

client alert | explanatory memorandum

October 2016

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 14 September 2016.

Personal middle income tax rate cut on the way

The *Treasury Laws Amendment (Income Tax Relief) Bill 2016* (the Bill) has been introduced in the House of Representatives. It proposes to amend the *Income Tax Rates Act 1986* to increase the third personal income tax threshold applying to personal income taxpayers. The rate of tax payable on individuals' taxable incomes from \$80,001 to \$87,000 would fall from 37% to 32.5%. The non-resident tax schedule would also be amended to increase the first income tax bracket to \$87,000. The rate of tax of 37% would apply to taxable income between \$87,001 and \$180,000, and the top marginal rate of tax would remain at 45% for taxable income over \$180,000. This measure was announced in the 2016–2017 Federal Budget.

On 2 September 2016, Federal Treasurer Scott Morrison announced that the ATO will now issue the new PAYG withholding tax schedules to reflect the lower personal tax rate in the Bill.

Employers will be required to lower the amount of tax withheld for affected taxpayers to factor in the new lower tax rate effective from 1 October 2016, Mr Morrison said. Any tax overpaid beforehand will be refunded by the ATO on assessment after the end of the 2016–2017 financial year. "This means that contrary to suggestions in media reports [...] all affected taxpayers will be able to obtain the benefit of the cut – not at the end of the year but within one month of new PAYG withholding tax schedules being published", the Treasurer said.

Shortly following the Treasurer's announcement, the ATO registered *Taxation Administration Act Withholding Schedules October 2016* (2 September 2016). This instrument contains eight withholding schedules and applies from 1 October 2016.

Tax rates summarised

The currently legislated rates for 2015–2016 and the proposed new personal tax rates and thresholds for 2016–2017 (including the 2% temporary budget repair levy, but excluding the 2% Medicare levy) are shown in the following: tables.

Personal income tax rates and thresholds

	2015–2016		2016–2017	
	Threshold (\$)	Rate (%)	Threshold (\$)	Rate (%)
First rate	0–18,200	0	0–18,200	0
Second rate	18,201–37,000	19.0	18,201–37,000	19.0
Third rate	37,001–80,000	32.5	37,001–87,000	32.5
Fourth rate	80,001–180,000	37.0	87,001–180,000	37.0
Fifth rate	180,001	47.0	180,001	47.0

With Medicare levy included, the top marginal rate is 49% from 1 July 2014 to 30 June 2017.

The following table shows the proposed rates for the 2016–17 year (including the 2% temporary budget repair levy, but excluding the 2% Medicare levy).

2016–2017

Taxable income (\$)	Tax payable
0–18,200	Nil
18,201–37,000	Nil + 19% of excess over \$18,200
37,001–87,000	\$3,572 + 32.5% of excess over \$37,000
87,001–180,000	\$19,822 + 37% of excess over \$87,000
180,001+	\$54,232 + 47% of excess over \$180,000

Finally, the following table shows the proposed tax rates for non-residents (including the temporary budget repair levy) for the 2016–2017 year.

2016–2017

Taxable income (\$)	Tax payable
0–87,000	32.5%
87,001–180,000	\$28,275 + 37% of excess over 87,000
180,001+	\$62,685 + 47% of excess over \$180,000

Date of effect

This measure applies to the 2016–2017 income year and later years.

Source: *Treasury Laws Amendment (Income Tax Relief) Bill 2016*, before the House of Representatives as at 14 September 2016,

<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3A5683%20Reconstruct%3A3Abillhome>; Treasurer’s media release, “Tax relief for average full-time wage earners to be delivered within weeks”, 2 September 2016, <http://sjm.ministers.treasury.gov.au/media-release/088-2016/>; Taxation Administration Act Withholding Schedules October 2016, registered 2 September 2016, <https://www.legislation.gov.au/Details/F2016L01380>.

Small business tax breaks in the pipeline

The *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016* (the Bill) has been introduced in the House of Representatives. It proposes to:

- increase the small business entity turnover to \$10 million from 1 July 2016;
- increase the unincorporated small business tax discount from 5% to 16% over a 10-year period; and
- increase the turnover threshold to qualify for the lower company tax rate and lower the company tax rate on a schedule over 11 income years, reaching a unified company tax rate of 25% in 2026–2027.

The proposal was announced as part of the 2016–2017 Federal Budget.

Corporate tax rate reduction

The Bill proposes to amend the *Income Tax Rates Act 1986* to reduce the corporate tax rate to 27.5% for the 2016–2017 income year for corporate tax entities that are small business entities; that is, corporate tax entities that carry on a business and have an aggregated turnover of less than \$10 million. This lower corporate tax rate would progressively be extended to all corporate tax entities by the 2023–2024 income year. The corporate tax rate would then be cut to:

- 27% for the 2024–2025 income year;
- 26% for the 2025–2026 income year; and
- 25% for the 2026–2027 income year and later income years.

The 27.5% corporate tax rate would progressively be extended to all corporate tax entities by the 2023–2024 income year.

To achieve the progressive extension of the 27.5% corporate tax rate to all corporate tax entities by the 2023–2024 income year, the 27.5% corporate tax would apply to a base rate entity from the 2017–2018 income year. A corporate tax entity would be a base rate entity if it carried on a business and had an aggregated turnover for the 2017–2018 income year of less than \$25 million. The aggregated turnover threshold that would apply to determine whether a corporate tax entity was a base rate entity that qualified for the lower corporate tax rate would be raised annually, so that:

- in 2018–19, the annual aggregated turnover threshold would be \$50 million;
- in 2019–2020, the annual aggregated turnover threshold would be \$100 million;
- in 2020–2021, the annual aggregated turnover threshold would be \$250 million;
- in 2021–2022, the annual aggregated turnover threshold would be \$500 million;
- in 2022–2023, the annual aggregated turnover threshold would be \$1 billion.

In the 2023–2024 income year, the aggregated turnover threshold test to qualify for the lower corporate tax rate would be removed. The corporate tax rate in that income year would therefore be 27.5% for all corporate tax entities. The corporate tax rate would then be further reduced in stages: to 27% for the 2024–2025 income year, 26% for the 2025–2026 income year and 25% for the 2026–2027 income year and later years.

In the period from the 2016–2017 income year until the 2022–2023 income year, the corporate tax rate would remain at 30% for companies that have an aggregated turnover equal to or exceeding the threshold for the income year.

Franking

The maximum franking credit that could be allocated to a frankable distribution paid by a corporate tax entity would be based on a tax rate of 27.5%. However, if the entity's aggregated turnover for the prior income year was equal to or exceeded the aggregated turnover threshold for the current income year, then the maximum franking credit that could be allocated to a frankable distribution paid by the entity would be based on the headline corporate tax rate of 30%.

Carry forward tax offset rules

Sections 65-30 and 65-35 of the *Income Tax Assessment Act 1997* (ITAA 1997) relate to the operation of the tax offset carry-forward rules. Consequential amendments would be made in particular income years to ss 65-30 and 65-35 to reflect the staged reduction in the corporate tax rate.

NFP companies

As the corporate tax rate for companies that are small business entities would be reduced to 27.5%, the shade-in limit for non-profit companies that are small business entities would be reduced to \$832 for the 2016–2017 income year.

Life insurance companies

The rate of tax paid by life insurance companies on the ordinary component of the company's taxable income would be reduced to 27.5% in the 2023–2024 income year (when the corporate tax rate would become aligned for all companies). Consistent with the treatment of other companies, the rate would then be cut: to 27% for the 2024–2025 income year, 26% for the 2025–2026 income year and 25% for the 2026–2027 income year and subsequent income years.

Date of effect

The corporate tax rate will be reduced from the 2016–2017 income year.

SME entity threshold increase

The Bill also proposes to amend the definition of "small business entity" in s 328 of ITAA 1997 to increase the aggregated turnover threshold for eligibility as a small business entity from \$2 million to \$10 million. The aggregated turnover threshold for access to the small business income tax offset would be limited to \$5 million, and the current aggregated turnover threshold of \$2 million would be retained for the small business CGT concessions. The proposal was announced as part of the 2016–2017 Federal Budget.

Small business entities with aggregated turnover of less than \$10 million would be able to access a number of small business tax concessions, including:

- immediate deductibility for small business start-up expenses;
- simpler depreciation rules;
- simplified trading stock rules;
- rollover for restructures of small businesses;

- immediate deductions for certain prepaid business expenses;
- accounting for GST on a cash basis;
- annual apportionment of input tax credits for acquisitions and importations that are partly creditable;
- paying GST by quarterly instalments; and
- the FBT car parking exemption.

The Bill would also amend Subdiv 328-F to create a different aggregated turnover threshold of \$5 million for the purposes of the small business income tax offset. It proposes to achieve this by modifying the meaning of “small business entity”. For the purposes of Subdiv 328-F, and therefore the small business income tax offset, an entity would work out whether it was a small business entity for the income year as if each reference in s 328-110 (which imposes the aggregated turnover threshold) to \$10 million were a reference to \$5 million.

Small business CGT concessions

The Bill proposes to amend Div 152 to retain the current aggregated turnover threshold of \$2 million for the purposes of the small business CGT concessions contained in that Division. It achieves this by replacing references to “small business entity” with the new defined term “CGT small business entity”. An entity will be a CGT small business entity for an income year if that entity is a small business entity for the income year, and would still be a small business entity for the income year if each reference in subs 328-110(1)(b) (which imposes the aggregated turnover threshold) to \$10 million were a reference to \$2 million.

Date of effect

The new thresholds would apply from the 2016–2017 income year. For the FBT car parking exemption, the new threshold would apply from the FBT year commencing on 1 April 2017.

Tax discount increase for unincorporated small businesses

The Bill also proposes to amend ITAA 1997 to increase the small business income tax offset to 16% of net small business income by the 2026–2027 income year. The proposal was announced as part of the 2016–2017 Federal Budget. In the 2025–2026 income year and earlier income years, lower rates of offset would apply as follows:

- For the 2016–2017 to 2023–2024 income years the offset would be 8% of net small business income.
- For the 2024–2025 income year the offset would be 10% of net small business income.
- For the 2025–2026 income year the offset would be 13% of net small business income.

The offset, introduced in the 2015–2016 income year, entitles individuals who are small business entities, or who are liable to pay income tax on a share of the income of a small business entity, to a tax offset equal to 5% of their basic income tax liability that relates to their total net small business income, capped at \$1,000. Although the proposed increases in the offset would increase the percentage of offset an eligible individual may claim, the offset amount would remain capped at \$1,000.

Date of effect

The first increase to the offset would commence on 1 July 2016 and apply from the 2016–2017 income year.

Source: *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016*, before the House of Representatives as at 14 September 2016,

<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5684%20Reconstruct%3Abillhome>.

Single touch payroll reporting legislative changes

The *Budget Savings (Omnibus) Bill 2016* (the Bill) has passed through the House of Representatives. It seeks to achieve savings across multiple portfolios to contribute to budget repair. The Bill would implement measures announced in the 2016–2017 Federal Budget and earlier Budget updates.

The Bill creates a new reporting framework, Single Touch Payroll (STP), for substantial employers to automatically provide payroll and superannuation information to the Commissioner of Taxation at the time it is created. A number of related amendments aim to streamline employer payroll and superannuation choice processes by allowing the ATO to pre-fill and validate employee information. The framework would apply from the first quarter beginning on or after the day the Bill receives Royal Assent.

Key points include the following:

- Entities with 20 or more employees (substantial employers) would be required to report the following information to the Commissioner:
 - withholding amount and associated withholding payment, on or before the day by which the amount was required to be withheld;
 - salary or wages and ordinary time earnings information, on or before the day on which the amount was paid; and
 - superannuation contribution information, on or before the day on which the contribution was paid.
- Employers that report these obligations (including those that voluntarily report) would not need to comply with a number of other reporting obligations under the existing law.
- For the first 12 months, reporting entities would not be subject to administrative penalties, unless first notified by the Commissioner.
- An employee may make a valid choice of superannuation fund by providing the relevant information to the Commissioner. In this situation, the Commissioner may disclose an employee's TFN and protected information to the employer.
- An employee may make an effective TFN declaration by providing the declaration to the Commissioner. In this situation, the Commissioner may make available to the employer the information in the employee's TFN declaration. Where the information has been provided by the employee to the Commissioner, the employer would not be required to send the declaration to the relevant Deputy Commissioner, nor would they be required to notify the Commissioner where no TFN declaration was provided to them by the employee. However, if an employee chose not to provide their TFN, the obligation would remain for the employer to notify the Commissioner.
- The Commissioner may provide employers with confirmation that a recipient's information, including their TFN, matched or did not match the information held by the ATO about the recipient (positive and negative validation).
- In general, STP reporting would commence on 1 July 2018 for substantial employers and the related amendments would apply more broadly from 1 January 2017. In some cases, the Commissioner may defer these start dates by legislative instrument.

The ATO has released a consultation paper (available on the ATO website at: <https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Papers-for-comment/Single-Touch-Payroll--ATO-consultation-paper/>) which seeks comments on the ATO's proposed administration of STP reporting, including the form the ATO guidance may ultimately take.

Previous announcements

The proposal was first flagged by then Minister for Small Business Bruce Billson on 20 June 2014. The Government officially announced the proposal on 28 December 2014. The ATO then released a discussion paper in February 2015. Following feedback, the Government announced on 10 June 2015 that it would undertake further consultation.

As part of the Mid-Year Economic and Fiscal Outlook 2015–2016 (MYEFO), released on 15 December 2015, the Government announced a \$100 non-refundable tax offset for expenditure on Standard Business Reporting enabled software for small businesses. The offset is not covered in the Bill's amendments. The MYEFO also announced the timetable for piloting STP reporting.

Other important changes

Other important changes proposed by the Omnibus Bill include:

- Rates of research and development (R&D) tax offset – reducing the rates of the tax offset available under the R&D tax incentive for the first \$100 million of eligible expenditure by 1.5%. The higher (refundable) rate of the tax offset will be reduced from 45% to 43.5% and the lower (non-refundable) rates of the tax offset will be reduced from 40% to 38.5%. Key points include the following:
 - Eligible entities that have annual turnover of less than \$20 million and are not controlled by an exempt entity or entities may obtain a refundable tax offset equal to 43.5% of the first \$100 million of eligible R&D expenditure in an income year, and a further refundable tax offset equal to the amount by which the R&D expenditure exceeds \$100 million multiplied by the company tax rate.
 - All other eligible entities may obtain a non-refundable tax offset equal to 38.5% of the eligible R&D expenditure and a further non-refundable tax offset equal to the amount by which the R&D expenditure exceeds \$100 million multiplied by the company tax rate.
 - The changes would apply from 1 July 2016.

- Fringe benefits – changing the treatment of fringe benefits under the income tests for family assistance and youth income support payments and for other related purposes. These proposed changes are also relevant for a number of income tax provisions. The meaning of “adjusted fringe benefits total” would be modified so that the gross rather than adjusted net value of reportable fringe benefits was used, except in relation to fringe benefits received by individuals working for public benevolent institutions, health promotion charities and some hospitals and public ambulance services. The changes would apply from the first 1 January or 1 July to occur after the day the Bill receives the Royal Assent.
- Indexation of private health insurance thresholds – pausing the income thresholds that determine the tiers for the Medicare Levy Surcharge (MLS) and the Australian Government Rebate (the Rebate) on private health insurance at the 2014–2015 rates until 2020–2021. This proposal was announced in the 2016–2017 Federal Budget.
- Indexation of family tax benefit and parental leave thresholds – making amendments to the family assistance indexation provisions to maintain the higher income free area for family tax benefit (FTB) Part A and the primary earner income limit for FTB Part B for a further three years. Under the current law, indexation of these amounts is paused until and including 1 July 2016. These amendments ensure that indexation does not occur on 1 July of 2017, 2018 and 2019. Similarly, amendments are proposed to ensure that the paid parental leave income limit is not indexed for a further three years, until 1 July 2020. These changes would apply from the date the Bill receives Royal Assent.
- Pension means testing for aged care residents – introducing the 2015–2016 MYEFO measure aligning the pension means testing arrangements with residential aged care arrangements. Key points include the following:
 - The changes would amend the social security and veterans’ entitlements legislation to remove the pension income and assets test exemptions that are currently available to pensioners in aged care who rent out their former home and pay their aged care accommodation costs by periodic payments.
 - The removal of the income test exemption is proposed to ensure that net rental income earned on the former principal residence of new entrants into residential aged care would be treated the same way under the pension income test as under the aged care means test, regardless of how the resident chooses to pay their aged care accommodation costs.
 - The current indefinite assets test exemption of the former principal residence from the pension assets test, where the property is rented and aged care accommodation costs are paid on a periodic basis, would also be removed. A person who enters a residential or flexible aged care service after the commencement of changes could still benefit from provisions in the *Social Security Act 1991* and *Veterans’ Entitlements Act 1986* that treat a person’s former residence as their principal home for a period of up to two years from the day on which the person enters care (unless the home is occupied by their partner, in which case it continues to be exempt).
 - The changes would only apply to pensioners who enter aged care on or after the commencement of the amendments. Existing aged care residents and those who entered aged care before the commencement date would be protected from the amendments. The changes would commence from the first 1 January or 1 July to occur after the day the Bill receives the Royal Assent.
- Minimum repayment income for HELP debts – establishing a new minimum repayment threshold for HELP debts of 2% when a person’s income reaches \$51,957 in the 2018–2019 income year.
- Indexation of higher education support amounts – changing the index for amounts that are indexed annually under the *Higher Education Support Act 2003*, from the Higher Education Grants Index (HEGI) to the Consumer Price Index (CPI), with effect from 1 January 2018. The proposal was announced in the 2016–2017 Federal Budget.
- Removal of HECS-HELP benefit – discontinuing the HECS-HELP benefit from 1 July 2017. The proposal was announced in the 2016–2017 Federal Budget.
- Job commitment bonus – giving effect to the “cessation of the job commitment bonus” proposal announced in the 2016–2017 Federal Budget.
- Interest charge on debts of ex-welfare payment recipients – introducing the legislative amendments required for the 2015–2016 MYEFO proposal to apply a general interest charge to the debts of ex-recipients of social security and family assistance payments. The interest charge would apply to social security, family assistance (including child care), paid parental leave and student assistance debts. The rate of the proposed interest charge (approximately 9%) would be based on the 90-day Bank Accepted Bill rate (approximately 2%), plus an additional 7%, as is already applied by the ATO under the *Taxation Administration Act 1953*. The charge would apply from 1 January 2017.

- Debt recovery for welfare payment integrity – introducing the legislative amendments required for the 2015–2016 MYEFO proposal to expand debt recovery for enhanced welfare payment integrity. The changes would allow departure prohibition orders (DPOs) to be made to prevent targeted debtors from leaving the country. DPOs would be used for debtors who persistently fail to enter into acceptable repayment arrangements. The changes would also remove the six-year limitation on recovery of welfare debts. The amendments would apply from the later of 1 January 2017 and the day after the Bill receives Royal Assent.
- Parental leave payments – introducing the amendments required for the 2015–2016 MYEFO proposal to apply consistent treatment of Commonwealth parental leave payments for income support assessment. The changes would amend the social security and veterans’ entitlements legislation to ensure Commonwealth parental leave payments and dad and partner pay payments under the *Paid Parental Leave Act 2010* would be included in the income test for Commonwealth income support payments. The changes would commence on the first 1 January, 1 April, 1 July or 1 October that occurs after the day the Bill receives Royal Assent.
- Carer allowance – aligning carer allowance and carer payment start day provisions by removing provisions that apply to backdate a person’s start day in relation to payment of carer allowance in certain circumstances. The general start day rules under Pt 2 of Sch 2 to the *Social Security Administration Act 1999* would apply to determine the date of effect of a decision to grant carer allowance. The changes would commence on the later of 1 January 2017 and the day after the Bill receives the Royal Assent.
- Employment income – removing the exemption from the income test for FTB Part A recipients and the exemption from the parental income test for dependent young people receiving Youth Allowance and ABSTUDY living allowance if the parent is receiving either a social security pension or social security benefit and the fortnightly rate of pension or benefit is reduced to nil because of employment income (either wholly or partly). The change would commence on 1 July 2018.
- Other changes proposed in the Bill relate to the following:
 - abolishing the National Health Performance Authority;
 - aged care – creating civil penalties for approved providers that do not make required notifications;
 - removing the family member exemption from the newly arrived resident’s waiting period;
 - repealing student start-up scholarships; and
 - creating a single appeal path under the *Military Rehabilitation and Compensation Act 2004*.

Watch for amendments

At the time of writing, the Bill had passed the House of Representatives with 19 Government amendments. The Government amendments to the Bill include:

- adding a new schedule which provides an income limit of \$80,000 on payment of the FTB Part A supplement;
- removing proposed amendments that would have stopped relevant social security payments to individuals undergoing psychiatric confinement because of serious offences;
- removing the Energy Supplement only for new recipients of FTB Part A, FTB Part B and the Commonwealth Seniors Health Card;
- restoring funding to the Australian Renewable Energy Agency (ARENA) of \$800 million over five years to 2021–2022; and
- removing proposed amendments to create a Child and Adult Public Dental Scheme.

Source: *Budget Savings (Omnibus) Bill 2016, before the Senate at as at 14 September 2016*, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5707%20Reconstruct%3Abillhome>.

Take care with work-related deduction claims, says ATO

The ATO has reminded individuals to make sure they get their deductions right this tax time. Assistant Commissioner Graham Whyte said the ATO has seen “claims for car expenses where logbooks have been made up and claims for self-education expenses where invoices were supplied for conferences that the taxpayer never attended”. While noting that most tax agents do the right thing, Mr Whyte said “sometimes the ATO identifies tax agents offering special deals, inflating claims to generate larger refunds”.

Mr Whyte said that in 2014–2015 the ATO conducted around 450,000 reviews and audits of individual taxpayers, leading to revenue adjustments of over \$1.1 billion in income tax. Mr Whyte said “every tax return

is scrutinised” and if a red flag is raised and the claims seem unusual, the ATO will check them with the claimant’s employer. In addition, Mr Whyte reminded taxpayers that this year the ATO has introduced “real-time checks of deductions for tax returns completed online”.

The ATO has prepared the following case studies.

Case study 1

A railway guard claimed \$3,700 in work-related car expenses for travel between his home and workplace. He indicated that this expense related to carrying bulky tools, including large instruction manuals and safety equipment. The employer advised the equipment could be securely stored on their premises. The taxpayer’s car expense claims were disallowed because the equipment could be stored at work and carrying them was his personal choice, not a requirement of his employer.

Case study 2

A wine expert working at a high end restaurant took annual leave and went to Europe for a holiday. He claimed thousands of dollars in airfares, car expenses, accommodation and various tour expenses, based on the fact that he’d visited some wineries. He also claimed over \$9,000 for cases of wine. All his deductions were disallowed when the employer confirmed the claims were private in nature and not related to earning his income.

Case study 3

A medical professional made a claim for attending a conference in America and provided an invoice for the expense. When the ATO checked, it found that the taxpayer was still in Australia at the time of the conference. The claims were disallowed and the taxpayer received a substantial penalty.

Case study 4

A taxpayer claimed deductions for car expenses using the logbook method. The ATO found the taxpayer had recorded kilometres in the logbook on days where there was no record of the car travelling on the toll roads, and further enquiries identified that the taxpayer was out of the country. The claims were disallowed.

Case study 5

A taxpayer claimed self-education expenses for the cost of leasing a residential property, which was not his main residence. The taxpayer claimed he had to incur the expense of renting the property as he “required peace and quiet for uninterrupted study which he could not have in his own home”. This was not deductible.

In addition to the rental expenses, the cost of a storage facility was claimed where “the taxpayer needed to store his books and study materials”. The taxpayer claimed he needed this because of the huge amount of books and study material associated with his course and had no space in his private or rented residence where these could be housed. This was not deductible.

The cost of renting the property was around \$57,000, with additional expense of \$7,500 for the storage facility. The actual cost of the study program he attended that year was only \$1,200.

Source: ATO media release, “ATO exposes dodgy deductions”, 16 August 2016,
<https://www.ato.gov.au/Media-centre/Media-releases/ATO-exposes-dodgy-deductions/>.

ATO eye on SMSFs and income arrangements

The ATO is reviewing arrangements where individuals (at or approaching retirement age) purport to divert personal services income (PSI) to a self managed superannuation fund (SMSF) to minimise or avoid income tax obligations, as described in Taxpayer Alert TA 2016/6 *Diverting personal services income to self managed superannuation funds*.

Taxpayers who have entered into a similar arrangement are encouraged to contact the ATO so it can help resolve any issues in a timely manner and minimise the impact on the individual and the fund. Where individuals and trustees come forward to work with the ATO on resolving issues, it anticipates that in most cases the PSI distributed to the SMSF by the non-individual entity would be taxed to the individual at their marginal tax rate.

The ATO will address issues affecting SMSFs on a case-by-case basis, but it will take individuals’ cooperation into account when determining final outcomes. Individuals and trustees who are not currently subject to ATO compliance action and who come forward before 31 January 2017 will have administrative penalties remitted in full. However, shortfall interest charges will still apply.

The ATO can be contacted by email at: SMSFStrategicCampaigns@ato.gov.au (with “TA 2016/6” in the subject line).

Taxpayer Alert 2016/6

On 29 April 2016, the ATO issued Taxpayer Alert TA 2016/6 to warn individuals about arrangements purporting to divert PSI to an SMSF to avoid paying tax at personal marginal rates.

Arrangements of concern

The ATO said it is reviewing arrangements whereby individuals (typically SMSF members at or approaching retirement age) perform services for a client but do not directly receive any (or adequate) consideration for the services. Rather, the client remits the consideration for the services to a company, trust or other non-individual entity (including an unrelated third party). That entity then distributes the income to the individual's SMSF, purportedly as a return on an investment in the entity. The SMSF treats the income as subject to concessional tax (15%) or as exempt current pension income.

Other variations of the arrangement include the income being remitted by the entity to the SMSF via a written or an oral agreement between the entity and SMSF, instead of as a return on an investment. The SMSF may also record the income from multiple entities or through a chain of entities. Alternatively, the entity may distribute the income to more than one SMSF of which the individual or associates are members.

ATO's view

The Commissioner considers that the arrangements may be ineffective at alienating income such that it remains the assessable income of the individual under s 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) or PSI. The ATO also warns that Pt IVA may apply.

The amounts received by the SMSF may also constitute non-arm's length income of the SMSF under s 295-550 of ITAA 1997, and therefore be taxable at 47%. Other compliance issues include:

- that the amounts received by the SMSF may be a contribution and generate excess contributions tax consequences for the individual; and
- superannuation regulatory issues – the arrangement may breach the sole purpose test under s 62 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Such breaches of the SIS Act may lead to the SMSF being made non-complying or to the disqualification of an individual as a trustee.

Source: ATO, Taxpayer Alert TA 2016/6, 29 April 2016,

<https://www.ato.gov.au/law/view/document?DocID=TPA/TA20166/NAT/ATO/00001>.

Social welfare recipients data-matching program

The Department of Human Services (DHS) has released details of a data-matching program which will enable it to match income data it collects from social welfare recipients with tax return-related data reported to the ATO.

The data matching will assist DHS to identify social welfare recipients who may not have disclosed income and assets to it. In addition, data received from the ATO will be electronically matched with certain departmental records to identify noncompliance with income or other reporting obligations.

DHS expects to match each of the approximately seven million unique records held in its Centrelink database. Based on non-compliance criteria, DHS anticipates it will examine approximately 20,000 records in the first phase of the project.

The category of people who may be affected by the data-matching includes welfare recipients who have lodged a tax return with the ATO during the period 2011 to 2014.

DHS says the information will be used to:

- verify the information reported to it by social welfare recipients;
- identify social welfare recipients who may not have disclosed income to DHS;
- match and validate the tax return and the PAYG datasets;
- identify discrepancies in the income declared to DHS by social welfare recipients; and
- consider whether it will initiate compliance action in relation to particular social welfare recipients (including debt recovery or a referral to the Commonwealth Director of Public Prosecutions).

Source: *Commonwealth Gazette*, Notice of data matching project between Department of Human Services and Australian Taxation Office, 19 August 2016, <https://www.legislation.gov.au/Details/C2016G01112>.

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