client alert | explanatory memorandum

November 2018

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 19 October 2018.

Transfer balance cap: ATO highlights admin issues

On 30 August 2018, ATO Assistant Commissioner Superannuation Tara McLachlan gave a speech on *Administration issues under the transfer balance cap* at the Tax Institute Sixth National Superannuation Conference. She highlighted the following:

- Common events that will need to be reported include:
  - the start of new pensions which began to be in retirement phase on or after 1 July 2017; and
  - full and partial commutation of pensions on or after 1 July 2017, regardless of whether or the commutation was paid out as a lump sum, retained in accumulation phase or rolled over to another super fund.
- Self managed superannuation funds (SMSFs) do not need to report:
  - pension payments made on or after 1 July 2017;
  - investment earnings and losses that occurred on or after 1 July 2017;
  - when an income stream ceases because the capital has been exhausted; or
  - the death of a member – although if the member's pension was reversionary, reporting of the pension may be required.
- Individuals can use myGov online to see what amounts have been credited to their transfer balance account.
- As multiple transfer balance events occur when individuals have multiple pensions paid from the same fund, it's important to cancel incorrect events before reporting the correct information, otherwise a duplication can occur.

Other issues mentioned during the speech concerned the treatment of excess transfer balance (ETB) determinations, commutation authorities, partial commutations and minimum pension requirements.

Source: www.ato.gov.au/Media-centre/Speeches/Other/Administration-issues-under-the-transfer-balance-cap/.

Australian Small Business White Paper: tax reform a key

After more than 18 months of extensive research and consultation, the Institute of Public Accountants (IPA) and the IPA Deakin SME Research Centre have released the second edition of the Australian Small Business White Paper.

"Numerous policy recommendations have been adopted from the first edition which was launched in 2015. However, we recognise that the state of our economy is reliant on the productivity, growth and prosperity of the small business sector so this work must be ongoing", said IPA chief executive officer Professor Andrew Conway.

The White Paper covers a range of topics, including productivity, regulation, taxation, SME financial markets and workplace relations. On taxation, it makes several recommendations:

- Broaden the base and lift the rate of GST (subject to appropriate equity measures).
- Cut direct taxes.
- Undertake a zero-base design of a thoroughly modern taxation system.
- Reform and simplify the personal income tax scale.
- Standardise the company tax rate at 25%.

It also poses a number of thought-provoking questions, including:

- What would it look like if Australia's GST rate rose to 15% and personal income taxes were slashed or removed for a new entrepreneur's first five years in business?

- What does a tax system look like that rewards rather than punishes people under the age of 50 for saving for their retirement?
- Why do we have excess contributions taxes for those wanting to remove the burden from the state in their retirement?
- What about a tax rate that applied a tax-free threshold at $30,000 per annum and 15% for minimum wage earners?

Source: www.publicaccountants.org.au/news-advocacy/media-releases/australian-small-business-white-paper-released.

ATO expects 200,000 to miss out on refunds by failing to lodge

The ATO expects that 200,000 individuals could miss out on a tax refund this year by failing to lodge a return.

So far this tax time, the ATO says over 2.7 million taxpayers have already lodged their income tax returns via myTax, while another 4.3 million taxpayers have lodged via a tax agent. Assistant Commissioner Kath Anderson says many salary and wage earners end up with a tax refund but some are missing out because they haven't lodged.

Taxpayers have until 31 October to either lodge their own return, or ensure they are on an agent's books, Ms Anderson said. Failing to lodge by the deadline can attract a penalty of $210 for every 28 days that the return is overdue, up to a maximum of $1,050.

The ATO believes that some taxpayers may not lodge a return, even if they are due a refund, because they don't realise they need to. For example, where they are on a low income or haven't worked recently. Ms Anderson said others might be worried about lodging because they haven't lodged for several years and suspect that they may have a debt, which often causes them stress and anxiety. For self-preparers, the payment is due on 21 November whether or not a return is lodged. Ms Anderson said the ATO will help people who may have difficulties paying a tax debt, and tailor a payment plan to the taxpayer's circumstances. The ATO is also alert to some people who are deliberately not lodging in an attempt to avoid their child support obligations.

The ATO also reminds that taxpayers who have already lodged, but realise that they have made a mistake, should make an amendment using myTax or by contacting their tax agent. Not correcting errors may mean the ATO has to contact the taxpayer, which may cause unnecessary processing delays. More information on making an amendment is available on the ATO's website at www.ato.gov.au/fixamistake.

Source: www.ato.gov.au/Media-centre/Media-releases/Are-you-missing-out-on-a-tax-refund-/.

Black economy: electronic sales suppression tools now banned

Activities involving electronic sales suppression tools (ESST) and that relate to people or businesses with Australian tax obligations are now legally banned, effective from 4 October 2018. This is part of the measures under the recently passed *Treasury Laws Amendment (Black Economy Taskforce Measures No 1) Bill 2018*. People or entities may be liable for criminal and administrative penalties if they produce, supply, possess or use an ESST or knowingly assist others to do so.

The ATO has noted that ESSTs can come in different forms and are constantly evolving. For example, an ESST can be:

- an external device connected to a point of sale (POS) system;
- additional software installed into otherwise-compliant software; or
- a feature or modification, like a script or code, that is a part of a POS system or software.

An ESST may allow income to be misrepresented and under-reported by:

- deleting transactions from electronic record-keeping systems;
- changing transactions to reduce the amount of a sale;
- misrepresenting a sales record, for example by allowing GST taxable sales to be re-categorised as GST non-taxable sales; or
- falsifying POS records.

It is now an offence to produce or supply an ESST, possess an ESST or incorrectly keep records using an ESST. A court may impose a criminal penalty up to a maximum of 5,000 penalty units (currently $1,050,000). Otherwise, the ATO may impose an administrative penalty of 60 penalty units (currently $12,600).

The ATO has found cases of taxpayers using such software to deliberately not report all their cash income, falsely report regular losses and/or manipulate their employee obligations.

However, businesses may have inadvertently purchased software with a suppression function. The ATO has advised there will be a transitional grace period for these businesses – if the software was purchased before 9 May 2017 (the date the measures were announced), the business has until 3 April 2019 to advise the ATO and apply for the transitional arrangements.

The ATO has reiterated the need for taxpayers to keep detailed records of every transaction.

Source: www.ato.gov.au/General/Other-languages/In-detail/Information-in-other-languages/Ban-on-electronic-sales-suppression-tools/.

Super work test exemption for recent retiree contributions

The Government has released draft legislation and regulations to give effect to its 2018–2019 Federal Budget measure to provide a one-year exemption from the work test for superannuation contributions made by recent retirees aged 65–74 who have total superannuation balances less than $300,000. Currently, individuals aged 65–74 must work at least 40 hours in any 30-day period in the financial year in which the contributions are made (the work test) in order to make voluntary contributions.

The draft regulation proposes to amend reg 7.04 of the Superannuation Industry (Supervision) Regulations 1994 to allow these recent retirees to make voluntary contributions to their superannuation for 12 months from the end of the previous financial year in which they last met the work test.

The member's total superannuation balance will be assessed for eligibility against the $300,000 threshold at the end of the previous financial year. Once eligible, there will be no requirement for individuals to remain below the $300,000 balance cap for the duration of the 12-month period.

The existing annual caps for concessional contributions and non-concessional contributions ($25,000 and $100,000 respectively) will continue to apply to contributions made under the proposed one-year exemption from the work test. However, the proposal would allow individuals to access the first year of the bring-forward arrangements in a particular financial year if their non-concessional contributions exceed their general non-concessional contributions cap ($100,000). Individuals would also be able to access unused concessional cap space to contribute more than $25,000 under existing concessional cap carry-forward rules during the 12 months.

The amendments would apply to eligible contributions made from 1 July 2019.

Source: https://treasury.gov.au/consultation/c2018-t331580/.

Bringing forward small business tax cuts by five years

Prime Minister Scott Morrison has announced that the Government will bring forward its planned tax cuts for small business by five years. He said the Government would introduce the necessary legislation in Parliament during mid-October 2018. Labor has indicated it will support the bring-forward of the tax cuts, thereby ensuring quick passage of the legislation through Parliament.

As shown in the following tables, this means businesses with a turnover below $50 million will have a tax rate of 25% in 2021–2022 rather than from 2026–2027 as currently legislated. Similar timing changes will apply to the roll-out of the 16% tax discount for unincorporated businesses.

Mr Morrison said this means that a small business that makes $500,000 profit will have an additional $7,500 in 2020–2021 and $12,500 in 2021–2022.

Company tax rates

	2018–2019	**2019–2020**	**2020–2021**	**2021–2022**	**2022–2023**	**2023–2024**	**2024–2025**	**2025–2026**	**2026–2027**
Corporate	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**
Existing legislated rates	27.5	27.5	27.5	27.5	27.5	27.5	27	26	25
Fast-tracked rates	27.5	27.5	26	25	25	25	25	25	25

	2018–2019	**2019–2020**	**2020–2021**	**2021–2022**	**2022–2023**	**2023–2024**	**2024–2025**	**2025–2026**	**2026–2027**
Unincorporated	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**	**(%)**
Existing legislated rates	8	8	8	8	8	8	10	13	16
Fast-tracked rates	8	8	13	16	16	16	16	16	16

Source: www.pm.gov.au/media/fast-tracking-tax-relief-small-and-medium-businesses.

Business tax rates and small business tax offset changes

The *Treasury Laws Amendment (Lower Taxes for Small and Medium Businesses) Bill 2018* was introduced into and passed by the House of Representatives on 16 October 2018 and passed by the Senate on 18 October 2018. The Bill implements the proposal to accelerate reduction of the tax rate for base rate entities (ie corporate tax entities that derive no more than 80% of their income in passive forms and have an aggregated turnover of less than $50 million).

Corporate tax rate

Under the measures, the corporate tax rate for base rate entities will reduce from 27.5% to 26% in 2020–2021, before being cut to 25% for 2021–2022 and later income years. This means eligible taxpayers will have a tax rate of 25% in 2021–2022, rather than from 2026–2027 as previously legislated. This is summarised in the following table.

Year	Revised rate	Previously legislated
	(%)	(%)
2018–2019	27.5	27.5
2019–2020	27.5	27.5
2020–2021	26	27.5
2021–2022	25	27.5
2022–2023	25	27.5
2023–2024	25	27.5
2024–2025	25	27
2025–2026	25	26
2026–2027 on	25	25

Note that the tax rate for corporate tax entities which do not qualify as base rate entities remains unchanged at 30%.

Unincorporated businesses' tax offset

In addition, the Bill increases the small business income tax offset rate to 13% of an eligible individual's basic income tax liability that relates to their total net small business income (ie unincorporated businesses) for 2020–2021. This offset rate will then increase to 16% for 2021–2022 and later income years. This is summarised in the following table.

Year	Revised rate	Previously legislated
	(%)	(%)
2018–2019	8	8
2019–2020	8	8
2020–2021	13	8
2021–2022	16	8
2022–2023	16	8
2023–2024	16	8
2024–2025	16	10
2025–2026	16	13
2026–2027 on	16	16

Note that the small business income tax offset continues to be capped at $1,000 per individual per year.

The changes will commence in 2020–2021. The measure was previously announced by the Government on 11 October 2018. The speedy passage demonstrates that tax legislation can in fact pass through Parliament promptly, if it is deemed politically expedient.

Residential rental property travel expenses: ATO guidance

From 1 July 2017, non-business travel costs incurred by individuals, self managed super funds (SMSFs) and "private" trusts and partnerships in relation to residential rental properties are not deductible (s 26-31 of the *Income Tax Assessment Act 1997*). Such expenditure is also excluded from forming part of the cost base or reduced cost base of a CGT asset.

Law Companion Ruling LCR 2018/7, issued by the ATO on 10 October 2018, provides guidance on the following matters:

- the meaning of the term "residential premises" in s 26-31;
- the meaning of "carrying on a business" for the purposes of the business exclusion in s 26-31(1)(b), and
- the application of s 26-31 to travel expenditure that serves more than one purpose.

LCR 2018/7 applies from 1 July 2017. It finalises Draft LCR 2018/D2 and contains the same views as the draft.

Residential premises

Section 26-31 of the ITAA 1997 refers to the "use of residential premises as residential accommodation". The expression "residential premises" takes its meaning from the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act), which defines it as land or a building that is occupied, or is intended to be and is capable of being occupied, as a residence or for residential accommodation. The ATO's views on what constitutes "residential premises" for GST purposes are set out in GST Ruling GSTR 2012/5.

LCR 2018/7 mirrors the GST ruling by providing that:

- the premises must be fit for human habitation, providing shelter and basic living facilities;
- the actual use of the premises as a residence or for residential accommodation is relevant to satisfying the first limb of the definition (concerning actual occupation);
- the second limb of the definition (concerning intended occupation) refers to premises that are designed, built or modified so as to be suitable to be occupied, and capable of being occupied, as a residence or for residential accommodation;
- the term of occupation or intended occupation is not determinative; and
- the premises may be in any of a number of forms, including single rooms or suites of rooms within larger premises.

Carrying on a business of property investing

A deduction is not denied under s 26-31 for travel expenditure necessarily incurred in carrying on a business. This exclusion covers taxpayers carrying on a business of property investing or a business of providing retirement living, aged care, student accommodation or property management services. The ATO may take the following matters into account in determining whether a business of letting residential properties is being carried out:

- the number of residential properties being rented out;
- the hours per week spent actively engaged in managing the properties;
- the skill and expertise exercised in undertaking these activities; and
- whether professional records are kept and maintained in a business-like manner.

It is generally harder for individuals to demonstrate that they are carrying on a business of property investing than it is for companies (which are specifically exempt from s 26-31 anyway). In the ATO's view, "the receipt of income by an individual from the letting of property to a tenant, or multiple tenants, will not typically amount to the carrying on of a business as such activities are generally considered a form of investment rather than a business".

Apportionment if travel expense serves mixed income-producing purposes

The expenditure made non-deductible by s 26-31 is a loss or outgoing "insofar as it is related to travel". The ATO says that the use of the word "insofar" means that an apportionment is required if there are mixed income-producing purposes for the travel costs. If a single outlay of travel expenditure is incurred partly for producing income from the use of residential premises as residential accommodation and partly for other income-producing purposes (eg business or employment), the ATO expects the taxpayer to fairly and reasonably assess how much of the amount relates to each purpose. Factors to take into account include floor-area ratio, rental income and travel time spent attending to each income-producing purpose.

Source:
www.ato.gov.au/law/view/view.htm?docid=%22COG%2FLCR20187%2FNAT%2FATO%2F00001%22.

Tax on compensation received for inappropriate advice

The ATO has recently provided information about how the tax system applies for someone who receives compensation from a financial institution that provided inappropriate advice and/or did not provide advice it should have. This can include compensation for the loss of an investment, or a refund of fees or interest.

Capital gains tax comes into play, because CGT event A1 happens when an individual disposes of an investment. The capital gain or loss made from a CGT event is to be reported in the same financial year as the event occurs.

Compensation may be paid to a person in connection with an investment they have already disposed of. This type of compensation payment can be treated as additional capital proceeds associated with the disposal. If more than one investment is associated with a compensation payment, the ATO says the additional capital proceeds need to be apportioned among the disposed-of investments.

If a person has been compensated for investments they still own, they need to reduce either the cost base or the reduced cost base by the compensation amount they receive, depending on whether they make a loss or gain when they later dispose of the investments. Again, the compensation amount needs to be apportioned if it relates to more than one investment.

A compensation payment may also include an amount that is a refund or reimbursement of adviser fees. If the compensated person claimed a deduction for the adviser fees in a tax return, the amount they receive as a refund or reimbursement will form part of their assessable income in the year they receive it. If they did not claim a deduction for the adviser fees, the refund or reimbursement does not form part of their assessable income. However, where the adviser fees were included in the cost base or reduced cost base of any investments, the cost base and reduced cost base must be reduced by the amount of the refund or reimbursement. When the person later disposes of the investment, these reductions will be used to calculate the capital gain or loss they make.

Source: www.ato.gov.au/Individuals/Income-and-deductions/In-detail/Compensation-paid-from-financial-institutions/.

ATO set to issue excess super contribution determinations

From mid-October 2018, the ATO has started issuing excess concessional contributions (ECC) determinations for the 2017–2018 financial year. At the Superannuation Administration Stakeholders Group (SASG) meeting on 12 September 2018, the ATO said super funds should prepare for an influx of engagement and queries from members who receive these ECC determinations in relation to contributions above the $25,000 concessional cap for 2017–2018.

A taxpayer may also receive an amended income tax return assessment together with the ECC determination. This is because any excess concessional contributions are included in the taxpayer's assessable income for the corresponding financial year (and subject to an interest charge). The taxpayer is also entitled to a 15% tax offset for the tax already paid by the super fund.

A taxpayer has 60 days from receiving an ECC determination to elect to release up to 85% of their excess concessional contributions from their super fund. However, they should first ensure that their super fund has correctly reported their contributions to the ATO before making an irrevocable election to withdraw any excess contributions.

Upon receipt of a valid election to release, the ATO will provide a release authority to the taxpayer's relevant super fund requiring the amount specified to be paid to the ATO. The taxpayer will receive a credit equal to the amount released to the ATO. The ATO will use any money released from the individual's super funds to first pay any tax or government debts before refunding any remaining balance to the individual. Accordingly, most taxpayers (below the top marginal rate) should have no tax debt on the released excess concessional contributions included in their assessable income.

Non-concessional contributions determinations

The ATO also started issuing excess non-concessional contributions (ENCC) determinations for 2017–2018 from mid-to-late October 2018. The non-concessional cap from 2017–2018 is $100,000 (or $300,000 over three years for those under 65), provided that they have a total superannuation balance of less than $1.6 million at 30 June of the prior year.

Taxpayers who exceed the non-concessional cap for the year and receive an ENCC determination can elect within 60 days to withdraw the excess non-concessional contributions (plus 85% of the associated earnings) from their super fund. The full amount of the earnings (100%) are then included in the taxpayer's assessable income (and subject to a 15% tax offset). If an individual does not withdraw the excess contributions, they will be taxed at the top marginal tax rate (plus Medicare levy).

The ATO has previously suggested that for "most people" who exceed the non-concessional cap it is "easiest to do nothing". If a taxpayer does not make an irrevocable election within 60 days of receiving an ENCC determination, the ATO says it will ask the taxpayer's super funds to release and send excess amounts to the ATO. It will also amend the taxpayer's income tax assessment to include the associated earnings, which will be taxed at the individual's marginal tax rate (plus Medicare levy). While the ATO suggests that it is "easiest to do nothing" for "most people" who exceed the non-concessional cap, each taxpayer needs to consider the tax implications for their own circumstances.

Source: www.ato.gov.au/General/Consultation/Consultation-groups/Stakeholder-relationship-groups/Superannuation-Administration-Stakeholder-Group/.

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