

DESPS ADVISORY NOTICE 03/2007

ESP CLAIMS

SHARE TRADING

DESPS Advisory Notices provide advice or more detailed explanations concerning aspects of the ADF Reserves Employer Support Payments (ESP) Scheme.

ADVICE

The following advice is provided specifically in relation to Self-Employed Reservist claims when the Reservist claims to be in the share trading business.

Share Trading

When a Self-Employed Reservist claimant submits a claim on the basis of having a share trading business, normal eligibility criteria, including Principal Source of Income requirements, apply. However, delegates may have difficulty determining whether the claimant is in the share trading business or is simply a share holder.

A share trader is a person who carries out business activities for the purpose of earning income from buying and selling shares. Share trading may be accepted as a business for ESP purposes.

A share holder is a person who holds shares for the purpose of earning income from dividends and similar receipts. Share holding would not be accepted as carrying on a business for ESP purposes.

Section 3A(2)(b) outlines that an amount is taken to be income earned, derived or received by a member from a business or a company if the amount relates to the activities of the business.

As share trading can vary from a highly active to a largely passive activity (and a person can engage in both types of investing at the one time), it may be difficult to ascertain whether a Reservist who claims to operate a share trading business is really a 'share trader' or a 'share holder'.

In some cases, a Reservist may be both a share trader and a share holder at the same time (with some funds involved in regular share trading activities as part of a share trading business and other funds invested in longer term investments as a share holder). In this case, income should be apportioned (as appropriate) to the separate types of share activity.

The question of whether a person is a share trader or a share holder is determined on the facts of each individual case. This should be done by considering the following factors, which have been used in court cases for this purpose:

1. The nature of the activities, particularly whether they have the purpose of profit making.

2. The repetition and regularity of the activities.
3. Organisation in a business-like manner, the keeping of books or records and the use of a system.
4. The volume of the operations.
5. The amount of capital employed.

The way in which income and expenditure are dealt with in relation to shares varies depending on whether a person is a share trader or a share holder. This may also provide indicators as to a claimant's status.

A share trader's position may be briefly summarised as:

- Receipts from the sale of shares constitute income.
- Purchased shares would be regarded as trading stock.
- Costs incurred in buying or selling shares are an allowable deduction in the year in which they are incurred.
- Dividends and other similar receipts are included in assessable income.

A share holder's position may be briefly summarised as:

- The cost of purchase of shares is not an allowable deduction but is a capital cost.
- Receipts from the sale of shares are not assessable income – however, any net profit is subject to capital gains tax.
- A net loss from sale of shares may not be offset against income from other sources but may be carried forward to offset against future capital gains made from the sale of shares.
- Costs incurred in buying or selling shares are not an allowable deduction in the year in which they are incurred but are taken into account in determining the amount of any capital gain.
- Dividends and other similar receipts are included in assessable income.
- Costs (such as interest on borrowed money) incurred in earning dividend income are an allowable deduction at the time they are incurred.

Where a Reservist owns shares but is holding them for the purpose of generating a passive income from them through dividends, the Reservist is not considered to be carrying on a business, regardless of whether or not income received from dividends from these shares provides the Reservist with his or her PSI.

Examples

Example 1

CPO Smith decides to become involved in share trading. He has \$100,000 of his own funds available to purchase shares and access to a \$50,000 borrowing facility from his bank. He sets up a home office and conducts extensive research through mediums

such as investment magazines, financial newspapers and stock market reports, which he intends to continue to do throughout the share trading venture. His objective is to identify stocks that will increase in value in the short term enabling him to sell them after holding them for a short period.

CPO Smith invests \$50,000 in shares that he hopes will increase in value and can sell at a profit after holding them for approximately 10 weeks. During the Financial Year (FY) CPO Smith conducts 60 share transactions: 35 buying (average cost \$1,000 involving 500 shares) and 25 selling (average selling price \$1,500 involving 750 shares, after holding shares for 12 weeks). All transactions were conducted through stockbroking facilities on the internet. All receipts for shares purchased by CPO Smith and invoices for shares sold by CPO Smith are kept electronically. After expenses, CPO Smith made a \$2,000 profit.

This venture would be classified as a share trading business, as CPO Smith has demonstrated that he conducts his business on a regular basis, keeps organised records and conducts his business in a professional manner. He has traded a significant number of shares in a short period and has entered into the venture with the intention to make a profit. In this case, CPO Smith's share trading business would be classified as such because it has demonstrated all of the indicators of a share trading business.

Example 2

MAJ Taylor is an accountant. He has bought 200,000 shares in twenty 'blue chip' companies over several years. His total portfolio cost \$1.5 million. MAJ Taylor bought the shares because of consistently high dividends. He would not consider selling the shares unless their price appreciated markedly before selling them. In the FY, he sold 20,000 shares over the year for a gain of \$50,000.

Although MAJ Taylor has made a large gain on the sale of shares, he would not be considered to be carrying on a business of share trading. He has purchased his shares for the purpose of gaining dividend income rather than making a profit from buying and selling shares.

Full Time Work

The fact that a Reservist has been determined by a delegate to be conducting a share trading business does not automatically mean that the Reservist is employed in that business in a full time capacity (as the time required by a claimant to conduct a share trading business may vary considerably). When a Reservist has submitted a claim on the basis of working full-time in share trading, a delegate may still require evidence to satisfy themselves that the Reservist is involved in the work of share trading for at least 35 hours per week.

Further queries

Much of the content of this Advisory Notice was drawn from the Australian Tax Office fact sheet *Carrying on a business of share trading*, available at <http://www.ato.gov.au/businesses/content.asp?doc=/content/21749.htm>.

If **delegates or clerks** have any queries about this topic (or about any aspect of the ESP Scheme), they are encouraged to ring the ESP Help Line on 1800 001 696.

If **claimants** have any queries about this topic (or about any aspect of the ESP Scheme), they are encouraged to ring the Defence Reserves Support Help Line on 1800 803 485.

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Director ESP Scheme

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