client alert | explanatory memorandum

September 2015

CURRENCY:

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

Small business tax discount on the way

The *Tax Laws Amendment (Small Business Measures No 3) Bill 2015* (No 3 Bill) was introduced in the House of Representatives on 24 June 2015.

The No 3 Bill proposes to provide a tax offset (the small business income tax offset) to individuals who run small businesses (businesses with an aggregate annual turnover of less than $2 million) or who pay income tax on a share of the income of a small business. The amount of the tax offset will be 5% of the income tax payable on the portion of an individual's income that is small business income. In addition to calculating the offset in this way, the maximum amount of the tax offset available to an individual in an income year will be capped at $1,000.

The tax offset will be available to individuals who are small business entities, individuals who are a partner in a partnership that is a small business entity, and individuals who are a beneficiary of a trust that is a small business entity. The small business tax offset is designed to apply to trusts that actively carry on a business as a small business entity. Such trusts are unlikely to have beneficiaries under a legal disability that relates to a physical or mental disability. However, in the event that a trustee is assessed on the income of a beneficiary under a legal disability, the offset could be obtained by the beneficiary if they lodged a tax return, or a return was lodged on their behalf. Where a trust has a beneficiary who is under a legal disability because they are a minor, that minor will not have access to the tax discount. The tax offset will, however, not be available to individuals in their capacity as trustees.

An individual's "total net small business income" will comprise the "net small business income" they make as a small business entity together with any share of the "net small business income" of a small business entity that is included in the individual's assessable income.

The small business tax offset for an income year is calculated by first determining the percentage of an individual's taxable income for the income year that is "total net small business income". This percentage is then applied to the individual's basic income tax liability for the income year, with the amount of the tax offset being equal to 5% of the result of that calculation, up to a maximum amount of $1,000. For most individuals, total net small business income will be worked out by reference to their own net small business income, and their share of the net small business income of another entity.

In general terms, the net small business income of a small business entity (including an individual) is the assessable income of the entity that relates to the entity carrying on a business, less any deductions to which the entity is entitled, to the extent those deductions are attributable to the income. Where an individual has a share of the net small business income of another entity included in their assessable income, the individual also reduces the share by any deductions to which the individual is entitled, to the extent those deductions are attributable to the share of the entity's net small business income. An individual's total net small business income will not include a share of the net small business income of a corporate tax entity. The net small business income of a small business entity will not include assessable income that is a net capital gain or personal services income, unless the personal services income is produced from conducting a personal services business.

The "net small business income" of a small business entity will be calculated by working out the assessable income of the entity that relates to it carrying on a business, and subtracting from that assessable income the entity's deductions, to the extent its deductions are attributable to that income.

Where an individual receives a share of an entity's net small business income, the individual's total net small business income will also be reduced by the deductions to which the individual is entitled, to the extent their deductions are attributable to that share.

An individual will be able to claim one small business tax offset for an income year, irrespective of the number of sources of small business income that individual has.

The small business tax offset will not be restricted to individuals who are Australian residents. To the extent that the Australian sourced income of a foreign resident satisfies the requirements for obtaining the offset, the offset will be available to that foreign resident. Similarly, the small business tax offset can apply to the foreign business income of an Australian resident.

Example

Adrian is a small business entity. For the 2015–2016 income year, his taxable income is $100,000, his basic income tax liability is $25,000 and his total net small business income is $50,000.

To work out the amount of his small business income tax offset for the 2015–2016 income year, Adrian first divides his total net small business income by his taxable income ($50,000/$100,000 = 0.5). The result of this calculation shows that half of Adrian's taxable income relates to his total net small business income.

Adrian then multiplies the result of the first calculation by the amount of his basic income tax liability (0.5 × $25,000 = $12,500). The result of this second calculation shows that $12,500 of Adrian's basic income tax liability is from his total net small business income.

Adrian's small business tax offset is equal to 5% of the result of this second calculation (0.05 × $12,500 = $625). The full amount of his small business tax offset is therefore $625.

Adrian can claim the full amount of the small business tax offset for the 2015–2016 income year because it is less than $1,000.

Date of effect

The amendment will apply from the 2015–2016 income year.

Other important amendments

The Bill also proposes the following amendments:

- **Immediate deductibility of start-up expenses:** amendment of the ITAA 1997 to allow small businesses and individuals to immediately deduct certain costs incurred when starting up a business, including government fees and charges as well as costs associated with raising capital, which are presently only deductible over five years under s 40-880 of the ITAA 1997.
- **Extension of the FBT exemption:** this exemption applies to employers that provide employees with work-related portable electronic devices such as mobile phones, laptops and tablets. The amendments would extend the exemption to small businesses that provide employees with more than one work-related portable electronic device, even where the devices have substantially identical functions.

CGT restructure relief measure still to come

The Government, via Small Business Minister Bruce Billson, said the 5% tax discount, plus the start-up deduction measures and FBT red tape reduction measures, mean that five out of the six small business measures from the 2015–2016 Budget have been introduced. The Minister said the remaining measure, to enable small businesses to restructure without facing an immediate CGT liability, is scheduled to be introduced in the 2015 spring sittings (scheduled to run from 10 August to 3 December 2015).

Source: Tax Laws Amendment (Small Business Measures No 3) Bill 2015, which has passed all stages without amendment and is awaiting Royal Assent at the time of publication, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5494%20Recstruct%3Abillhome; Small Business Minister's media release, 24 June 2015, http://bfb.ministers.treasury.gov.au/media-release/055-2015/.

Ride-sharing provider challenges ATO's GST view

Uber BV has lodged an application in the Federal Court against the Commissioner of Taxation. The matter concerns the ATO's view on GST in relation to ride-sharing drivers. In May 2015, the ATO released information on its website providing its view of the tax obligations of people providing services in the sharing economy. The ATO was of the view that people who provide ride-sourcing (or ride-sharing) services were providing "taxi travel" under the GST law, and were required to register for GST regardless of turnover, charge GST on the full fare, lodge BASs and report the income in their tax returns. The ATO had given ride-sourcing drivers until 1 August 2015 to obtain their ABN and be registered for GST.

ATO affirms view on ride-sharing services

Following the announcement of Uber's court challenge, the ATO updated the guidance on its website (as at 5 August 2015). The ATO affirmed that people who provide ride-sourcing services are providing "taxi travel" under the GST law. The guidance also states that from 1 August 2015 the ATO expects all drivers involved in providing ride-sourcing services to be registered for GST.

The guidance refers to the current court challenge of the ATO's advice. In this regard the guidance states: "Taxpayers often challenge the Commissioner's view but this does not affect our continued administration of the GST law. Similarly, current legal proceedings do also not change the Commissioner's view on our published guidance, therefore the ATO will continue to support and advise impacted drivers on how to demonstrate their compliance with the law and the ATO position."

The guidance also sets out the ATO responses to "what the community is asking" it in relation to ride-sourcing services. In relation to passengers, the ATO notes that if a passenger is running a GST-registered business and the travel is part of running that enterprise, they can generally claim a GST credit for the fare charged. The ATO says that for fares over $82.50 a passenger must hold a tax invoice in order to claim a GST credit. If the passenger doesn't get a tax invoice for a fare of more than $82.50, the ATO suggests that "it would be ideal if you captured the details of the car number plate and advised the ATO via the 'Report a Concern' function on the ATO's mobile phone app."

The ATO set out the following key issues and points in relation to "drivers":

- **ABN registration:** Drivers can use business industry codes 46239 (Road Passenger Transport) or 46231 (Taxi Service Operation). The ATO also recommends drivers use "ride-sourcing" or "ride-sharing" as their business description.
- **Employee or contractor:** The ATO considers drivers to be independent contractors instead of employees.
- **Small business concessions:** In response to the question "Are ride-sourcing drivers eligible for all small business concessions and what deductions can be claimed?", the ATO said, "If you are carrying on a business, and you bought an asset for less than $20,000 (excluding GST) on or after 1 July 2015, you would be entitled to claim an immediate deduction for the asset in your 2015–2016 tax return. If your purchase is used for both business and private use, you can only claim a GST credit or an income tax deduction for the part of the purchase relating to your business use. For example if you use your car 50% for your business, you can claim 50% of the GST on the fuel and other car-related expenses and 50% of the GST-exclusive cost as an income tax deduction. You need to keep records of the income and expenses and how you apportioned for private use."

The ATO has also released a factsheet entitled "Ride-sourcing – the facts", summarising key points on its view of the GST treatment of ride-sharing services. The factsheet is available on the ATO website at https://ato.gov.au/Media-centre/Articles/Ride-sourcing---the-facts/.

Source: ATO website "Providing taxi travel services through ride-sourcing and your tax obligations", last modified 5 August 2015, https://ato.gov.au/Business/GST/In-detail/Managing-GST-in-your-business/General-guides/Providing-taxi-travel-services-through-ride-sourcing-and-your-tax-obligations/.

Crowdfunding for small proprietary companies: consultation

Minister for Small Business Bruce Billson has released a consultation paper on facilitating crowd-sourced equity funding (CSEF, or equity crowdfunding) and reducing compliance costs for small businesses. In releasing the paper, the Minister said the Government was "committed to this important consultation as part of our $5.5 billion Growing Jobs and Small Business package in the 2015–2016 Budget."

Public consultation closes on 31 August 2015.

Public companies

The consultation paper outlines for the first time the key elements of the Government's proposed CSEF framework for public companies. Mr Billson said further details will be available in draft legislation that will be released for public comment later in the year. Introduction of legislation to Parliament is expected to follow in the spring sittings.

The key elements of the proposed framework for public companies cover issuers, intermediaries and investors. The following are some of the key points from the proposed framework:

- An issuer must be incorporated as a public company in Australia; limited to certain small enterprises that have not raised funds under existing public offer arrangements.
- An issuer may raise up to $5 million in any 12-month period, inclusive of any raisings under the small scale offerings exception but excluding funds raised under existing prospectus exemptions for wholesale investors.
- Intermediaries must hold an Australian financial services licence. Intermediaries would be responsible for monitoring compliance for investments made via their platform. They must provide generic risk warnings to investors.
- Investment caps for retail investors are $10,000 per offer per 12-month period and $25,000 in aggregate CSEF investment per 12-month period, self-certified by investors. Investors have an unconditional right to withdraw five days after accepting an offer.

Proprietary companies

Proprietary companies are subject to limitations on the ways they can raise funds, including that:

- they must not have more than 50 non-employee shareholders; and
- they must not, except in limited circumstances, offer shares to the general public or undertake other fundraising activities that would require the issue of a disclosure document to investors.

These limitations would make it difficult for proprietary companies to effectively use CSEF to raise funds from a large number of small shareholders.

The consultation paper seeks views on whether to extend the proposed CSEF framework to proprietary companies, and outlines a potential model. The paper seeks comments to identify which areas of the *Corporations Act 2001* could be amended to reduce the burdens on small proprietary companies and make capital raising more flexible.

Mr Billson noted that the paper specifically discusses whether it may be possible to simplify:

- the requirement to make an annual solvency resolution;
- the requirement to maintain a share register;
- the execution of documents; and
- completion and lodgment of forms with the regulator.

Of particular interest to small businesses and entrepreneurs is the debate regarding the limit of 50 non-employee shareholders for proprietary companies and the "small scale offerings" exception to the disclosure requirements. Issues concerning these items are also discussed in the paper.

Next steps

The paper states that the Government will consider stakeholder feedback before making decisions on whether to proceed with CSEF for proprietary companies. However, the Government noted that regardless of whether the Government proceeds with CSEF for proprietary companies, it remains committed to facilitating CSEF for public companies.

Source: Treasury Consultation Paper, "Facilitating crowd-sourced equity funding and reducing compliance costs", 4 August 2015, http://treasury.gov.au/ConsultationsandReviews/Consultations/2015/Facilitating-crowd-sourced-equity-funding; Minister for Small Business, 4 August 2015, http://bfb.ministers.treasury.gov.au/media-release/071-2015/.

SMSFs in pension phase need to exercise care

Kasey Macfarlane, ATO Assistant Commissioner, SMSF Segment, Superannuation, recently delivered a speech covering compliance issues in relation to self managed super funds (SMSFs). She said the ATO was of the view that most trustees and advisors "do the right thing"; however, a few areas of concern were highlighted. One area was low-cost audits. Ms Macfarlane said the ATO appreciated that auditors would likely have a sliding scale of costs for SMSF audits, based on complexity and the time involved. However, she said the ATO still considered low cost "a potential indicator of lack of quality and will review SMSF auditors whenever necessary in this regard".

SMSFs in pension phase

Ms Macfarlane also discussed issues relating to SMSFs paying pensions, noting the growing number of people expected to receive a pension in the next 10 years. Key points included the following:

- **Setting up and starting a pension:** In the pension establishment phase, a fundamental but critical question that should not be overlooked is whether the member has reached preservation age. The ATO has reminded trustees that from 1 July 2015 the legislated rise in the preservation age came into effect – this affects people born after 30 June 1960. It is also necessary to consider whether there are any cashing restrictions applicable to the condition of release that the particular member has satisfied.
- **Paying a pension:** One of the most common reasons for an SMSF in pension phase not being entitled to applicable income tax exemptions under the exempt current pension income (ECPI) provisions is that the trustee fails to pay the required annual minimum pension amount to a member. This also has flow-on tax consequences for the individual member, because they are taken to have received lump-sum payments rather than pension payments throughout the whole income year. Also:
  - It is critical that trustees monitor and continually review the ongoing liquidity requirements of their SMSF from the outset when starting a pension, as well as throughout the life of the pension. For example, if the SMSF's only asset is property, making a cash payment and thus meeting the minimum pension payment requirements can be extremely difficult. Ms Macfarlane said the ATO has seen SMSFs paying pensions where the net rental income was insufficient and there were no other liquid assets or contributions being made to the SMSF.

- The ATO is starting to see liquidity problems associated with real property exacerbated for SMSFs in pension phase where the asset has been acquired under a limited recourse borrowing arrangement (LRBA). Ms Macfarlane said the ATO is finding that as income of the SMSF is diverted to meeting the loan obligations of the fund, there can be insufficient funds remaining to make the required pension payments. She further noted that there is an added level of complexity to LRBAs involving related parties where the trustees fall foul of the arm's-length rules in an effort to try to overcome their liquidity issues.
- The Commissioner has general powers of administration (GPA) allowing a catch-up pension payment as having been made in the relevant income year, so that a fund can continue to report ECPI even though the minimum payment requirements have not been satisfied. Trustees can self-assess for the treatment, or if they do not meet the criteria for self-assessment, they can apply to the ATO for exercise of the GPA. The Commissioner may exercise his powers to allow a fund to continue to report ECPI even though the minimum pension amount is not paid where an honest mistake by the trustee has resulted in a "small underpayment" of the minimum amount. Ms Macfarlane said there has been confusion that this "small underpayment" means the underpayment must total 1/12th or less of the minimum annual payment. To clarify, Ms Macfarlane said the Commissioner will consider the specific facts of each individual matter; in some cases a small underpayment that is due to an honest mistake and is a bit higher than 1/12th of the minimum annual payment, or that is a small amount in absolute dollar terms, may still satisfy the criteria for exercise of the GPA. However, she reaffirmed that the administrative concession is only for limited circumstances and that trustees should not rely on it as a "fix-it" for all pension underpayments.
- The ATO has received a number of enquiries "recently" about whether an actuarial certificate is required in cases where a pension starts part way through an income year when the segregated method is applied. The ATO's initial response has been that an actuarial certificate is required in those circumstances. However, Ms Macfarlane said that, following discussions with some professional and industry representatives, the ATO is working to get a better understanding of industry and commercial practice and expects to provide some "clearer guidance on this point in the near future".
- Since the release of Taxation Determination TD 2014/5 (about the circumstances when a bank account of a complying super fund is a segregated current pension asset), the ATO has received questions about the partial segregation of other asset types. The ATO view is that it is not possible to segregate part of an asset.
- Ms Macfarlane noted ATO ID 2014/39 and ATO ID 2014/40, which set out the ATO's view that the non-arm's length provision applies to the non-commercial LRBAs involving related parties in those cases. She said the ATO's position remains unchanged: it is likely to scrutinise related-party LRBAs where the terms of the loan, taken together, and the ongoing operation of the loan, are not consistent with a genuine arm's-length arrangement (ie the type of arrangement you would expect to get dealing with a third party such as a bank). In this regard, the Assistant Commissioner urged trustees to review any arrangements which may not be on commercial terms. She said the ATO is "keen to work with trustees who may be concerned about their particular arrangements". Depending upon the facts and circumstances of the case, she said this may involve refinancing the arrangement on a commercial arm's-length basis.
- Since the release of Taxpayer Alert TA 2015/1, the ATO has seen variations of the dividend stripping arrangements mentioned in the alert. Ms Macfarlane noted that even if a company (with retained earnings and franking credits) with business real property or residential property (leased to an unrelated party) transfers shares to an SMSF with a view to avoiding the stamp duty consequences that may otherwise arise if it transferred the property instead, this would not necessarily obviate the application of the dividend stripping provisions. Ms Macfarlane said the ATO will work with industry to develop an ATO view to support TA 2015/1 and provide further guidance and certainty to SMSF trustees and advisors.
- A number of SMSFs continue to incorrectly claim expenses as a deduction, despite having some members in pension phase. As a general rule, a fund cannot claim a deduction for expenditure incurred in gaining or producing exempt income unless a specific deduction provision applies.

- **Ceasing a pension:** Ms Macfarlane said the ATO is seeing a range of issues relating to what happens in the unexpected event of a pensioner's death. In cases where an SMSF is paying a pension and the pensioner dies, if there is an automatic reversionary beneficiary in place the pension does not stop on the pensioner's death. It simply transfers to the nominated beneficiary and they continue to receive it on the same terms as the original pensioner. The fund's ability to claim ECPI generally continues. However, Ms Macfarlane raised a number of issues in this regard, such as:
  - Firstly, is the nominated reversionary beneficiary entitled to receive a death benefit pension under the terms of the SMSF's deed and the law? The concern here is that not all SIS dependants can receive a death benefit pension under the law, irrespective of the terms of the deed.

- Secondly, in order to be able to report ECPI in the year of the death, the trustees must make sure that the annual minimum pension payment is still made. Although there is no requirement to adjust the minimum pension payment amount for the year of death, regardless of any difference in the minimum factors between the deceased pensioner and the reversionary beneficiary, there is still a need to make the full annual pension payment by 30 June. It is not until 1 July of the next financial year that the reversionary beneficiary's relevant drawdown factor is required to work out the minimum pension calculation.
- Thirdly, where the original pensioner was in receipt of a transition-to-retirement income stream, it is important for the trustees to recognise that the reversionary beneficiary's benefit should be recorded as unrestricted non-preserved. This is important if the reversionary beneficiary wishes to access any lump sum amounts in future. This also means that the reversionary beneficiary will be in receipt of an ordinary account-based pension without the limitations imposed by a transition-to-retirement pension, regardless of their age.

Other compliance issues

The Assistant Commissioner also identified the following additional compliance focus areas in relation to SMSFs for the ATO "in the coming year":

- inexplicable, significant and out-of-pattern changes in the value of an SMSF's assets and/or an SMSF's income; and
- related-party investments and/or transactions entered into on non-commercial terms.

Through monitoring of the SMSF sector, Ms Macfarlane said the ATO has also identified the following activities which have raised concerns:

- the marketing and selling of investment products such as real property investments via "cold calls", where the primary focus is on enticing people to invest and then having them establish an SMSF to invest in the product. Individuals are often advised to establish an SMSF without regard to whether an SMSF is appropriate to their particular needs and circumstances;
- LRBA loans that are not structured correctly, including incorrect registration of the ownership of property acquired under an LRBA, and other SMSF assets in addition to the asset acquired under the LRBA being used as security for the loan – that is, the lender's recourse is not appropriately limited to the underlying asset; and
- the promotion of arrangements that seek to gain a present-day benefit for the member (eg housing benefits, cosmetic surgery, holidays, etc).

Source: ATO speech, "What's ahead for SMSFs? The ATO perspective", last modified 28 July 2015, https://ato.gov.au/Media-centre/Speeches/Other/Whats-ahead-for-SMSFs-The-ATO-perspective/.

ATO data-matching: immigration visa holders

The ATO has announced that it will acquire names, addresses and other details of visa holders, their sponsors and their migration agents for the 2013–2014, 2014–2015, 2015–2016 and 2016–2017 financial years from the Department of Immigration and Border Protection. It is estimated that records relating to approximately a million individuals will be obtained.

Data items to be collected include:

- address history for visa applicants and sponsors;
- contact history for visa applicants and sponsors;
- all visa grants;
- visa grant status by point in time;
- migration agents (visa application preparer who assisted or facilitated the processing of the visa);
- address history for migration agents;
- contact history for migration agents;
- all international travel movements undertaken by visa holders (arrivals and departures);
- sponsor details (457 visa);
- education providers (educational institution where the student visa holder intends to undertake their study); and
- visa subclass name.

The records will be electronically matched with certain sections of ATO data holdings to identify non-compliance with tax obligations. The objectives of the data-matching program are to:

- improve intelligence on the overall level of compliance with taxation obligations by visa holders, sponsors and migration agents;
- test the veracity and strengths of existing risk detection models and treatment systems and identify areas for improvement in the ATO's suite of compliance models and treatment systems and practices;
- improve the integrity of the data on the Australian Business Register by cancelling ineligible registrants;
- identify potentially new or widespread fraud methodologies and entities controlling or exploiting those methodologies;
- assist in developing and implementing administrative strategies to improve voluntary compliance by visa holders, sponsors and migration agents; and
- ensure compliance with registration, lodgment, correct reporting and payment of taxation and superannuation obligations.

Further information on the ATO's data-matching program is available on its website at https://ato.gov.au/General/Gen/DIBP-Visa-Holders-Data-Matching-Program/.

Source: Notice of Data Matching Program – Immigration Visa Holders, Gazette – C2015G01255, 4 August 2015, https://comlaw.gov.au/Details/C2015G01255.

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