

client alert | explanatory memorandum

August 2018

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 23 July 2018.

Government launches new service to simplify business registrations

The government on 29 June 2018 officially launched the new stand-alone Business Registration Service, providing a simpler and clearer way to register a business. The service can be used for things such as applying for an Australian Business Number (ABN) or goods and services tax (GST) registration. It is designed for people starting a new business as a sole trader, company, partnership, trust or superannuation fund. Existing businesses with an ABN can also use the service to apply for tax registrations such as GST.

Revenue and Financial Services Minister Kelly O'Dwyer said the service will be more efficient for businesses, and they will avoid applying for registrations they do not need. She said the Business Registration Service is an integral part of the government's National Business Simplification Initiative.

Over 140,000 registrations have been submitted since the trial version of the service was released in April 2017. The Business Registration Service has reduced the average time taken to obtain a business and associated licences to under 15 minutes, the Minister said.

The Department of Industry, Innovation and Science, the ATO, ASIC and the Department of the Treasury collaborated to develop the service, which is available at www.business.gov.au.

Source: <http://kmo.ministers.treasury.gov.au/media-release/076-2018/>.

Illegal early access to super: ATO warning about scammers

The ATO has issued a warning to be aware of scammers who promise to organise access to people's retirement savings for a fee. Deputy Commissioner James O'Halloran said, "attempting to access your super early in this way is illegal, and people need to be aware of the financial dangers of falling prey to these promoters. These people could cost you a big part of your hard-earned retirement savings."

Unscrupulous promoters encourage people to illegally access their super early to help with expenses such as the purchase of a car, paying off debts, sending money to overseas relatives and taking a holiday. The ATO has seen promoters, mostly in western Sydney, targeting people with small to medium super balances, those involved in local community groups, and those who may not have engaged with their super before being approached.

The ATO suggests the following course of action if you are approached by someone claiming to be able to help with early access to super:

- do not sign any documents;
- do not provide the person with any of your personal details;
- stop any involvement with the scheme, the organisation or the person who approached you; and
- seek professional advice.

Source: www.ato.gov.au/Media-centre/Media-releases/Suburban-scammers-pushing-illegal-early-access-to-super/.

ATO gives small businesses the chance to seek independent review of ATO audit position

From 1 July 2018, the ATO is running a 12-month pilot to extend its independent review service to certain small business taxpayers. An independent review is where an independent technical officer from outside the ATO's audit area reviews the merits of the ATO's audit position before the assessment or amended assessment is issued.

The independent review is conducted by an officer from the ATO's Review and Dispute Resolution business line. This officer will not have been involved in the audit and will bring an independent "fresh set of eyes" to the case. The independent reviewer will consider the documents setting out the taxpayer's position and the ATO audit position. They will schedule a case conference with the taxpayer and the ATO audit officer

generally within one month of receiving the taxpayer's review request. The case conference is an opportunity for all parties to assist the independent reviewer with understanding the facts and contentions.

The independent reviewer will then consider both parties' positions and prepare recommendations as to the appropriate outcome. They will communicate the outcome to the taxpayer and the ATO audit officer. The ATO audit team will finalise the audit in accordance with the independent reviewer's recommendations.

The ATO says the pilot is limited to small business disputes involving income tax audits in Victoria and South Australia. (When the pilot ends, the ATO will decide whether to expand the program to other small businesses.) Disputes relating to the following topics are excluded: GST, superannuation, fringe benefits tax, fraud and evasion findings, and penalties and interest.

Eligible businesses with an audit in progress will be contacted directly by their case officer and offered the opportunity to participate in the pilot, the ATO said.

Source: www.ato.gov.au/General/Dispute-or-object-to-an-ATO-decision/In-detail/Avoiding-and-resolving-disputes/Independent-review/Independent-Review---Small-Business-Pilot/.

Transacting with cryptocurrency: updated ATO info

The ATO has updated the information on its website dealing with tax and cryptocurrency. The ATO says a capital gains tax (CGT) event occurs when a person disposes of their cryptocurrency. A disposal can occur when someone:

- sells or gifts cryptocurrency;
- trades or exchanges cryptocurrency (including the disposal of one cryptocurrency for another cryptocurrency) – if the cryptocurrency received cannot be valued, the capital proceeds from the disposal are worked out by using the market value of the cryptocurrency disposed of at the time of the transaction;
- converts cryptocurrency to fiat currency like Australian dollars; or
- uses cryptocurrency to obtain goods or services.

If a taxpayer holds the cryptocurrency as an investment, they will not be entitled to the personal use asset exemption. However, if it is held as an investment for 12 months or more, the taxpayer may have an entitlement to the CGT discount to reduce a capital gain made on disposal.

If a taxpayer holds cryptocurrency as an investment and they receive a new cryptocurrency as a result of a chain split (such as Bitcoin Cash being received by Bitcoin holders), the ATO says they do not derive ordinary income or make a capital gain at that time as a result of receiving the new cryptocurrency.

The ATO also notes that taxpayers may be able to claim a capital loss if they lose their cryptocurrency private key or their cryptocurrency is stolen. In this context, the ATO says the issue is likely to be whether the cryptocurrency is lost, whether the taxpayer has lost evidence of their ownership or whether they have lost access to the cryptocurrency.

Source: www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/.

Tax gap for individuals is \$8.8 billion, says ATO

The ATO has published the income tax gap for individuals not in business in 2014–2015. The gap is an estimate of the difference between the tax the ATO collects and the amount that would have been collected if every one of these taxpayers was fully compliant with the law. While no country will ever have a zero tax gap, revenue authorities continually strive to keep the gap to a minimum.

The estimated net tax gap for such individuals in 2014–2015 is approximately 6.4%, or \$8.8 billion. In other words, the ATO estimates that individuals not in business paid over 93% of the total theoretical tax payable in 2014–2015.

Key components of the tax gap are:

- deductions for work-related expenses – common mistakes include deduction claims where there was no connection to income, claims for private expenses and claims where there are no records to show that an expense was incurred;
- omitted income, particularly in relation to undeclared cash wages (an element of the black economy) – the ATO's estimate of the proportion of the \$8.8 billion tax gap for individuals not in business that is attributable to unreported income from cash wages is \$1.4 billion; and
- deductions for rental property expenses – the most common reasons for adjustments to rental items on a tax return are a lack of, or incorrect, apportionment of expenses. This includes, for example, deduction claims where the property was only available to rent for part of the year or claims for interest expenses where a portion of the loan was used for private purposes. The ATO also sees mistakes relating to capital works and capital allowance deductions.

Each case of taxpayer error or non-compliance that the ATO identifies (as part of the random enquiry program it uses to estimate the gap) can involve multiple adjustments across the return. Of the 2,388 adjustments made in identified cases, the ATO said almost 70% related to deduction items, and 51% (or 1,212) of all adjustments made were at work-related expense items. Of those work-related expense adjustments, 78% (or 949) were made in tax agent-prepared returns.

Adjustments to items tended to fall between \$150 and \$1,000 in value, with the median adjustment being \$210. While these adjustments are individually small, the ATO notes that when they are tallied across the whole population, the effect is significant. On average, three items were adjusted in each tax return.

The ATO observed claims for expenses that were actually paid for or reimbursed by the employer, as well as claims that appeared legitimate, but could not be substantiated. The ATO also saw mistakes and guesswork relating to apportioning work-related expenses along with claims for “standard” deductions where exceptions to substantiation provisions exist. Many taxpayers believed they did not have to explain their claim if a substantiation exception was applicable.

ATO Deputy Commissioner Alison Lendon said, “seven out of ten returns randomly selected for review had one or more errors. A smaller number of people are deliberately doing the wrong thing – that has a significant impact on revenue. These people can expect closer attention from us, especially this tax time.” The ATO will increase the use of data and technology to identify outliers, streamline processes, access third party data and provide pre-filled information in tax returns.

Additional note: The ATO reportedly has 500 tax agents in its sights and expects to review the practices of about 150 of them this year. With around 41,500 registered tax agents in Australia as at 30 June 2017, this is a low percentage so some perspective is required here. The ATO is concerned that too many of the errors it detected are what it terms “avoidable mistakes”, eg not checking records thoroughly.

Professor Bob Deutsch, Senior Tax Counsel at The Tax Institute, says the individual tax gap figure “suggests that the extent of non-compliance among individuals is substantially higher in macro terms than for large corporate groups.” However, in percentage terms, Professor Deutsch points out that there is approximately only a half percentage point difference – 6.4% for individuals versus 5.8% for companies. He says individuals contribute roughly 40% of the tax revenue and large corporate groups only contribute about 12%.

Source: www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Individuals-not-in-business-income-tax-gap/.

ATO warns about scammers at tax time

The ATO has warned taxpayers to be on “high alert” for tax-related scams.

ATO Assistant Commissioner Kath Anderson said most taxpayers expect some form of interaction with the ATO during tax time, and scammers take advantage of this to gain money and personal information from victims. She said scammers are busy all year round, but the ATO always sees an increase in activity at tax time. In fact, more than 37,000 scam attempts were reported to the ATO during tax time last year, she said. “Although many people were alert and didn’t fall for the scams, hundreds handed over a total of more than \$630,000, and thousands handed over their personal details.”

The Assistant Commissioner said the most common scam is still the “fake tax debt” phone scam, but the ATO is also seeing an increase in “fake refund” or “refund for a fee” scams, and email and SMS scams enticing people to click a hyperlink, download a file or open an attachment.

Scammers frequently claim to be from the ATO and according to Ms Anderson, taxpayers should be wary of any phone call, text message, email or letter about a tax refund or debt, especially if they were not expecting it. The ATO regularly sends emails and SMSs and makes many calls each week, but Ms Anderson said, “there are some tell-tale signs that it isn’t the ATO, including that the ATO will not:

- use aggressive or rude behaviour, or threaten [taxpayers] with arrest, jail or deportation;
- request payment of a debt via iTunes, pre-paid visa cards, cryptocurrency or direct credit to a bank account with a BSB that isn’t either 092-009 or 093-003;
- request a fee in order to release a refund owed to [a taxpayer]; or
- email or SMS [taxpayers] asking [them] to click on a link to provide login, personal or financial information, or to download a file or open an attachment.”

If taxpayers are unsure about whether a call, text message or email is genuine, Ms Anderson said not to reply, and to call the ATO on 1800 008 540.

Source: www.ato.gov.au/Media-centre/Media-releases/Watch-out,-scams-about!/.

Income tax residency rules for individuals: Board of Taxation recommends reform measures

On 9 July 2018, the Board of Taxation publicly released its initial report on its review of Australia's individual income tax residency rules. The report, *Review of the Income Tax Residency Rules for Individuals*, follows the completion of the Board's review in August 2017. The Minister for Revenue and Financial Services, Kelly O'Dwyer, said the Board found that the current individual tax residency rules require modernisation and simplification. The Board also identified opportunities for tax arbitrage, for example where individuals become "residents of nowhere" when they leave Australia and do not become tax residents of another jurisdiction. Ms O'Dwyer said that before the government takes any position on these matters, she has asked the Board to consult further on key recommendations, including how Australia could draw on residency tests in other countries.

The report considered whether the current Australian individual income tax residency rules (largely unchanged since 1930) are sufficiently robust to meet the requirements of the modern workforce, address the policy criteria of simplicity, efficiency, equity and integrity, and take into account a significant number of cases heard since 2009 relating to individual residency.

Following a consultation process, the Board concluded that the existing residency rules are no longer appropriate and need to be modernised. Thus, it has recommended a two-step model as follows:

- A primary "days count" bright-line test that automatically determines the residency status of inbound and outbound individuals. This test would be similar to the residency rules adopted in New Zealand and the UK.
- For inbound individuals, the report considered an inbound individual to be resident if they are physically present in Australia for 183 days or more in a 12-month period. This test would provide certainty for individuals and reflect the need to ensure that it is not open to overly simplistic manipulation (for example, by staying in Australia for less than half of two separate income years in one 12-month period).
- For outbound individuals, the report recommended individuals be considered non-resident if they work full-time overseas and spend less than 31 days working, or 61 days total, in Australia. Former residents would become non-resident if they spent less than 16 days in Australia; and individuals that have never been a resident of Australia would remain non-resident if they spent less than 46 days in Australia.
- The Board also recommends a secondary test that takes into consideration individual facts and circumstances. This secondary test would apply if an individual did not satisfy the primary test. This test would leverage some existing case law with respect to the principles of the resides test, the domicile test (in particular, the permanent place of abode test) and the 183-day tests (in particular, the usual place of abode test).

As regards the "resident of nowhere" concern, the Board has recommended that the new residency test for outbound individuals should ensure that all residents remain residents unless and until tax residency is established in another jurisdiction.

The Board also considered that the "superannuation test" no longer achieves its policy objective for government staff and their families and has recommended that the new residency definition not include the superannuation test. The report states that, "should the government continue to treat government officials as residents, the new residency definition should include a more effective rule that reflects the government's position, such as a specific government services rule."

Source: <http://kmo.ministers.treasury.gov.au/media-release/083-2018/>.

Retirement income covenant needs more flexibility: KPMG

KPMG has released a submission in response to the Treasury position paper on the proposed retirement income covenant announced as part of the 2018–2019 Budget. The proposed covenant will require trustees of superannuation funds (including self managed superannuation funds) to formulate a retirement income strategy for fund members. This requirement is aimed at supporting the government's development of a comprehensive income products for retirement (CIPR) framework.

While KPMG has expressed support for the establishment of a retirement incomes framework that aligns to the objective of superannuation, it has called for more flexibility for the advice models and the design of retirement income products. KPMG has recommended that trustees should be able to split the CIPR strategy into two phases – an account-based pension phase and a deferred lifetime annuity phase – and offer distinct products rather than a single blended product. Other product features, such as capital flexibility, may be as important as expected consistent income in the first phase, KPMG said.

The government is proposing to legislate the retirement income covenant by 1 July 2019, subject to a delayed commencement until 1 July 2020. This timing seeks to allow the market for pooled lifetime income products to develop in response to the changes to the Age Pension means test, and for other elements of the retirement income framework to be settled.

Source: <https://home.kpmg.com/au/en/home/insights/2018/06/retirement-income-framework-development-kpmg-submission.html>.

Illegal phoenix activity costs billions; new Phoenix Hotline

The ATO has released a new report on the economic impacts of potential illegal phoenix activity. It estimates that the annual direct impact of illegal phoenix activity on businesses, employees and the government was between \$2.85 billion and \$5.13 billion for the 2015–2016 financial year.

In particular, the report notes that:

- the cost to businesses from unpaid trade creditors was between \$1.2 billion and \$3.2 billion;
- the cost to employees from unpaid entitlements was between \$31 million and \$298 million; and
- the cost to the government in unpaid taxes and compliance costs was around \$1.7 billion.

The report, which was commissioned by the Phoenix Taskforce and prepared by PricewaterhouseCoopers, uses data from a range of information sources from Phoenix Taskforce member agencies, including ASIC external administration reports, details of unsecured creditors and unpaid superannuation, information from the Fair Entitlement Guarantee (FEG) scheme and ATO debts. Additionally, the report draws on the ATO's more sophisticated taskforce data-driven Phoenix Risk Model (PRM) built from data from member agencies to identify the potential illegal phoenix population.

New Phoenix Hotline and website

The government has also established a new Phoenix Hotline to combat phoenixing activity and to protect compliant Australian workers and businesses. Revenue and Financial Services Minister Kelly O'Dwyer said, "the new Phoenix Hotline will make it easier to report suspected phoenix behaviour directly to the Australian Taxation Office so they can pursue those who are doing the wrong thing."

Employees, creditors, competing businesses and the general public can confidentially provide information about possible phoenix behaviour via the hotline on 1800 807 875 or the ATO website. Disclosures will be protected by privacy laws and the government's legislative action in protecting whistleblowers. "For those who try to beat the system, it's only a matter of time before the law catches up with them," Ms O'Dwyer said.

Sources: www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illegal-phoenix-activity/The-economic-impact-of-potential-illegal-phoenix-activity-report/

<http://kmo.ministers.treasury.gov.au/media-release/084-2018/>

Super funds deliver healthy returns for 2017–2018

The median "growth" superannuation fund delivered a healthy investment return of 9.2% for 2017–2018, with the top spot going to Hostplus with a return of 12.5%, according to superannuation ratings and research firm Chant West. Growth super funds are those with a 61–80% allocation to growth assets.

Every fund in the growth category had positive returns, with even the lowest performer delivering a 6.5% return. Growth funds have delivered nine consecutive years of positive returns, averaging about 9% a year, said Chant West senior investment manager Mano Mohankumar.

With share markets remaining resilient despite emerging risks, the better performing funds were those that had higher allocations to listed shares and to unlisted assets (eg property, infrastructure and private equity). Chant West reports that hedged international shares rose 10.8% (15.4% for unhedged), while Australian shares gained 13.2%.

Chant West found that industry super funds outperformed retail funds over 2017–2018, returning 10.3% versus 9%, and over 10 years (6.9% versus 6.3%). Mr Mohankumar said industry funds as a group have outperformed retail funds over the longer term largely because of their higher allocations to unlisted assets, such as private equity, unlisted property and unlisted infrastructure (currently 21% versus 5%), which have performed well.

Mr Mohankumar reminded investors that they need to judge investment returns against a fund's risk objective. Risk is normally expressed as the chance of a negative return, and typically a growth fund would aim to post no more than one negative return in five years on average, he said.

Source: www.chantwest.com.au/resources/super-funds-have-that-positive-feeling---yet-again.

GST exemption for offshore sellers of hotel bookings to be removed: draft legislation released

On 20 July 2018, the Treasurer released draft legislation to ensure offshore sellers of hotel accommodation in Australia calculate their goods and services tax (GST) turnover in the same way as local sellers from 1 July 2019.

In particular, the government proposes to amend the GST Act by requiring offshore suppliers of rights or options to use commercial accommodation (eg hotels) in the indirect tax zone (broadly, Australia) to include these supplies in working out their GST turnover. If the GST turnover of such offshore suppliers equals or exceeds the registration turnover threshold, GST must be remitted for their taxable supplies.

Currently, unlike GST-registered businesses in Australia, offshore sellers of Australian hotel accommodation are exempt from including sales of hotel accommodation in their GST turnover. This means they are often not required to register for and charge GST on their mark-up over the wholesale price of the accommodation.

The government says both Australian and foreign consumers are increasingly booking Australian hotel rooms through online services based offshore, which are taking advantage of an exemption designed for offshore tour operators. Removing the exemption is designed to level the playing field by ensuring the same tax treatment of Australian hotel accommodation, whether booked through a domestic or offshore company.

The measure will apply to sales made on or after 1 July 2019. Sales that occur before 1 July 2019 will not be subject to the measure even if the stay at the hotel occurs after this date.

Submissions close on 9 August 2018.

Source: <https://treasury.gov.au/consultation/c2018-t310492/>.

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