



# client alert

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## Business sale earnout arrangements back in spotlight

The Coalition government has decided that it will proceed with a long-standing proposal to improve the current tax treatment of earnout arrangements.

Earnout arrangements are a common way of structuring the sale of a business. Under a standard earnout arrangement, business assets are sold for a lump sum plus a right to further payments that are contingent on the performance of the business for a specified period following the sale.

The earnout right typically reflects the uncertainty surrounding profitability, the value of goodwill and cash flow projections. Under the current rules, the calculation of the tax on the sale is based on the lump sum as well as the estimated value of the earnout right, which means the seller could end up paying tax on an amount not yet received. The proposed changes aim to resolve this, as well as other tax issues.

The government has indicated that it intends to pass legislation to implement this proposal during 2014.

**TIP:** Although the tax changes would not apply until changes to the law are formally passed, the ATO has released details of administrative treatment that allows a transitional approach for certain cases. Contact our office for further details.

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## ATO administration of valuations under review

The Inspector-General of Taxation, Mr Ali Noroozi, is reviewing the ATO's administration of valuation matters.

"Australia's tax and superannuation laws are increasingly relying on concepts such as market value", Mr Noroozi said. Valuations may be required for a variety of assets, transactions, businesses and liabilities for taxation purposes. For example, market

valuations may be required in order to access the capital gains tax concessions for small businesses.

"Whilst there may be sound economic reasons for using such concepts, their use has resulted in a growing need for taxpayers to undertake significant valuation work", Mr Noroozi said. The Inspector-General said the main source of taxpayer concern is the compliance burden associated with valuations. He said that, "critically, valuations are inherently subjective and can be a source of significant uncertainty leading to ATO disputes which can be frustrating, time-consuming and costly".

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## ATO data-matching targets bank card sales

The ATO has announced that it will request and collect data relating to credit and debit card sales of merchants for the periods from 1 July 2012 to 30 June 2014 from various financial institutions, including the four major banks in Australia: Australia and New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation.

The ATO says the data acquired will be matched with certain sections of its data holdings to identify non-compliance with various tax obligations, including under-reporting or omitting business income. Records relating to 900,000 merchants are expected to be matched under the program.

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## Motel business refused GST tax credits

A motel business has been mostly unsuccessful before the Administrative Appeals Tribunal (AAT) in a dispute with the ATO concerning claims for input tax credits.

Following a tax audit, the Tax Commissioner refused the taxpayer's input tax credit claims of around \$88,500 for the quarterly tax periods from 1 January

2007 to September 2010. This was on the basis that there was a lack of documentation to substantiate the claims. The Commissioner had sought documentation from the taxpayer on various occasions, including sampling documentation for the June 2010 quarter.

However, the representative of the motel business was unable to produce all of the relevant documentation. He argued that a substantial amount of the records sought were lost due to flooding of the motel office in December 2008 and that he had been unable to respond to the requests for information as he was overseas.

Based on information provided before the proceedings, the Commissioner accepted that the taxpayer was entitled to some \$16,000 of the original claim. The AAT found that this was acceptable in the circumstances. However, it affirmed the Commissioner's stance on the balance of the claim. The AAT also rejected the taxpayer's additional input tax credit claim of around \$28,000. The AAT said the taxpayer had been given "every opportunity to produce documentation or other evidence to support his claims for imputation credits". It further noted that the taxpayer was unable to produce documents or other evidence that demonstrated that the credits that the Commissioner had allowed were insufficient.

**TIP:** It is essential for small businesses to have adequate record-keeping practices. A key consideration is to make sure that records can be understood by more than one person. Another consideration is to document how records are kept (ie paper records or electronically), what records are maintained and where they are located, and how back-up records are managed.

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## Director penalty notices valid

A director of a company has been unsuccessful before the New South Wales Court of Appeal in arguing that director penalty notices issued to him for some \$1 million (including interest) were invalid.

The Court of Appeal heard that the company had failed to pay withheld tax amounts to the Commissioner. The Commissioner then issued notices to the director, which sought to recover penalties alleged to be owing by the director in respect of the company's failure to pay the withheld tax amounts to the Commissioner.

The director essentially argued that the notices were invalid as they did not state expressly that his liability arose "because of an obligation that he has or had under" the provision in the Taxation Administration Act that deals with directors' obligations, and that the Commissioner was therefore not entitled to prosecute the proceedings against him. It was argued that because the notice did not make that specific reference, it did not meet all the requirements to be a valid notice under the law. The notices only referred to a specific legislative section concerning director penalty notices.

The Court of Appeal found that while the notices failed to refer expressly to the fact that the obligation arose under the relevant provision, as contended by the director, the notices clearly informed him that he was liable because of statutory provisions associated with the section concerning director penalty notices.

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## Tax changes following mining tax repeal

The Coalition government late last year introduced a Bill into Parliament to repeal the mining tax. A number of other tax measures and concessions associated with the mining tax are also proposed to be repealed or revised.

Under the changes, the small business instant asset write-off threshold will be reduced from \$6,500 to \$1,000. This means that, with effect from 1 January 2014, small business entities (ie generally, those with an aggregated turnover of less than \$2 million) will be able to claim a deduction for a value of an eligible depreciating asset that costs less than \$1,000 (rather than \$6,500) in the income year in which the asset is first used or installed ready for use. If implemented, this proposed change will return the threshold to the level it was prior to changes made by the previous Labor government. The special rules allowing accelerated depreciation for motor vehicles will also be discontinued with effect from 1 January 2014.

The Coalition government also proposes to delay the phased-in increase in the superannuation guarantee charge percentage to 12% by two years. This means that the superannuation guarantee rate would:

- pause at 9.25% for the years starting on 1 July 2014 and 1 July 2015;
- increase to 9.5% for the year starting on 1 July 2016; and
- gradually increase by half a percentage point each year until it reaches 12% for years starting on or after 1 July 2021.

**Important:** Clients should not act solely on the basis of the material contained in Client Alert. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. Client Alert is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.