ratios need to reflect realistic profit expectations with appropriate and reasonable weightings for risks apparent at the date the property is required to be valued.
Market interest rates: Valuations need to reflect an open market interest rate. The ATO considers the use of negotiated commercial rates, "in-house" finance rates or special discounted rates may not be appropriate as these rates are not reflective of open market rates but, rather, are specific to a particular entity or a set of circumstances.	Valuers need to apply appropriate interest rates at the date the property is to be valued. These rates should reflect commercially available rates supported by evidence from within the industry at that point in time or alternatively based on the rates published by the Reserve Bank of Australia.
Comparable sales: Often comparable sales are unavailable at valuation date and pre- and post-valuation date sales are used as a reference point for a valuation. Also there are instances where	Comparable sales must withstand objective scrutiny of their comparability. If post valuation date sales or remote area sales are to be used, these must have commentary as to why the

Issue	ATO position
<p>purported comparable sales from a geographically different area or different market segment to that of the subject property are referenced in a valuation. Often, supporting sales data in property valuations is provided without any explanation as to why the data is comparable.</p>	<p>valuer considers it reasonable to use these sales to establish the subject property value.</p>
<p>Development costs: Many valuers undertaking hypothetical development valuations have completed these valuations with the exclusion of important development costs such as acquisition costs, legal costs and holding costs.</p>	<p>All relevant costs with appropriate weighting should be included in a hypothetical development valuation.</p>

Other issues covered in the paper include:

- project lead times, selling timeframes and completion timeframes;
- contamination on a site;
- assumptions and conclusions in conflict with evidence;
- value of interest that existed at the valuation date;
- pre-sale values increased for market movements when calculating gross realisations; and
- post-valuation date knowledge/events.

The ATO said it accepts that valuations can, by their very nature, be a subjective assessment of a property's value and in many cases there are interpretive assessments of impacts on the property value. However, it said that regardless of this subjectivity, there is still an expectation that values will fall within a "reasonable range". It added that this is regardless of the valuer who is valuing the property or the method adopted.

Where the AVO opinions are supported by evidence, and also align with the ATO's perception of reasonableness, the ATO said these will be referred to the relevant valuer to enable those noted elements of the valuation to be reviewed. If there is sufficient merit in the valuer's adopted assumptions and conclusions, such that these can be considered reasonable, the ATO said the valuation can be accepted as a complying valuation. Where the valuer's assumptions and conclusions are not sustainable based on evidence, or are not reasonable, the ATO said the valuation cannot be considered a complying professional valuation.

Source: ATO publication, "Valuation issues paper", 17 January 2012
www.ato.gov.au/businesses/content.aspx?doc=/content/00304814.htm

ATO to hold refunds pending checks

The government has announced that will introduce legislation into Parliament to allow the Tax Commissioner to hold onto refunds for verification checks prior to payment. The government has released exposure draft legislation for comment. Public consultation closed on 21 February 2012.

Assistant Treasurer Mark Arbib said the "legislation would provide the Commissioner with legislative discretion to delay refunding certain amounts to taxpayers pending necessary verification of their claims". Treasury indicated the "discretion would apply in relation to refunds and payments arising under all taxation laws that the Commissioner administers".

The proposed legislation follows the High Court's refusal to grant the Commissioner special leave to appeal against the Full Federal Court decision in *Multiflex Pty Ltd v FCT* [2011] FCA 1112. The Full Federal Court had dismissed the Commissioner's appeal against paying a GST refund and upheld the Federal Court's earlier order directing the Commissioner to comply with s 35-5 of the GST Act and s

8AAZLF of the TAA by immediately paying to the taxpayer the net amount notified in its GST return for each of the tax periods January, February, March, April and May 2011.

Following the High Court's decision, the ATO had issued a Decision Impact Statement on the decision. In the Statement, the ATO said the Commissioner must perform duties under s 35-5 of the GST Act within the reasonable time for administrative processing of a refund or credit. The ATO had also said, at the time, that it would "progressively release all affected activity statement refunds as soon as administratively possible". (Note: The ATO's view on the proposed legislative amendments was not known at the time of writing.)

Source: ATO publication, "Multiflex decision impacts to GST refunds", 13 December 2011
www.ato.gov.au/content/00301633.htm;

ATO Decision Impact Statement on Multiflex case, 12 December 2011
[http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2FM159of2011%2F00001%22](http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2FM159of2011%2F00001%22;);

Assistant Treasurer's media release No 008, 15 February 2012
www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/008.htm&pageID=003&min=mva&Year=&DocType=;

Treasury Exposure Draft, "Commissioner's Ability to Retain Refunds Pending Verification Checks", 15 February 2012,
www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2280

Tricky excess super refund proposal

On 20 December 2011, the government released draft legislation seeking to implement its proposal to give eligible individuals a once-only option to be refunded excess concessional contributions up to \$10,000 from 1 July 2011. The proposed measures are contained in the Exposure Draft – Tax Laws Amendment (2012 Measures No 1) Bill 2012. Public consultation closed on 20 January 2012.

The draft legislation will give individuals the option to have excess concessional contributions up to \$10,000 (not indexed) released from their superannuation fund to the Commissioner and assessed as income at the individual's marginal tax rate. The individual will effectively pay tax on a refunded contribution at their marginal tax rate (less a 15% refundable tax offset for the tax already paid by the fund on the contributions), rather than the potentially higher excess contributions tax (ECT) of 31.5% (in addition to the 15% contributions tax for the fund).

Notice of offer for refund

Under the draft legislation, the Commissioner will be able to issue an individual with a notice of offer for a refund if:

- the Commissioner is satisfied that the individual has excess concessional contributions for a financial year;
- the amount of excess concessional contributions is \$10,000 or less;
- the individual does not have excess concessional contributions for an earlier financial year starting from 1 July 2011 (disregarding any previous application of the refund measure); and
- the individual has lodged an income tax return for the relevant income year within 12 months of the end of that year (or within such longer period as the Commissioner allows).

The Draft notes the option for a refund does not apply retrospectively (ie does not apply to excess concessional contributions made before the 2011–12 financial year), and any excess contributions made prior to 1 July 2011 are not relevant in determining eligibility.

If the individual accepts the refund offer, the Commissioner will be able to make a determination that excess concessional contributions for that year will be disregarded for the purposes of the ECT provisions. The Draft proposes that the offer will need to be accepted within 28 days using an approved form. It says taxpayers are not required to formally reject the offer. However, a decision not to accept the offer will not result in the individual being entitled for a refund offer in a future year.

The written notice of offer will not affect individuals' ability to advise the Commissioner that the contribution amount is incorrect, or apply for the Commissioner's discretion to disregard or reallocate the excess concessional contributions.

The Draft indicates that once an individual has excess concessional contributions in any financial year from 2011–12, they would no longer be eligible for the refund option in any subsequent year. In addition, the Draft says an individual's eligibility in a particular year could be affected by amendments to ECT assessments in an earlier year that removes the individual from having excess concessional contributions (eg as a result of the Commissioner exercising his discretion under s 292-465 of the ITAA 1997).

The Draft also says the following:

- if taxpayers exceed the concessional cap in more than one financial year before receiving notification from the Commissioner, then only the first year would be eligible for the refund;
- existing ECT processes will apply to non-eligible individuals and for those who do not accept the refund offer.

When an individual accepts the Commissioner's offer for a refund, the Commissioner will send a release authority to the relevant super fund and include the amount of excess concessional contributions in the individual's assessable income. The Commissioner will allow a tax offset equal to 15% of the excess concessional contribution (the tax offset is a refundable tax offset).

Superannuation funds

Once the choice to refund is received from the individual, the Commissioner will provide a superannuation fund with a compulsory release authority for 85% of the amount of excess concessional contributions. This takes account of the 15% contributions tax effectively paid by the fund.

The super fund must pay the relevant amount to the Commissioner (together with a release authority statement) within 30 days of receiving the release authority. However, the measure will not apply to defined benefit interests, interests in non-complying super funds, interest supporting a superannuation income stream or where the sum of the values of the superannuation interests held by a fund is less than the amount stated in the release authority.

Other implications

The Draft Bill also proposes consequential amendments to ensure that the refunded contributions are not included twice in the taxpayer's adjusted taxable income (ATI). In addition, refunded excess concessional contributions will not be used to reassess whether an individual is entitled to deduct personal superannuation contributions or whether an individual is eligible for a Government co-contribution.

Date of effect

The proposed amendments will apply to excess concessional contributions on and from 1 July 2011 and later financial years.

Industry responses

The following industry bodies have issued statements:

- Self-Managed Super Fund Professionals' Association media release, 22 December 2011 www.spaa.asn.au/media/57974/11_12_22_media_release_spaa_excess_concessional_contributions_refunding_not_enough_says_spaa.pdf
- Association of Superannuation Funds of Australia submission to Treasury, 20 January 2012 www.superannuation.asn.au/ArticleDocuments/1065/sub1203_Treasury_refund%20of%20excess%20concessional%20conts.pdf.aspx
- See also the 22 submissions received by Treasury in response to its previously released consultation paper, www.treasury.gov.au/contentitem.asp?ContentID=2199&NavID=037

Legislation proposed for introduction

The Superannuation Legislation Amendment (Stronger Super and Other Measures) Bill 2012 is proposed for introduction in Parliament in the 2012 Autumn Sittings. It is expected to contain the relevant amendments.

Source: Treasury Exposure Draft, "Refund of Excess Concessional Contributions", 20 December 2011
www.treasury.gov.au/contentitem.asp?NavId=&ContentID=2274

No more deductions with Youth Allowance

The government announced in the 2011–12 Budget that it would disallow deductions against government assistance payments following the High Court decision in *FCT v Anstis* [2010] HCA 40. The High Court held that individuals who incurred study expenses in gaining Youth Allowance (Student) were able to deduct the expenses from their assessable income.

On 20 January 2012, Treasury released draft amendments seeking to amend the ITAA 1997 (by inserting a new s 26-19) to disallow deductions against taxable government assistance payments that are eligible for a rebatable benefit. Government assistance payments that are eligible for the beneficiary rebate include, but are not be limited to: Austudy living allowance; ABSTUDY living allowance; Newstart Allowance; Youth Allowance (Student); and Youth Allowance (Jobseeker).

Under the proposed changes:

- Individuals would not be able to deduct a loss or outgoing they incur in gaining or producing a rebatable benefit (as defined in s 160AAA of the ITAA 1936) even if the loss or outgoing is not considered private or domestic in nature. The government considers that disallowing a deduction for expenses incurred in gaining or producing a rebatable benefit recognises taxable government assistance payments are effectively tax-free and individuals should not be able to receive an additional benefit by way of a tax deduction against their assessable income for any expenses they incur in qualifying for the payment.
- If an individual uses property in gaining or producing a rebatable benefit, the use of property will be taken to not have been for the purpose of producing assessable income, and will not be deductible.

Date of effect

The amendment is proposed to have effect from 1 July 2011.

Legislation proposed for introduction

The Tax Laws Amendment (2012 Measures No 1) Bill 2012 is proposed for introduction in Parliament in the 2012 Autumn Sittings. It is expected to contain the relevant amendments.

Source: Treasury Exposure Draft, "Disallow Deductions Against Rebatable Benefits", 20 January 2012
www.treasury.gov.au/contentitem.asp?NavId=002&ContentID=2296

Personal services income test failed

The Federal Court has confirmed the decision in AAT Case [2011] AATA 386, *Re Cameron and FCT* that the taxpayer failed the "unrelated clients" test for the purposes of the Personal Service Income (PSI) rules in Div 87 of the ITAA 1997 in relation to a drafting business he carried on through his private company. In doing so, it found that although the AAT failed to make relevant findings of fact on the nature and character of the offers or invitations to the public (or a section of it), nevertheless if it had done so it would have come to the same conclusion that it did – namely, that the test had been failed.

The "offers and invitations" in question comprised of the taxpayer contacting various clients by way of phone or email messages through his personal contacts or relationships in the industry (or to whom he

was recommended by other clients). The AAT found that this did not amount to “making offers or invitations to the public at large or a section of the public” as required by s 87-20(1)(b). In particular, the AAT found that such “word of mouth” advertising and “direct offers” did not meet this requirement and, in doing so, distinguished the decision in *FCT v Yalos Engineering Pty Ltd* (2009) 75 ATR 744.

On appeal, the Federal Court found that although the AAT had failed to make full findings of fact on the nature of the offers or invitations to the public, any such findings would not have resulted in a different outcome. This was because, in terms of High Court authority on the issue in *Lee v Evans* (1964) 112 CLR 276:

- (a) there was no evidence which pointed to the offers or invitations being “general”, rather they were made to particular persons;
- (b) the offers or invitations were not made to persons chosen at random or to the public at large, but to an exclusive select group; and
- (c) if the offer had been declined there was no evidence that further offers would have been made or accepted by other parties.

However, the Federal Court held that the AAT erred in applying the “business premises” test in its finding that the test had been failed. In particular, the Court found it was not appropriate to determine the issue by merely comparing the turnover from the drafting business and the stevedoring business that was also conducted by the taxpayer (and his wife) from the premises without paying appropriate regard to the “temporal” aspect, ie the time spent in conducting drafting services from the premises. Accordingly, the Court remitted the matter to a differently constituted AAT to re-determine this issue.

Cameron v FCT [2011] FCA 1378, Federal Court, Edmonds J, 8 December 2011
www.austlii.edu.au/au/cases/cth/FCA/2011/1378.html

Unfranked dividends from off-market share buy-back

The AAT has held that an amended assessment for the year ended 30 June 2009 issued to a taxpayer was not excessive and the amount of \$451,600 for unfranked dividends received from a selective off-market buy-back of her shares in Edgecombe Bros Pty Ltd was properly included in her assessable income for that income year.

In February 2008, Edgecombe made an offer under the Corporations Act 2001 for the selective buy-back of all of the shares held by the taxpayer (and six other shareholders) in the company for \$93.25 per share, less amounts unpaid on any partly paid shares. The taxpayer held a total of 5,449 shares (“A” class and “E” class shares) in Edgecombe before the buy-back, issued to her at par value. The Tribunal said it was common ground that the taxpayer acquired all of her shares in Edgecombe before 20 September 1985 such that the sale of her shares did not have any CGT consequences.

The taxpayer accepted Edgecombe’s offer in August 2008. The taxpayer’s tax return for the 30 June 2009 year was lodged disclosing a taxable income of \$41,489 but it did not disclose any proceeds from the buy-back of the taxpayer’s shares. An amended return was later lodged which included “unfranked dividends” of \$451,600 relating to the taxpayer’s entitlement to the proceeds from the buy-back of her shares. This resulted in a tax shortfall of \$194,967.51. The Commissioner then issued an amended assessment and the taxpayer’s objection was disallowed. The taxpayer has paid the shortfall in full.

Although the deemed dividend was capable of being franked pursuant to s 200-20 of the ITAA 1997, the AAT said there was no evidence that Edgecombe allocated a franking credit to all or any part of the taxpayer’s deemed dividend and the amount of \$451,600 which was included in her amended tax return for the year ended 30 June 2009 was described as an “unfranked dividend”. Consequently, the AAT said the taxpayer was not entitled to any imputation credit in respect of that deemed dividend.

The AAT said the transaction whereby Edgecombe purchased the taxpayer’s shares was a “buy-back” (as defined in s 159GZZZK of the ITAA 1936) for the purposes of Div 16K of Pt III of the ITAA 1936 and was an “off-market” buy-back for Div 16K purposes. As the buy-back was an “off-market” buy-back, the

AAT said s 159GZZP applied and s 159GZZP(1) deemed the difference between the “purchase price” in respect of the buy-back and the part, if any, of the “purchase price” in respect the buy-back of the share which is debited against amounts standing to the credit of Edgcombe’s “share capital account” to be a “dividend” paid by the company. Pursuant to s 44 of ITAA 1936, the AAT held that the deemed dividend was assessable income of the taxpayer for the year ended 30 June 2009. Accordingly, the Tribunal said the amended assessment for the year ended 30 June 2009 was not excessive.

AAT Case [2011] AATA 878, Re Fitzgerald and FCT, AAT, Ref No: No 2011/1594, Walsh SM, 7 December 2011, www.austlii.edu.au/au/cases/cth/AATA/2011/878.html

Tribunal highlights responsibility of SMSF trustee

The AAT has affirmed that a SMSF was a non-complying fund for the year ended 30 June 2005 and that a deduction was not available for the misappropriation of funds by a trustee. Further, it affirmed that the base penalty of 75% of the shortfall was appropriate given the circumstances of the breach.

Background

The taxpayer was a trustee of an SMSF along with her husband. Between 9 May and 6 June 2006, an amount totalling \$3,460,000 was removed from the SMSF cash management account and transferred to the overseas bank account of the husband. At the time of the transfer, neither the taxpayer nor her husband had reached their preservation age, and no condition of release for the payment of benefits had been met. In addition, no income tax return for the SMSF was lodged for the 2005 year.

The Commissioner issued a notice of non-compliance to the taxpayer and an income tax assessment assessing the taxable income of the SMSF to be \$3,369,944 with associated tax payable of \$1,583,873.68. In addition, the Commissioner also issued a penalty assessment of \$1,475,322.50 in relation to the shortfall.

The taxpayer first argued that since she had no knowledge of her husband’s acts as co-trustee, she could not be held accountable for his actions. In addition, she said she had not derived any income as a trustee or in her own right or in any other way, as a consequence of her husband’s breach. Secondly, the taxpayer argued in any case that the SMSF was entitled to a deduction in respect of the misappropriated funds under s 25-45 of the ITAA 1997 such that the taxable income of the SMSF was nil. Thirdly, the taxpayer argued that the 75% administrative penalty imposed was incorrect as there had been no intentional disregard of the law.

Decision

The AAT held that, even though it was difficult not to feel sympathy for the taxpayer, the SMSF was a non-complying fund for the year ended 30 June 2005 as it had failed to pass the compliance test in s 42A(5) of the SIS Act. It said “although the taxation consequences are clearly significant to the [taxpayer], this is insufficient in the Tribunal’s opinion to overcome the seriousness of the contravention”.

Further, the Tribunal held that no deduction was available for the misappropriated funds to reduce the taxable income of the fund as the requirement in s 25-45 of the ITAA 1997 was not satisfied (as it was not misappropriated by an employee or agent). The Tribunal said “it could not be the intention of s 25-45 that a fund would be entitled to deduct a loss for which the trustee was responsible”. It also said there was no evidence that the taxpayer knew of the loss in the financial year ended 30 June 2005 and hence no deduction would be available in any case.

In relation to penalties, the Tribunal said the taxpayer “bore the onus of proving that the amount of taxable income assessed exceeded the actual taxable income of the fund, and she had failed to demonstrate that the estimates were excessive”. Hence, the AAT held the 75% shortfall penalty was appropriate given the “flagrancy of the breach by the trustee of the Fund as an entity” and that there was no basis for remission.

Appeals update

The taxpayer has appealed to the Federal Court against the decision.

AAT Case [2011] AATA 940, Re Shail Superannuation Fund and FCT, AAT, Ref No 2010/0950, Hughes M, 23 December 2011, www.austlii.edu.au/au/cases/cth/AATA/2011/940.html