CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 27 April 2016.

Tax incentives to promote innovation

The Government has released draft legislation to implement more of the tax incentive measures announced as part of its National Innovation and Science Agenda (released in December 2015). The measures are designed to incentivise and reward innovation.

One of the measure will allow companies that have changed ownership to access past year tax losses if they satisfy a similar business test. Under the current law, businesses that have changed ownership must satisfy the same business test to access past year tax losses. This measure is designed to encourage entrepreneurship by allowing loss-making businesses to seek out new opportunities for returning to profitability. (See **Increasing access to company losses** below for further details.)

The other measure will allow taxpayers the choice to either self-assess the effective life of certain intangible depreciating assets or use the statutory effective life. The current law only provides an effective life set by statute. According to the Government, the changes will better align the taxation treatment of these intangible depreciating assets with the actual period of time that the assets provide economic benefits. It will also align the treatment of intangible depreciating assets with that of tangible assets. (See **Faster depreciation for intangible assets** below for further details.)

Public consultation on the draft legislation closed on 22 April 2016.

At the time of writing, the Government has proposed to introduce the *Tax and Superannuation Laws Amendment (2016 National Innovation and Science Agenda) Bill 2016* into the House of Representatives. It is understood the Bill would contain these two measures.

Increasing access to company losses

The draft legislation proposes to amend the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to supplement the existing same business test with a more flexible "similar business test" to improve access to losses for companies that have changed ownership. Under the proposed amendments, those companies would be able to deduct losses if they satisfy the similar business test, which is framed to allow companies to seek out opportunities to innovate and grow without losing access to losses.

The similar business test would also supplement the same business test for the other purposes to which the latter currently applies (such as working out whether a debt written off as bad can be deducted in an income year, and for certain purposes with respect to listed widely held trusts).

As with the same business test, the similar business test focuses on the identity of the business. It is not sufficient that the current business is of a similar "kind" or "type" to the former business. For example, it is not enough to say that the former business was in the hospitality industry and the current business is in the hospitality industry. Instead, the test looks at all of the commercial operations and activities that the former business carried on and compares them with all of the commercial operations and activities that the current business carries on, to work out if the businesses are similar.

Where a company has undergone a change of ownership or control, it may also access losses from years preceding that change if it passes the similar business test. A company passes the similar business test if its current business is a similar one to its former business. Under the proposed changes, in working out whether the business carried on throughout the business continuity test period (the "current business") is similar to the business carried on immediately before the test time (the "former business"), three factors, which are not exhaustive, should be considered:

- **Factor 1 – same assets used to generate income:** the extent to which the assets (including goodwill) that are used in its current business to generate assessable income were also used in the company's former business to generate assessable income;

- **Factor 2 – assessable income generated from the same sources**: the extent to which the sources from which the current business generates assessable income were also the sources from which the former business generated assessable income; and
- **Factor 3 – changes to a similarly placed business:** whether any changes to the former business are changes that would reasonably be expected to have been made to a similarly placed business. This factor requires taking a hypothetical business that is similarly placed to the company's former business, and asking whether a reasonable person would expect the changes to be made to that business. Importantly, this factor looks at the business of the company, rather than the company itself. That is, it focuses on the commercial operations and activities that the company carries on, rather than the structure of the company itself.

Source: Treasury, "National innovation and science agenda: increasing access to company losses", 6 April 2016, www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/NISA-increasing-access-to-company-losses.

Faster depreciation for intangible assets

The changes are proposed to apply for intangible depreciating assets, listed in the table in subs 40-95(7) of the ITAA 1997, that an entity starts to hold on or after 1 July 2016. That is, the current law continues to apply to these intangible depreciating assets that an entity holds before 1 July 2016.

Under the proposed changes:

- to calculate the decline in value of certain intangible depreciating assets, a holder of the asset has the choice to either self-assess the effective life or use the statutory effective life;
- unless the asset is copyright, a licence relating to copyright or in-house software, a subsequent holder of certain intangible depreciating assets must use the remaining statutory effective life, if the holder chooses to use the statutory effective life;
- if a subsequent holder of certain intangible depreciating assets self-assesses the effective life of the asset, the holder is not able to adjust the prime cost method formula;
- if in a later income year the effective life used for certain intangible depreciating assets is no longer accurate due to a change in circumstances relating to the nature of the use of the asset, a holder of the asset can recalculate the effective life;
- if the cost of the intangible depreciating asset increases by at least 10% in a later income year, a holder of the asset must recalculate the effective life; and
- a new holder must recalculate the effective life for the income year that they start to hold certain intangible depreciating assets, if the cost of the asset increases by at least 10% and the asset:
  - is acquired from an associate;
  - continues to be used by the former user; or
  - has a new user who is an associate of the former user.

Source: Treasury, "National innovation and science agenda: intangible asset depreciation", 1 April 2016, www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/NISA-intangible-asset-depreciation.

Car expenses and special arrangements for the 2016 FBT year

The ATO has updated information about use of the cents per kilometre basis for claiming car expenses and making fringe benefits calculations.

From 1 July 2015, separate rates based on the size of the engine no longer apply. Taxpayers can use a single rate of 66 cents per kilometre for all motor vehicles for the 2015–2016 income year. The Commissioner will determine the rate for future income years.

However, the ATO acknowledges there has been uncertainty about the correct rate to apply for the 2016 FBT year. Therefore, the ATO has advised of a special arrangement for 2016 whereby it will also accept 2016 FBT returns based on the 2014–2015 rates (which are 65, 76 or 77 cents per kilometre depending on the engine capacity of the employee's car).

For future FBT years, which end on 31 March, the ATO says employers should use the rate determined by the Commissioner for the income year that ends on the following 30 June. For example, for the FBT year ending 31 March 2017, employers should use the basic car rate determined by the Commissioner for the 2016–2017 income year.

Source: ATO, "Cents per kilometre", 30 March 2016, https://www.ato.gov.au/Business/Income-and-deductions-for-business/Business-travel-expenses/Motor-vehicle-expenses/Calculating-your-deduction/Cents-per-kilometre/.

Holiday homes: tax considerations

The ATO has released a publication concerning tax issues and holiday homes. It features eight worked examples and sets out key points that include the following.

"Genuine" availability for rent

Factors that may indicate a property is not genuinely available for rent include that:

- it is advertised in ways that limit its exposure to potential tenants – for example, the property is only advertised by word of mouth;
- the location, condition of the property or accessibility to the property mean that it is unlikely tenants will seek to rent it;
- there are unreasonable or stringent conditions on renting out the property that restrict the likelihood of the property being rented out; or
- interested people are turned away without adequate reasons.

Both rented out and used privately

The ATO notes that taxpayers who rent out their holiday home and also use it for private purposes cannot claim deductions for the proportion of expenses that relate to the private use. The ATO also makes the following key points:

- where the property is used for private purposes for part of the year, expenses are apportioned on a time basis;
- private purposes include use by the taxpayer, the taxpayer's family, relatives and friends free of charge; and
- if the holiday home is rented out to family, relatives or friends below market rates, deductions are limited to the amount of rent received for the period(s).

Travel to inspect and repair

The ATO notes that taxpayers who rent out their holiday home can claim reasonable costs that relate to those people inspecting, maintaining and making repairs to their property.

However, the ATO also notes that where a taxpayer who is primarily visiting the property to have a holiday and undertakes repairs and maintenance during this period, they can only claim repair and maintenance costs based on the proportion of the income year for which the property was rented out or genuinely available for rent. The taxpayer cannot claim travel costs to and from the property.

Source: ATO, "Holiday homes", 5 April 2016, https://www.ato.gov.au/General/Property/In-detail/Holiday-homes/.

Individuals caught in "Panama Papers" leak

The ATO has released a statement on the release of taxpayer data in relation to a Panamanian law firm.

The ATO said it recently received data in relation to the Panamanian law firm containing names of a significant number of Australian residents. It has identified over 800 individual taxpayers and has now linked over 120 of them to an associate offshore service provider in Hong Kong. These cases relate to the release of data by transparency or media organisations in Australia and overseas.

ATO Deputy Commissioner Michael Cranston said that since the completion of its offshore disclosure initiative "Project DO IT", the ATO has ramped up its compliance work to deal with taxpayers who have failed to disclose offshore income and assets. Sharing information and coordinating action closely with other tax administrations is a large part of this work.

Mr Cranston said the ATO has been analysing the latest data against information these taxpayers had reported and the information the ATO already had. The ATO is also working closely with the Australian Federal Police, Australian Crime Commission and Australian Transaction Reports and Analysis Centre (AUSTRAC) to further cross-check the data and strengthen the ATO's intelligence. Some cases may be referred to the Serious Financial Crime Taskforce, Mr Cranston said.

The information the ATO received regards some taxpayers it had previously investigated, as well as a small number who disclosed their arrangements to the ATO under Project DO IT. It also includes information about a large number of taxpayers who have not previously come forward, including high-wealth individuals, and the ATO is already taking action on those cases, Mr Cranston said.

Source: ATO, "ATO statement regarding release of taxpayer data", 4 April 2016, https://www.ato.gov.au/Media-centre/Media-releases/ATO-statement-regarding-release-of-taxpayer-data/.

ATO safe harbour for SMSF borrowings

The ATO has issued Practical Compliance Guideline PCG 2016/5, which sets out the "safe harbour" terms on which self managed superannuation fund (SMSF) trustees may structure related-party limited recourse borrowing arrangements (LRBAs) consistent with an arm's-length dealing.

The ATO generally takes the view that an SMSF may derive non-arm's length income (NALI) under s 295-550 of ITAA 1997 (taxable at 47%) if the terms of an LRBA are not consistent with an arm's-length dealing: see ATO Interpretative Decisions ATO ID 2015/27 and ATO ID 2015/28.

If an LRBA under s 67A of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) is structured in accordance with PCG 2016/5, the ATO accepts that the LRBA is consistent with an arm's-length dealing and the NALI provisions will not apply to the income generated from the LRBA asset. While a practical compliance guideline (PCG) is not legally binding on the Commissioner, generally the ATO will not take action against a taxpayer who relies on a PCG in good faith.

Safe harbour terms: real property LRBAs

Where an SMSF uses an LRBA to acquire real property (including residential, commercial or primary production properties), the ATO will accept that the LRBA is consistent with an arm's-length dealing if the following terms of the borrowing are established and maintained:

- **Interest rate:** 5.75% for 2015–2016; for 2016–2017 and later years, the interest rate must be set according to the Reserve Bank Indicator Lending Rates for banks providing standard variable housing loans for investors (the rate published for May immediately prior to the start of the relevant financial year; see www.rba.gov.au/statistics/tables/xls/f05hist.xls).
- **Fixed/variable rate:** the interest rate may be variable (using the applicable rate as set out above for each year of the LRBA) or fixed (but only up to a maximum of five years). The 2015–2016 rate of 5.75% may be used for existing LRBAs if the total period for which the interest rate is fixed does not exceed five years.
- **Term of loan:** cannot exceed 15 years.
- **Loan-to-value ratio (LVR):** a maximum 70% LVR applies for both commercial and residential property. The market value of the asset is established when the loan (original or refinancing) is entered into. Trustees of existing loans may use the market value at 1 July 2015.
- **Repayments:** must be made monthly. Each repayment is of both principal and interest.
- **Security:** a registered mortgage over the property is required.
- **Personal guarantees:** are not required.
- **Loan agreement:** must be in writing and properly executed.

Safe harbour terms: listed securities

Where an SMSF uses an LRBA to acquire a collection of listed securities (eg listed shares and listed units in a unit trust), the ATO will accept that the LRBA is consistent with an arm's-length dealing if the following terms of the borrowing are established and maintained:

- **Interest rate:** the rate above for real property LRBAs, plus 2%; that is, 7.75% (5.75% + 2%) for 2015–2016. For 2016–2017 and later years, the interest rate must be set according to the Reserve Bank Indicator Lending Rates (as noted above for real property) plus 2%.
- **Fixed/variable rate:** the interest rate may be variable (using the applicable rate as set out above for each year) or fixed (but only up to a maximum of three years).
- **Term of loan:** cannot exceed 7 years.
- **Loan-to-value ratio (LVR):** a maximum 50% LVR applies for listed securities.
- **Repayments:** must be made monthly. Each repayment is of both principal and interest.
- **Security:** a registered charge/mortgage or similar security (that provides security for loans for such assets) is required; see the Personal Property Securities Register (PPSR) website: https://www.ppsr.gov.au/.
- **Personal guarantees:** are not required.
- **Loan agreement:** must be in writing and properly executed.

Failure to meet safe harbour rules

If an LRBA does not meet all of the safe harbour terms, it does not mean that the borrowing is deemed not on arm's-length terms. It merely means that the SMSF trustee cannot take advantage of the certainty (provided under Practical Compliance Guideline PCG 2016/5) that the Commissioner will accept the

arrangement is consistent with an arm's-length dealing. Rather, trustees who do not meet the safe harbour terms need to otherwise demonstrate that their arrangement was entered into and maintained on terms consistent with an arms'-length dealing. For example, they may do so by documenting evidence that shows their particular arrangement is established and maintained on terms that replicate the terms of a commercial loan that is available in the same circumstances.

ATO grace period to 30 June 2016

The ATO has previously announced a grace period whereby it will not select an SMSF for review for the 2014–2015 year or earlier years provided that arm's-length terms for its LRBA are implemented by 30 June 2016 (or the LRBA is brought to an end before that date).

Importantly, the ATO Compliance Guideline requires arm's-length payments of principal and interest to be made for the year ended 30 June 2016 (including where the arrangement is brought to an end before 30 June 2016). SMSF trustees who are concerned about their ability to make the required payments on commercial terms before 30 June 2016 can contact the ATO to discuss their particular circumstances: write to PO Box 3100, Penrith NSW 2740.

Accordingly, SMSF trustees should review the terms of their LRBAs before 30 June 2016 to ensure that each LRBA:

- is on terms that are consistent with an arm's-length dealing (and arm's-length payments of principal and interest have been made for 2015–2016); or
- is brought to an end (and the payments of principal and interest are made under LRBA terms consistent with an arm's-length dealing).

The ATO states that SMSF trustees who satisfy these conditions and apply Practical Compliance Guideline PCG 2016/5 in good faith to revise the terms of their existing LRBAs before 30 June 2016 will not be subject to any further compliance action for 2014–2015 and earlier years.

Example: real property

The ATO compliance guideline sets out examples (for both real property and listed shares) illustrating how SMSF trustees can review and revise the terms of their LRBAs before 30 June 2016 to access the safe harbours.

The ATO example for real property involves a situation for a complying SMSF with borrowed money under an LRBA on terms consistent with s 67A of the SIS Act. The SMSF used the funds to acquire commercial property valued at $500,000 on 1 July 2011. Other facts include that:

- the borrower is the SMSF trustee;
- the lender is an SMSF member's father (a related party);
- a holding trust has been established, and the holding trust trustee is the legal owner of the property until the borrowing is repaid;
- the property was valued at $643,000 (at 1 July 2015);
- the SMSF has not repaid any of the principal since the loan commenced.

The loan has the following features:

- the total amount borrowed is $500,000;
- the SMSF met all the costs associated with purchasing the property from existing fund assets;
- the loan is interest-free;
- the principal is repayable at the end of the term of the loan, but may be repaid earlier if the SMSF chooses to do so;
- the term of the loan is 25 years;
- the lender's recourse against the SMSF is limited to the rights relating to the property held in the holding trust; and
- the loan agreement is in writing.

The ATO considers that this LRBA has not been established or maintained on arm's-length terms according to the view set out in ATO ID 2015/27 and ATO ID 2015/28. As such, the ATO believes that the income earned from the property (rented to an unrelated party) gives rise to NALI.

To avoid having to report NALI for the 2015–2016 year (and earlier years), the SMSF trustees have the following three options.

Option one: alter loan terms to meet guidelines

The SMSF and the lender could alter the terms of the loan arrangement to meet the safe harbour conditions for real property. To bring the terms of the loan into line with the safe harbour rules, the ATO says the trustees of the SMSF must ensure that:

- The 70% LVR is met (in this case, the value of the property at 1 July 2015 may be used). Based on a property valuation of $643,000 at 1 July 2015, the maximum the SMSF can borrow is $450,100. The SMSF needs to repay $49,900 of the principal as soon as practical before 30 June 2016.
- The loan term cannot exceed 11 years from 1 July 2015. The SMSF must recognise that the loan commenced four years earlier. An additional 11 years would not exceed the maximum 15-year term.
- The SMSF can use a variable interest rate. Alternatively, it can alter the terms of the loan to use a fixed rate of interest for a period that ensures the total period for which the rate of interest is fixed does not exceed five years. The loan must convert to a variable interest rate loan at the end of the nominated period.
- The interest rate of 5.75% per annum applies from 1 July 2015 to 30 June 2016. The SMSF trustee must determine and pay the appropriate amount of principal and interest payable for the year. This calculation must take into account the opening balance of $500,000, the remaining term of 11 years and the timing of the $49,900 capital repayment.
- After 1 July 2016, the new LRBA must continue under terms that comply with the ATO's guidelines relating to real property at all times. For example, the SMSF must ensure that it updates the interest rate used for the loan on 1 July each year (if variable) or as appropriate (if fixed), and make monthly principal and interest repayments accordingly.

Option two: refinance through commercial lender

The fund could refinance the LRBA with a commercial lender, extinguish the original arrangement and pay the associated costs.

While the original loan remains in place during the 2015–2016 income year, the SMSF must ensure that the terms of the loan are consistent with an arm's-length dealing and that the relevant amounts of principal and interest are paid to the original lender. The SMSF may choose to apply the terms set out under the safe harbour rules to calculate the amounts of principal and interest to be paid to the original lender for the relevant part of the 2015–2016 year.

Option three: pay out the LRBA

The SMSF may decide to repay the loan to the related party, and bring the LRBA to an end before 30 June 2016.

While the original loan remains in place during the 2015–2016 income year, the SMSF must ensure that the terms of the loan are consistent with an arm's-length dealing, and the relevant amounts of principal and interest are paid to the original lender. The SMSF may choose to apply the terms set out under the safe harbour rules to calculate the amounts of principal and interest to be paid to the original lender for the relevant part of the 2015–2016 year.

Date of effect

Practical Compliance Guideline PCG 2016/5 applies to LRBAs commenced both before and after 6 April 2016.

Source: ATO, Practical Compliance Guideline PCG 2016/5, 6 April 2016, https://www.ato.gov.au/law/view/pdf/cgl/pcg2016-005.pdf.

ATO's data-matching net widens

The ATO has gazetted notices announcing details of various data-matching programs. Most of the notices announce extensions to existing data-matching programs. Records will be electronically matched with ATO data holdings to identify non-compliance with registration, lodgment, reporting and payment obligations under taxation laws. Details are as follows.

Commonwealth electoral roll details

The ATO will acquire details of registered voters on the Commonwealth electoral roll from the Australian Electoral Commissioner. This data will be collected on an ongoing basis and refreshed every three months.

Details to be collected include the name, residential address, date of birth, and occupation of the registered voter. It is estimated that records for 15 million individuals will be obtained each quarter.

The ATO has said the program aims to:

- identify taxpayers who are not registered with the ATO when they are required to be;
- locate taxpayers who may have outstanding taxation and superannuation lodgment, correct reporting or payment obligations;
- identify potential instances of taxation or superannuation fraud; and
- assist with the administration of Australia's Foreign Investment Framework.

Source: Commonwealth Gazette, "Notice of a data matching program – Commonwealth electoral roll details", 14 April 2016, https://www.legislation.gov.au/Details/C2016G00501.

Contractor payments 2016–2019

The ATO will acquire data from businesses that it visits as part of its employer obligations compliance program during the 2016–2017, 2017–2018 and 2018–2019 financial years.

Data to be collected includes the:

- Australian Business Number (ABN) of the payer business;
- ABN of the payee business (contractor);
- name, address and contact details of the contractor;
- dates of payment to the contractor; and
- amounts paid to the contractor (including details of whether the payments included GST).

It is estimated that records for 25,000 entities will be obtained, including the records of 12,500 individuals.

The program aims to:

- assess the integrity of the information held on the Australian Business Register to assist the Registrar in developing educational and compliance strategies;
- obtain intelligence to identify risks and trends about contractors who may not be complying with their taxation obligations;
- ensure compliance with registration, lodgment, correct reporting and payment of taxation and superannuation obligations;
- promote voluntary compliance and better tailor educational products and services.

This program has been ongoing since the 2008–2009 financial year and has resulted in improved compliance with obligations, and additional income tax, GST and PAYG withholding liabilities being raised.

Source: Commonwealth Gazette, "Notice of a data matching program – Contractor Payments – 2016–19", 14 April 2016, https://www.legislation.gov.au/Details/C2016G00502.

Merchants: specialised payment systems 2014–2017

The ATO will acquire data related to electronic payments made to merchants through specialised payment systems for the 2014–2015, 2015–2016 and 2016–2017 financial years. This program is designed to obtain data on electronic payments received by businesses that complement data obtained from the ongoing credit and debit card data-matching program (see below). Transactions processed through the specialised payment systems in this program cover those transactions either not included or not visible at the "end merchant" level in the ATO's merchant credit and debit card data collection.

The ATO said data will be initially obtained from the following specialised payment system facilitators:

- Debitsuccess Pty Ltd;
- Ezidebit Pty Ltd;
- Ezypay Pty Ltd;
- FFA Paysmart Pty Ltd;
- Integrapay Pty Ltd;
- Flexi Online Pty Ltd (T/A Paymate);
- PayPal Australia Pty Ltd;
- Southern Payment Systems Pty Ltd (T/A Pin Payments); and
- Stripe Payments Australia Pty Ltd.

The data items to be obtained are personal details of:

- merchants using the services of a specialised payment system to take electronic payments; and
- the amount and quantity of the transactions processed.

It is estimated that records for 300,000 entities will be obtained, including around 50,000 for individuals.

The ATO said this program will be the second collection of specialised payment systems data. The first collection revealed discrepancies between electronic payments received and information declared in businesses' tax returns, and the ATO is investigating these discrepancies.

The ATO said the data will be used to:

- detect unreported income through discrepancy matching;
- identify those operating a business but failing to meet their registration, lodgment or payment obligations;
- identify liquidated or de-registered businesses that are continuing to trade (phoenix operators);
- identify "cash only" businesses, by exception; and
- support analytical models to detect high-risk activity and cases for administrative action.

From 1 July 2017, providers of specialised payment systems will be required to report details to the ATO as part of the Government's legislated compliance measure on improving compliance through third-party reporting, announced in the 2013–2014 Budget.

Source: Commonwealth Gazette, "Notice of a data matching program – Specialised Payment Systems 2014–17", 14 April 2016, https://www.legislation.gov.au/Details/C2016G00503.

Credit and debit cards 2014–2015

In August 2015, the ATO announced it will request and collect data relating to credit and debit card payments to merchants for the period 1 July 2014 to 30 June 2015 from 11 specified financial institutions. The ATO has now also advised that it will collect data from Suncorp-Metway Ltd as part of that data-matching program.

The purpose of the data-matching program is to ensure that merchants are correctly meeting their taxation obligations in relation to their business income. These include registration, lodgment, reporting and payment responsibilities.

Source: Commonwealth Gazette, "Notice of a data matching program – Credit & Debit Cards 2014–15 – Addendum", 14 April 2016, https://www.legislation.gov.au/Details/C2016G00504.

Further details

Additional details of the data-matching programs, and details of other programs, are available on the ATO website at https://www.ato.gov.au/General/Gen/Data-matching-protocols/.