client alert | explanatory memorandum

October 2015

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 17 September 2015.

Excessive deduction claims on holiday homes on ATO hit list

The ATO is increasing its focus on holiday home investors and, in particularly, whether they are correctly claiming deductible expenses. The ATO has recently advised that it will send letters to taxpayers in approximately 500 postcodes across Australia, reminding them to only claim the deductions they are entitled to, for the periods the holiday home is rented out or is genuinely available for rent.

Note: If a property is rented at below market rates, for example to family or friends, deduction claims must be limited to the income earned while rented.

The ATO is of the view that holiday home investors may be misinterpreting the rules regarding tax deductions for rental properties and may therefore be over-claiming on tax deductions for periods when the property is not being rented out. There are suggestions that the confusion among taxpayers as to what constitutes personal use or reasonable (or realistic) efforts to lease out a holiday home has resulted in homes that are not genuinely available for rent. The ATO has indicated that it will focus on the following:

- excessive deductions claimed for holiday homes;
- properties that are located in remote locations, with limited rental period and minimal income;
- the use of risk detection data models and market analysis to identify and investigate claims where taxpayers have unusual rental income and deductions patterns compared to other investors in similar locations;
- writing to owners to remind them of what they cannot claim; and
- jointly owned holiday homes where husband and wife unequally divide the income and deductions.

It is important that the ATO continues to educate rental property owners on what they can and cannot claim. Taxpayers may have negatively geared investment properties giving rise to significant deductions and it is therefore inevitable that the need for review and monitoring arises.

Having said that, it should be noted that there is no clear guidance as to what constitutes “reasonable”, “genuine” or “realistic” in the context of making all the relevant attempts to rent out a holiday home. There is also a concern that investors may have to prove that efforts were undertaken to rent out the holiday home, perhaps by demonstrating that they have advertised the property for rent, engaged rental agents and so forth.

If the ATO were to commence a review or audit on a holiday home rental property, it is hoped that the ATO would not make any conclusions regarding the use of the holiday home or the intention of the taxpayer prior to objectively considering all the available evidence. This is especially the case if the holiday home is subject to seasonal demand.

Source: ATO media release, 31 August 2015, https://www.ato.gov.au/Media-centre/Media-releases/Helping-taxpayers-get-it-right-this-tax-time-on-rental-properties/.

Foreign property investors – reduced penalty period ending

The ATO has reminded foreign investors of a reduced penalty period if they disclose possible breaches of Australia’s foreign investment rules for purchases of Australian real property. The reduced penalty period is only available until 30 November 2015. To apply for the reduced penalty period, foreign investors must complete the reduced penalty disclosure form (available at http://compliance.firb.gov.au/personal-circumstances/).

From 1 December 2015, new criminal and civil penalties will apply. The ATO has also reminded foreign investors with an existing interest in agricultural land that they must notify it of their interests by 31 December 2015 and that the obligation to register exists regardless of the value of the land.

Note that a package of Bills to tighten Australia's foreign investment framework has been introduced (see article below).

Source: ATO publication, "Foreign investors need to report", 25 August 2015, https://www.ato.gov.au/Tax-professionals/Newsroom/Income-tax/Foreign-investors-need-to-report/.

Foreign investment framework rules to be tightened: Bills introduced

The Treasurer said the "legislative package shall ensure Australia maintains a welcoming environment for investment – but one that ensures that the investment is not contrary to our national interest". Mr Hockey said the "reforms shall ensure that from 1 December 2015, Australia's foreign investment framework is more modern, simple and effective." The Bills are:

- *Foreign Acquisitions and Takeovers Legislation Amendment Bill 2015* (http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5519%20Recstruct%3Abillhome) – makes substantial changes to the Foreign Acquisitions and Takeovers Act 1975 to modernise the rules and strengthen the enforcement of the foreign investment system. The Bill will:
  - introduce civil penalties and additional stricter criminal penalties to ensure foreign investors and intermediaries do not profit from breaking the rules. Mr Hockey said the criminal penalties will be increased from $90,000 to $135,000 for individuals and will be supplemented by civil pecuniary penalties and infringement notices for less serious breaches of the residential real estate rules. Third parties such as real estate agents, migration agents, conveyancers and lawyers who knowingly assist a foreign investor to breach the rules will also be subject to both civil and criminal penalties. Note the ATO is administering a reduced penalty period for those who self-report non-compliance before 30 November 2015 (see above);
  - transfer to the ATO the responsibility of regulating foreign investment in residential real estate. The Treasurer noted the Government has provided $47.5 million over four years to the ATO to improve compliance and enforcement of the rules. In this regard, Mr Hockey noted the ATO's data-matching abilities. Note that in May 2015, the ATO had announced that it will require details of foreign investors that apply to the Foreign Investment Review Board (FIRB) to purchase residential or agricultural land in Australia for the 2010–2011 to 2015–2016 financial years;
  - enable the lowering of screening thresholds for investments in Australian agriculture. Since 1 March 2015, the screening threshold for foreign purchases of agricultural land has been lowered from $252 million to $15 million based on the cumulative value of agricultural land owned by that investor. The Government is also introducing a $55 million threshold for direct interests in agribusinesses from 1 December 2015; and
  - reduce red tape by removing routine cases and better aligning the foreign investment framework with other corporate legislation. For example, Mr Hockey said the substantial interest threshold will be raised from 15% to 20% to better align the foreign investment rules with the takeover rules in the Corporations Act 2001. This means investors acquiring a stake of less than 20% will no longer need foreign investment approval.
- *Foreign Acquisitions and Takeovers Fees Imposition Bill 2015* (http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5515%20Recstruct%3Abillhome) – introduces fees on all foreign investment applications to fund the costs of administration and enforcement of the new regime. For residential and agricultural properties valued at $1 million or less, foreign investors will pay a fee of $5,000. Higher fees apply to more expensive residential and agricultural properties as well as commercial real estate and business applications.
- *Register of Foreign Ownership of Agricultural Land Bill 2015* (http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5516%20Recstruct%3Abillhome) – establishes a register of foreign ownership of agricultural land operated by the ATO. On 1 July 2015, the Government established a register of foreign ownership of agricultural land operated by the ATO. All existing holdings must be registered with the ATO by 31 December 2015 and any new interests registered within 30 days. The ATO is collecting information such as the location and size of the property and size of the interest acquired. The Government has previously advised that the data will be made available to the public from 2016. The Government is also working with the states and territories to use their land titles data to expand the register in the future.

Note the Bills were still before the House of Reps at the time of writing.

Source: Treasurer's second reading speech, "Foreign investment reform package", 20 August 2015, http://jbh.ministers.treasury.gov.au/speech/026-2015/.

Payroll tax grouping – know the rules

The payroll tax grouping rules are complex and many employers across Australia are not aware of their existence or their obligations under these rules.

The payroll tax grouping rules require employers to group their payroll tax liabilities with other businesses that they control and have the effect of deeming businesses to be a single entity for payroll tax purposes.

Under the payroll grouping rules, wages of these related businesses are then added together, and the calculation of their payroll tax liability is based on the group's total wages.

Further, all members of the group become liable for the payroll tax debts of the group which are incurred while they are members of that group. This means that if one member defaults in the payment of tax, that amount may be recovered from any of the other group members.

This article provides a basic overview of the rules.

Payroll tax – background

Payroll tax is a state or territory based tax payable by employers as a percentage of total wages paid to employees.

Although payroll tax is a state tax, different jurisdictions have different payroll tax rates and general deduction thresholds. New South Wales, Northern Territory, South Australia, Tasmania and Victoria have substantially identical payroll tax legislation and Queensland has legislation to align to these states and territories.

Payroll tax is calculated on wages and salaries paid (or payable) by an employer to its employees and deemed employees at the following rates:

State/territory	Payroll tax rate 2015–2016
ACT	6.85%
NSW	5.45%
NT	5.5%
Qld	4.75%
SA	4.95%
Tas	6.1%
Vic	4.85%
WA	5.5%

Payroll tax only becomes payable by an employer (or group – see below) when the total of all wages paid exceeds a general deduction threshold. The annual thresholds are different in each state and territory and are as follows:

State/territory	General deduction threshold 2015–2016
ACT	$1,850,000
NSW	$750,000
NT	$1,500,000
Qld	$1,100,000
SA	$600,000
Tas	$1,250,000
Vic	$550,000
WA	$800,000 (phases out to $7,500,000)

Each state and territory also has a monthly threshold which, with the exception of New South Wales and Tasmania (which have different thresholds for 28-day, 30-day and 31-day months), is 1/12th the annual threshold.

For New South Wales and Tasmania, the monthly thresholds are as follows:

	New South Wales 2015–2016	Tasmania 2015–2016
29-day month	$59,426	$99,044
30-day month	$61,475	$102,459
31-day month	$63,525	$105,874

Generally, employers are required to self-assess their liability to payroll tax on a monthly basis, which is then reconciled at the end of each financial year. Employers are required to register for payroll tax if during any one month their total Australian wages (or the group's total Australian wages) exceed the relevant monthly deduction threshold level.

For payroll tax purposes the definition of wages is very wide and includes:

- normal wages;
- staff allowances;
- staff commissions and bonuses;
- employer (pre-tax) superannuation contributions including super guarantee payments, monetary and non-monetary salary sacrifice contributions and contributions to defined benefit funds;
- the aggregate grossed up (using type 2 factor) amount fringe benefits;
- the value of shares and options;
- payments made to certain contractors;
- certain payments made by employment agencies in relation to employment agency contracts;
- director payments; and
- termination payments and paid-out accrued leave.

There are, however, a number of payments that are specifically exempted from payroll tax such as:

- maternity or adoption leave paid in addition to normal leave entitlements;
- payments made under the Commonwealth Government's Paid Parental Leave scheme;
- contributions made by employers to a non-fringe benefit portable long service leave scheme or a redundancy or severance scheme;
- the reimbursements of business expenses incurred by employees for expenses incurred in the course of the employer's business but only where the precise amount is reimbursed;
- the income tax free portion of redundancy or early retirement payments; and
- certain payments made by an insurer, and compulsory Workers Compensation payments.

Illustrative example 1

ABC Pty Ltd has employees in both Victoria and Tasmania and in a 31-day month, the monthly wages paid for all of those employees is $50,000. As ABC Pty Ltd has businesses in more than one Australian jurisdiction, it will need to calculate its payroll tax liability in both states.

Victoria

The monthly Victorian general deduction threshold is $45,833 (based on $550,000/12 months). ABC Pty Ltd would therefore need to register for payroll tax in Victoria as it has exceeded the monthly Victorian general deduction threshold of $45,833.

Tasmania

The monthly Tasmanian general deduction threshold is $105,874 (the specific threshold for a 31-day month). Given that ABC Pty Ltd pays its employees $50,000, it would not need to register for payroll tax in Tasmania as it has not exceeded the monthly Tasmanian threshold.

The nexus test for payroll tax

The payroll tax legislation has provisions to determine in which Australian jurisdiction a payroll tax liability arises in situations where the employees of a business work in more than one state or territory. The nexus provisions look at a number of factors in order to determine the state or territory most closely connected with the employee's services. These factors are considered in the following order:

- the state or territory where the employee's principal place of residence is;
- where the employee has no principal place of residence, the state or territory where the address of the Australian Business Number of the employer is registered;
- where the employer does not have an Australian Business Number or has more than one, the jurisdiction where the employer has their principal place of business;
- if none of the above can apply, the state or territory jurisdiction where the wages, or the majority of the wages, are paid or payable. This would generally be the jurisdiction in which the employee has their bank account; and
- if none of the above apply, the state or territory where the majority of the employee's work occurs.

The nexus test is also important when considering the available general deduction thresholds because if a business pays wages in more than one state or territory the threshold is calculated as a proportion equal to the ratio of wages paid in a particular state or territory.

For example, if the wages paid in Victoria were 25% of the total Australian wages paid, then the relevant threshold for Victoria would be 25% of the full threshold of $550,000, ie $137,500.

Payroll tax grouping – basic rules

The grouping provisions have the effect of deeming businesses to be related and include these businesses in a group for payroll tax purposes.

Businesses will be grouped for payroll tax purposes if there is a common link between them. That is, if the grouping definitions are met, businesses are obliged to form a group unless they can obtain the relevant exemption.

Where payroll grouping occurs, a single threshold deduction applies to the group as if it were a single entity.

Nonetheless, each group member has to register for payroll tax and lodge a separate return but the calculation of their payroll tax liability is based on the group's total wage.

When will grouping occur?

A payroll tax group will occur in the following circumstances:

1. Related companies

All corporations that meet the *Corporations Act 2001* definition of "related companies" are grouped. In that definition companies are taken to be related if two or more companies are:

- a holding company and a subsidiary; or
- both subsidiaries of the same holding company.

This applies even if the common ownership is by virtue of an overseas holding company.

It should also be noted that the potential exemption from grouping referred to above is not available at all to companies grouped under the related companies' provisions.

2. Use of common employees

Businesses will be required to be grouped when any services agreement between two or more businesses results in the employees of one business performing duties as an employee for another business.

Not all service agreements will trigger this provision. In order for this to apply the service agreement must set out the specific duties to be performed by the employees of a business for the other business.

Illustrative example 2

Alpha Pty Ltd and Beta Pty Ltd are related companies. During recent times, Beta Pty Ltd has been struggling to meet increased demand from customers and requires additional administrative support at its head office located in NSW.

As a result, Alpha Pty Ltd enters into a service agreement with Beta Pty Ltd under which Alpha will provide two of its employees to Beta. The employees will undertake specific receptionist, secretarial and administrative duties at Beta Pty Ltd for a period of six months.

This arrangement would be considered to be the provision of employees for specific duties connected with the business and a grouping requirement between the two businesses would arise.

Alpha Pty Ltd and Beta Pty Ltd will therefore be required to form a tax group for payroll tax purposes.

3. Commonly controlled businesses

Where two or more businesses are controlled by the same person or persons there is a requirement to group for payroll tax purposes. For these purposes a person includes individuals or a trustee or a corporate entity.

Businesses are considered to be commonly controlled where a person or persons control more than 50% across different entities. For example:

- One person is the sole business owner (whether or not as trustee).
- Joint owners, together as trustees, are the sole business owners.
- A person or set of persons are entitled to exercise more than 50% of the voting power at directors' meetings or more than 50% of voting rights attached to voting shares that the company has issued.
- A person or set of persons constitute or control more than 50% of the board of management of a business entity.

- A person or set of persons own more than 50% of the capital of a partnership or are entitled to more than 50% of the profits.
- A person or set of persons are a beneficiary of more than 50% of the value of a trust. (Under a discretionary trust, all beneficiaries are deemed to have a controlling interest).
- An entity has a direct, indirect or aggregate interest of more than 50% in any corporation.

With the exception of entities grouped for payroll tax under the related companies' provision, a business may apply for an exclusion from grouping. This may be granted where the relevant state or territory is satisfied the business is conducted independently and not connected with any other group member.

Only one member of a payroll tax group can claim the group's threshold entitlement. The net effect is therefore, a reduction in the availability of the threshold(s).

Take home message

A careful examination of the implications of the payroll tax grouping provisions should be made for all business structures. In particular, the application of the grouping provisions may vary for each state or territory, so the applicable provisions should be reviewed. The potential eligibility for exclusion from the rules should also be assessed. Furthermore, as business conditions may change and as part of the overall management of a business, it may be prudent to regularly examine your business's payroll tax obligations.

No GST credits for mining accommodation

In a succinct nine-paragraph decision, the Full Federal Court has dismissed the taxpayer's appeal from the decision in *Rio Tinto Services Ltd v FCT* [2015] FCA 94 that it was not entitled to input tax credits (ITCs) for acquisitions relating to mining accommodation (employee/contractor housing) in the Pilbara.

Background

This was a test case on whether the definition of "creditable purpose" in s 11-15 of the GST Act contains a principal purpose test. Section 11-15(2)(a) provides that a thing is not acquired for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed. The provision of residential accommodation is an input taxed supply under s 40-35.

The taxpayer, Rio Tinto Services Ltd, was the representative member of the Rio Tinto Ltd GST group, which carried on a large scale mining enterprise in outback Australia. The group provided and maintained residential accommodation for its workforce in various locations, comprising some 2,300 houses and apartments. This was operated at a considerable loss, eg in 2010 the taxpayer received $6.1 million in rent but the associated costs exceeded $38.8 million.

The case was conducted as a test case for GST paid in October 2010 on expenditure including construction and purchase of new housing, repairs, cleaning and landscaping. The taxpayer claimed it was entitled to input tax credits of nearly $600,000 for acquisitions made by group members in providing and maintaining residential accommodation for the group's workforce in the Pilbara region.

The taxpayer argued that the acquisitions were made wholly for a creditable purpose because the supply was not an "end commercial objective" in itself but was a necessary and essential part of its mining operations. The taxpayer said it was not in the business of providing residential accommodation. Rather, it provided housing at a loss in order to attract workers who would provide the labour necessary to carry on its mining enterprise. In other words, the taxpayer sought to link the acquisitions to its general operations (which were taxable and/or GST-free), so that an input tax credit could be claimed.

The Commissioner accepted that the provision of residential accommodation was a necessary and essential part of the group member's business. However, the taxpayer's ITC claims were rejected on the basis that they came within the terms of s 11-15(2)(a) of the GST Act.

Decision at first instance

In *Rio Tinto Services Ltd v FCT* [2015] FCA 94, Davies J rejected the taxpayer's construction of s 11-15, holding that s 11-15(2)(a) prevented input tax credits from being claimed in relation to the supply of residential accommodation.

Davies J followed the view that s 11-15(1) is a "positive test", while s 11-15(2)(a) is a "negative test" or "blocking provision". According to her Honour, s 11-15(2)(a) is concerned with the objective relationship between an acquisition and making supplies which would be input taxed, not the "moving cause or principal purpose" behind the acquisition. Her Honour noted that something may be acquired in carrying on an enterprise but nonetheless wholly or partly relate to making supplies that would be input taxed. The words "relate to" denote that there must be a relationship or connection between an acquisition and the making of input taxed supplies, not that a principal purpose must be determined, the Court said.

In this case, Davies J found there was a direct and immediate connection between the acquisitions and the provision of the leased accommodation, and this triggered s 11-15(2)(a). Her Honour also rejected the taxpayer's alternative argument that the input tax credits should be apportioned by applying the same proportion that mining product revenue formed to total revenue (in this case, 99.88%).

The taxpayer appealed to the Full Federal Court.

Full Federal Court decision

The Full Federal Court gave an ex tempore ("at the time") judgment, unanimously holding that the terms of s 11-15(2)(a) of the GST Act do not depend on the reason or purpose for making the supply or acquisition. Rather, the Court said, they turn on characterising the extent to which the acquisition relates to the subsequent supply. This requires the precise identification of the relevant acquisition and a factual inquiry into the relationship between that acquisition and the making of supplies that would be input taxed. Where an acquisition relates wholly to input taxed supplies, it is not to be apportioned merely because that supply may also serve some broader commercial objective of the supplier.

In this case, the Full Federal Court said it was clear from the facts that all of the acquisitions related wholly to making supplies of rental residential accommodation. Although the supplies of accommodation were for the broader business purpose of carrying on the taxpayer's mining operations, this did not alter the fact that the acquisitions all related to supplying premises by way of lease, which were input taxed supplies.

Accordingly, the Full Federal Court dismissed the taxpayer's appeal.

Rio Tinto Services Ltd v FCT [2015] FCAFC 117, Full Federal Court, Middleton, Logan and Pagone JJ, 24 August 2015, http://www.austlii.edu.au/au/cases/cth/FCAFC/2015/117.html.

ATO's proportionate compliance approach to SMSFs

From 1 July 2014, the ATO has had three new regulatory compliance powers to deter and address SIS Act contraventions by self-managed superannuation fund (SMSF) trustees: education directions, rectification directions and administrative penalties. The new laws were introduced to give the ATO more flexible and proportionate powers to deal with the various levels of non-compliant behaviour by trustees. ATO Assistant Commissioner, SMSF Segment, Superannuation, Kasey Macfarlane, recently delivered a speech covering how the new regime works, its interaction with the ATO's existing enforcement and other powers, how the ATO was applying the regime, and how it works for individual versus corporate trustees.

Some key points from the speech:

Identifying risk

The ATO selects SMSFs for audit and review using risk models, intelligence or referrals from other state or commonwealth departments and law enforcement agencies. The ATO has two primary automated risk models – when an SMSF is established and when an SMSF is operation.

In the SMSF establishment model, the ATO will, among other things, focus on the compliance history of the trustees/directors (eg if they have previously been part of another SMSF the ATO has had issues with). The ATO will also approach trustees by telephone and asks them questions about key obligations and concepts (eg sole purpose test). Depending on the answers, the ATO may allow registration or put conditions in place. Once the SMSF is in operation, the ATO will look at the income tax and regulatory history of the SMSF – this includes the SMSF annual return, auditor contravention reports, and other data sources. In addition, the ATO receives "dob-ins" from the general public and related parties of SMSF trustees and directors and the ATO manually reviews alerts and information in databases like RP data and AUSTRAC.

Rectifying contraventions

Many SMSF professionals use the Super P2P service. Ms Macfarlane said the ATO expects that in most cases where a trustee or auditor finds an issue or contravention, they can rectify it without ATO assistance. She said the auditor would likely report the contravention and the rectification and this would "generally be enough" to satisfy the ATO. Ms Macfarlane said the ATO encourages all trustees and their advisors to adopt this type of approach, ie to take steps to rectify a breach as soon as it is identified. She said in these circumstances, the ATO would be "unlikely to apply further sanctions unless other factors are identified, such as if the same or similar contraventions frequently arose".

Enforcement outcomes

The ATO reported the following enforcement outcomes for 2014–2015: 361 accepted enforceable undertakings; 54 education directions given (new power); 27 rectification directions given (new power); 92 funds made non-compliant, with trustees receiving a notice of non-compliance; 662 disqualified trustees; and 44 SMSFs wound-up due to compliance action.

Education and rectification directions

Ms Macfarlane made the following points:

- **Education directions** – When a contravention of the SIS Act or regulations occurs due to a lack of knowledge or understanding by the trustee, an education direction may be appropriate. A trustee may be directed to undertake education in addition to other compliance action. For example, they could be directed both to undertake education and to rectify the contravention, and potentially also have an administrative penalty imposed.
- **Rectification directions** – For contraventions of the SIS Act or regulations that occurred on or after 1 July 2014, the ATO can now direct the trustees to rectify a contravention with specified action and to provide the ATO with evidence of compliance with the direction. Generally, the ATO allows six months to rectify an issue, but in limited circumstances a slightly longer period may apply. This doesn't prevent the ATO considering whether to accept an enforceable undertaking from a trustee if offered. These arrangements rely on SMSF trustees initiating the undertaking with the ATO before it issues the rectification direction (and this may be more practical for the trustees).

  When considering whether to issue a direction, the ATO will take into account: any financial detriment that might reasonably be expected to be suffered by the fund as a result of the person's compliance with the direction; the nature and seriousness of the contravention; and any other relevant circumstances.
- **Failure to comply with rectification direction** – If the trustee fails to comply with the rectification direction within the specified period, then they have committed an offence of strict liability and are liable for a penalty of $1,800 (10 penalty units). The trustee or director may also be disqualified or issued with a notice of non-compliance. A trustee may request the terms of the rectification direction be varied, for example more time to complete the rectification. Requests must be made in writing, be received on or before the end of the period specified, be signed and dated, and set out the reasons for making the request. The ATO must make a decision on the request within 28 days or they will be taken to have refused the request. The trustee may object to the ATO decision to: give a rectification direction; or refuse to vary a rectification direction.

Administrative penalties

Where a trustee contravenes a specific provision of the SIS Act, an administrative penalty will automatically be imposed, as set out in s 166 of the SIS Act. From 31 July 2015, the Commonwealth penalty unit increased from $170 to $180. In the case of contraventions by a corporate trustee of an SMSF, the directors are jointly and severally liable for the one administrative penalty imposed whereas individuals will each receive a separate administrative penalty. Where there is more than one trustee, Ms Macfarlane said it's expected each trustee will have the penalty imposed on them individually unless there are exceptional circumstances supporting the imposition on specific trustees only. The burden will be on the trustee to prove, for example that another trustee committed fraud against them. Ms Macfarlane made the following points re penalty remission:

- When considering remission, the ATO will take into account: compliance history; rectification action; and any other relevant circumstances.
- Trustees may object to the ATO's decision not to remit, or not to remit in full, the administrative penalty. However, Ms Macfarlane said it is unlikely that a trustee will be given more than one penalty remission as multiple breaches demonstrate poor compliance history.
- As the rules are new, so far the ATO has either remitted the penalty or are considering a remission request. However, Ms Macfarlane said that as the ATO audits more SMSFs for breaches made since 1 July 2014, people can expect to see increasing application of SMSF administrative penalties over the next 18 months, with requests for remission being denied in instances of serious and/or repeated non-compliance.
- The ATO needs to confirm a contravention before it will apply a penalty. Ms Macfarlane said the ATO does not intend to automatically apply penalties to all contraventions reported to it. "We must impose the SMSF administrative penalty when we confirm an eligible breach during an ATO audit, so it's best to avoid the audit by taking steps to rectify the breach before we get involved," she said.

Approach to new powers

Ms Macfarlane said the ATO uses "the new powers and penalties to drive compliance, not to increase revenue". "So while you can expect to see us actively using the directions powers, in a large percentage of cases our application of SMSF administrative penalties will be more judicious, via favourable remission requests, for first offences," she said. However, Ms Macfarlane also reminded people of the purpose of SMSFs to provide retirement benefits for members. "Those people looking to 'play the system' and receive a present-day tax benefit in their personal or business affairs are on notice; regulatory and income tax breaches related to the same transaction or arrangement will no longer be treated in isolation. If we find an aggressive taxation approach coupled with a regulatory breach we will definitely look to disqualify the trustee," she said.

Ms Macfarlane also discussed four case studies illustrating how the new regime will operate. The following case study (Case study 4) illustrates a scenario where the ATO considers an education direction, a rectification direction and remission of administrative penalties:

Case Study 4

The Northern Super Fund, a regulated SMSF was established on 4 May 2011. John and Martha are members of this SMSF. The trustee is Vineyard Video Pty Ltd with John and Martha as directors. The fund's total assets as at 30 June 2014 are $400,000. The fund lodged all SMSF annual returns on time with no prior contraventions reported.

The 2014–2015 SMSF annual return was due on 28 February 2016. An ATO audit of the 2014–2015 income year starts on 1 April 2017 as the SMSF annual return has still not been lodged and no extension to lodge has been requested.

The directors admit to the ATO case officer that they have not lodged because they are behind in the administration of the SMSF. For the 2014–2015 income year, it is found that the trustee has failed to: prepare the accounts and statements of the fund; appoint an approved SMSF auditor within the prescribed timeframe, and lodge the SMSF annual return.

Accordingly, in the 2014–2015 income year the trustee has contravened ss 35B, 35C and 35D of the SIS Act. As the contravention occurred after 1 July 2014, an education direction can be considered. Although an education direction may not be the most appropriate tool in this instance, as the trustee has lodged all previous annual returns on time, it appears that the trustee has knowledge of and is aware of the requirements.

It may be appropriate to issue a rectification notice to prepare the accounts and statements for the 2014–2015 income year, to provide the accounts and statements to an SMSF auditor and to lodge the 2014–2015 SMSF annual return.

Under s 166(1), the body corporate is liable for administrative penalties of $1,700 (10 penalty units) for contravening s 35B. Additionally the trustee is also liable for a failure to lodge penalty.

The trustee has lodged all other SMSF annual returns on time and has no prior contraventions. This is a first contravention and may warrant full remission of the administrative penalty.

Source: ATO speech, "The new administrative penalty regime: the ATO's new stick", Address to the Tax Institute National Superannuation Conference, Doltone House, Sydney, 20 August 2015, https://www.ato.gov.au/Media-centre/Speeches/Other/The-new-administrative-penalty-regime--the-ATO-s-new-stick/.

Find your small lost superannuation accounts

The *Tax and Superannuation Laws Amendment (2015 Measures No 4) Bill 2015* has been introduced. It proposes to amend the *Superannuation (Unclaimed Money and Lost Members) Act 1999* to increase the account balance threshold below which small lost member accounts will be required to be transferred to the Commissioner of Taxation, ie from $2,000 to $4,000 from 31 December 2015, and from $4,000 to $6,000 from 31 December 2016.

Other amendments

The Bill also proposes the following amendments:

- **CGT scrip-for-scrip rollover integrity** – makes amendments to improve the integrity of the scrip-for-scrip rollover in Subdiv 124-M of the ITAA 1997. Date of effect: applies in relation to CGT events that occur after 7.30pm (AEST) on 8 May 2012.
- **Government employees delivering overseas assistance** – amends the income tax law by removing an income tax exemption which applied to employees of an Australian government agency who work overseas for not less than 91 continuous days in the delivery of Official Development Assistance. These employees will no longer be able to claim an income tax exemption on the income they earn while overseas. Date of effect: applies from 1 July 2016.

Source: Tax and Superannuation Laws Amendment (2015 Measures No 4) Bill 2015 awaiting Royal Assent, before the House of Reps at the time of writing, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5517%20Recstruct%3Abillhome.

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