client alert | explanatory memorandum

July 2016

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 16 June 2016.

Tax Time 2016: take care with work and rental property claims

The ATO encourages taxpayers to check all claims before lodging their tax returns, and has highlighted a number of areas of specific concern for tax time 2016.

Work-related deductions

The ATO encourages people to check which work-related expenses they are entitled to claim and understand what records they need to keep. Assistant Commissioner Graham Whyte has reminded taxpayers that there has been a change in the rules for calculating car expenses this year, and people need to use a logbook or the cents-per-kilometre method to support their claims.

"It's important to remember that you can only claim a deduction for work-related car expenses if you use your own car in the course of performing your job as an employee. Most people can't claim the cost of travel between home and work because this travel is private", Mr Whyte said.

The ATO will pay extra attention to returns of people whose deduction claims are higher than expected, in particular those claiming car expenses – including for transporting bulky tools – and deductions for travel; internet and mobile phones; and self-education. For the first time ever, this year the ATO will check taxpayers' deductions in real-time as they complete their returns online. Mr Whyte said "a message will appear" if a taxpayer's claims are substantially higher than others' in similar occupations who earn similar amounts of income. He also noted that "the ATO will take a closer look at any unusual deductions and contact employers to validate these claims".

The ATO provides the following case studies.

Car expenses: transporting bulky tools

A car mechanic claimed $3,850 in car expenses for carrying their large toolbox to and from work each day. The employer told the ATO that they supply all of the necessary tools at the workshop for the mechanic to do their job but they preferred to use their own tools. The car expenses were disallowed because the mechanic chose to use their own tools, rather than the tools provided by their employer. Travel from home to work is private and not tax deductible. The mechanic was required to pay back more than $2,000 in tax and penalties.

Travel expenses

For each day a boilermaker worked away from home, they received a travel allowance from their employer. The boilermaker's payment summary showed they were paid a travel allowance of $8,000 during the year, the same amount that the boilermaker claimed as a deduction.

The employer paid the travel costs to get the boilermaker to and from work and provided accommodation and all meals. The claim for travel expenses was disallowed because the boilermaker did not spend any money. As the travel allowance was shown on the boilermaker's payment summary, it needed to be included as income on their tax return. After penalties were applied, the boilermaker received a bill for almost $4,000.

Car and uniform expenses

A real estate agent claimed work-related motor vehicle and work-related clothing, laundry and dry-cleaning expenses. During the audit process they provided allegedly false tax invoices from a commercial car wash and dry cleaner to support the deduction claims. The real estate agent was prosecuted, pleaded guilty and was fined $4,000.

Mobile phone expenses

A labourer claimed $1,200 in other work-related expenses for use of their mobile phone. The labourer told the ATO they used their phone at work to keep in touch with their co-workers but did not have records to show this usage. When the ATO spoke to the labourer's employer, they were told the labourer was not required to use their mobile phone as part of their duties. The ATO accepted that the labourer may have occasionally used their mobile phone for work purposes and allowed a claim of $50 for the year.

Self-education expenses

A retail sales assistant claimed a deduction for self-education expenses of $5,165 for course fees relating to a Bachelor of Arts degree. As the degree did not directly relate to the assistant's current job, and there was no requirement to undertake further education, the claim was disallowed.

False claims

An insurance broker claimed work-related expenses of over $65,000 in their tax returns. As well as car expenses, they claimed expenses for entertaining clients. When asked to prove the claims, the insurance broker provided receipts for significantly less than the amounts claimed. Many of the receipts were for meals on weekends and with family, and personal expenses such as school fees and pool supplies. When the insurance broker's vehicle logbooks were compared with other data held by the ATO, it became apparent that they were fabricated. The insurance broker's claims were substantially reduced and penalties were imposed for making false statements in the returns. The broker was found liable for tax, penalties and interest of over $75,000.

Source: ATO media release, "ATO helps to work out work-related expenses", 6 June 2016, https://www.ato.gov.au/Media-centre/Media-releases/ATO-helps-to-work-out-work-related-expenses/.

Rental property owners' obligations and claims

The ATO encourages rental property owners to better understand their obligations and get their claims right. Assistant Commissioner Graham Whyte has said the ATO will pay close attention to excessive interest expense claims and incorrect apportionment of rental income and expenses between owners.

"We are also looking at holiday homes that are not genuinely available for rent and incorrect claims for newly purchased rental properties", Mr Whyte said.

The ATO provides the following case studies.

Interest claims

Rental property owner Sarah reported high rental interest claims and was required to provide bank statements as evidence to the ATO. The statements showed borrowings well in excess of the purchase price of the rental property. The interest charges relating to the private part of the loan were disallowed. Sarah was required to pay more than $15,000 back to the ATO.

Holiday home

John has a newly purchased rental property that had not returned any rental income. He told the ATO that the property was occasionally advertised on community noticeboards and websites. John was unable to prove there was a genuine arrangement in which he actively sought tenants or had taken sufficient steps to genuinely advertise the property for rent. A claimed rental loss of almost $60,000 was disallowed and penalties were applied.

Newly purchased rental property

Nancy recently purchased a rental property and had her tax return amended by the ATO to remove deductions for repairs, capital works and incorrectly apportioned borrowing expenses. Nancy had inappropriately claimed a deduction for repairs to defects present in a newly purchased property and the capital works and borrowing expenses should have been spread over several years. Nancy also provided false fee receipts for property management undertaken by a family member. Nancy was required to pay more than $57,000 back to the ATO as well as over $10,000 in penalties for making a false statement in her tax return.

Apportioning expenses between joint owners

A rental property claim was investigated by the ATO where the rental expenses had not been apportioned correctly. The property was jointly owned by a couple but the higher-income earner claimed the larger proportion of the expenses. The expenses were adjusted to reflect the ownership interest and the higher earner had to pay back more than $8,000 in tax.

Recordkeeping

Ethan was required to provide evidence to the ATO to show that his property was genuinely rented at market rates. Ethan was unable to provide any documentation to show that a rental arrangement was in place. All rental income and expenses were removed from his tax return and he received a tax bill of more than $12,000.

Source: ATO media release, "ATO focuses on rental property owners", 6 June 2016, https://www.ato.gov.au/Media-centre/Articles/ATO-focuses-on-rental-property-owners/.

Share economy

The ATO also reminds tax professionals with clients engaged in the sharing economy (eg ride-sourcing) to include the income and deductions from those enterprises in the clients' tax returns. If a client is providing share economy services, they may need to:

- assess whether they carry on an enterprise;
- register for an ABN and/or GST;
- account for GST when they make taxable supplies of goods and services;
- declare their income; and
- determine if they can claim GST credits/input tax credits and income tax deductions for their expenses.

Source: ATO publication, "Tax implications for the sharing economy", 3 June 2016, https://www.ato.gov.au/Tax-professionals/Newsroom/Activity-statements/Tax-implications-for-the-sharing-economy/.

SMSF borrowing arm's-length terms deadline extended

The ATO has extended until 31 January 2017 the deadline for SMSF trustees to ensure that any related-party limited recourse borrowing arrangements (LRBAs) are on terms consistent with an arm's-length dealing.

The ATO had previously announced a grace period whereby it would not select an SMSF for review for the 2014–2015 year or earlier years provided that arm's-length terms for LRBAs were implemented by 30 June 2016 (or non-compliant LRBAs were brought to an end before that date).

The extension of the deadline to 31 January 2017 follows the ATO's release of Practical Compliance Guideline PCG 2016/5, which sets out "safe harbour" terms for LRBAs. If an LRBA is structured in accordance with PCG 2016/5, the ATO will accept that the LRBA is consistent with an arm's-length dealing and the non-arm's length income (NALI) rules (47% tax) will not apply to the income generated from the LRBA asset.

Arm's length terms by 31 January 2017

The Commissioner has received several requests from SMSF trustees for further time to ensure that their LRBAs are consistent with arm's-length dealings. These requests also highlighted that taxpayers may benefit from further ATO guidance about some aspects of the NALI provisions under s 295-550 of the ITAA 1997. For example, they suggested clarifying the circumstances in which an SMSF would be taken to receive a greater amount of ordinary or statutory income under a particular non-arm's length arrangement than it would have received under an arm's-length arrangement. The ATO intends to provide further information and illustrative examples by 30 September 2016.

If SMSF trustees ensure that any related-party LRBAs have terms consistent with an arm's-length dealing by 31 January 2017 (or are brought to an end by that date), the Commissioner will not select an SMSF for an income tax review purely because it has an LRBA for the 2014–2015 and earlier income years.

Importantly, the ATO requires payments of principal and interest for the year ended 30 June 2016 to be made under LRBA terms consistent with an arm's-length dealing by 31 January 2017 (including where the arrangement is brought to an end before 31 January 2017).

ATO safe harbour terms

Broadly, the ATO's safe harbour terms in PCG 2016/5 require an interest rate of 5.75% (for 2015–2016) for a related-party LRBA used to acquire real property (residential or commercial). Other requirements include that:

- the term of the loan cannot exceed 15 years;
- a maximum 70% loan-to-value ratio (LVR) applies;
- repayments must be made monthly; and
- a registered mortgage is required but personal guarantees are not.

If an LRBA does not meet all of the safe harbour terms by 31 January 2017, it does not mean that the borrowing is deemed not to be on arm's-length terms. Rather, trustees who do not meet the safe harbour terms will need to otherwise demonstrate that their arrangement was entered into and maintained consistent with arm's-length terms.

Source: ATO publication, "ATO's deadline for review non-arm's length LRBAs extended", 31 May 2016, https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News/ATO-s-deadline-for-review-non-arm-s-length-LRBAs-extended/.

Lifetime $500,000 non-concessional superannuation cap

As announced in the 2016–2017 Federal Budget, the Government has proposed a lifetime non-concessional superannuation contributions cap of $500,000 to apply from Budget night (3 May 2016). This means that people who are planning to make non-concessional contributions now need to check their historical non-concessional contributions data back to 1 July 2007 (which will be counted against the $500,000 lifetime limit).

To this end, the ATO can calculate non-concessional contribution amounts for the period 1 July 2007 to 30 June 2015, provided that the individuals and funds have met their lodgment obligations. The ATO says the amounts are calculated manually based on information from funds, income tax returns and excess contribution amounts released from funds.

The ATO has provided the following contact details:

- tax practitioners: phone 13 72 86 (Fast Key Code 4 4) or make contact via the online portal;
- individuals: phone 13 10 20; and
- those making written requests or bulk requests (for more than 10 clients): write to GPO Box 9990 in any capital city.

For phone contact, the ATO said a response will be provided through a call-back service within 48 hours. Written and bulk requests will take longer.

Note that to help the ATO provide information "within a few business days to those with a critical need", it asks tax practitioners to prioritise their clients' requests. In addition, the ATO asks tax practitioners making requests for more than 10 clients to lodge them via the Tax Agent Portal using portal mail (select topic "Superannuation" and "other").

Source: ATO Tax Practitioner Advisory Group meeting minutes, 20 May 2016, https://www.ato.gov.au/general/consultation/in-detail/stewardship-committees---minutes/ato-tax-practitioner-advisory-group-(atpag)/key-messages---ato-tax-practitioner-advisory-group-(atpag)/, "20 May 2016".

ATO clearance certificates for property disposals

Australian residents who are selling a taxable Australian property with a market value of $2 million or more need to obtain a clearance certificate from the ATO, to confirm that a 10% withholding amount does not need to be withheld from the transaction.

The new rules come into effect on 1 July 2016 and have been introduced to ensure foreign residents meet their CGT liabilities, the ATO says. Amounts withheld will be credited against the final income tax liability assessed on foreign residents' income tax returns. The ATO has talked to real estate agents, conveyancers and legal practitioners to ensure the industry is prepared to help its clients meet their withholding obligations.

The following publications are available on the ATO website:

- **Foreign resident capital gains withholding (**https://www.ato.gov.au/general/capital-gains-tax/in-detail/calculating-a-capital-gain-or-loss/foreign-resident-capital-gains-withholding/**).** New rules will apply to vendors disposing of certain taxable Australian property under contracts entered into from 1 July 2016. A 10% non-final withholding will be incurred on these transactions at settlement. Australian resident vendors selling real property will need to obtain a clearance certificate from the ATO before settlement to ensure they do not incur the 10% non-final withholding. Vendors can also apply for a variation if they are not entitled to a clearance certificate, if a vendor's declaration is not appropriate or if 10% withholding is too high compared to the actual Australian tax liability on the sale of the asset.
- **Foreign resident capital gains withholding – common questions (**https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/Foreign-resident-capital-gains-withholding-payments---common-questions/**).** Key common questions answered include:
  - When is a vendor a relevant foreign resident?
  - When will a purchaser know or have reasonable grounds to believe that the vendor is a foreign resident, or that the vendor is not an Australian resident?

- To which types of Australian property does this withholding tax apply?
- Does the withholding tax apply to share issuances?
- Does the withholding tax apply to intra-consolidated group transactions?
- Does the withholding tax apply to transactions involving members of consolidated groups and third parties?
- How is the market value of the asset determined?
- What is the effect of GST on market value?
- Does the $2 million threshold apply to the assignment of a lease?
- In what circumstances would a clearance certificate be obtained?
- Does the vendor declaration have to be in a specified form?
- What special rules apply for CGT assets that are options or the result of exercising an option?
- When would a variation request apply?

- **Foreign resident capital gains withholding clearance certificate application instructions (**https://www.ato.gov.au/Forms/Foreign-resident-capital-gains-withholding-clearance-certificate-application-instructions/**).** The ATO has released a foreign resident capital gains withholding clearance certificate application form. Points to note include:
  - The form is to be used by Australian resident vendors to notify the ATO that the foreign resident capital gains withholding does not need to be withheld from the sale of taxable Australian real property.
  - The form provides the details of vendors so the ATO can establish their tax residency status.
  - The form needs to be completed and lodged with the ATO as early as is practical. There is no ATO fee for clearance certificate applications.
  - The vendor will have to provide the purchaser with an ATO-issued clearance certificate on or before the day of settlement of the sale of the asset to ensure no withholding occurs.
  - The ATO notes that vendors may either complete and lodge the form themselves or have it completed and lodged on their behalf by a third party, such as a solicitor or an accountant.
  - A clearance certificate is valid for 12 months from issue, and must be valid at the time it is made available to the buyer.
  - Penalties apply where sellers make false or misleading declarations to the ATO, or where the buyer fails to withhold when they should.
  - An online version of the form will be available from 27 June 2016. Where applications are submitted online, most certificates will be issued electronically within a few days. Paper applications may take two to four weeks to process.
- **Foreign resident capital gains withholding rate variation application: instructions (**https://www.ato.gov.au/Forms/Foreign-resident-capital-gains-withholding-rate-variation-application-instructions/**).** The ATO has released instructions on how to apply for a reduction in the rate of foreign resident capital gains withholding on the sale of certain taxable Australian property. The foreign resident capital gains withholding variation application form requires the details of the vendor, the asset and the reason for a variation. The variation may reduce the withholding rate to nil. The form needs to be completed and lodged with the ATO as early as is practical. The vendor will have to provide the purchaser with an ATO-issued variation notice on or before the day of settlement of the asset to ensure the reduced rate of withholding applies. The ATO notes that conveyancers who are not legal practitioners or tax agents cannot complete the form on behalf of a vendor.

Law Companion Guides

The ATO notes that Law Companion Guidelines are being developed on a number of specific issues relating to the new withholding regime. Once available, these will supplement and should be read in conjunction with the other general information on the ATO website.

Sources: ATO media releases, "New tax rules for property sales over $2 million", 19 May 2016, https://www.ato.gov.au/Media-centre/Media-releases/New-tax-rules-for-property-sales-over-$2-million/; "Property withholding rules explained", 19 May 2016, https://www.ato.gov.au/Media-centre/Articles/Property-withholding-rules-explained/.

Hotel owner liable to GST for accommodation supply

The AAT has affirmed an objection decision of the Commissioner concerning GST on the supply of accommodation in commercial residential premises.

Background

The taxpayer was a hotel owner that had a management agreement with another entity (the operator). Under the agreement, the operator was to have control and discretion in the operation, direction, management and supervision of the hotel as required to give effect of the terms of the agreement. In addition, under the agreement, the operator was to "act solely as the agent" for the taxpayer.

The taxpayer claimed that it had incorrectly accounted for GST, and sought refunds totalling $476,610 for the periods between 1 July 2010 and 31 December 2013. Information provided to the ATO by the taxpayer's accountant was treated as an application for a private binding ruling (PBR).

The ATO handed down its PBR in a letter dated 8 December 2014. It ruled that the taxpayer was making a taxable supply of accommodation in commercial residential premises for the purposes of the GST Act (*A New Tax System (Goods and Services Tax) Act 1999*). The taxpayer objected. The Commissioner disallowed the objection and the taxpayer then sought review of the Commissioner's objection decision.

The AAT said the only issue it was required to determine was whether the supply of accommodation in the hotel by the taxpayer from May 2014 (the apparent date of the management agreement) was correctly described as a supply of accommodation in commercial residential premises provided to an individual by the entity that owns or controls the commercial residential premises. If it was so, then the taxpayer could not claim that the supply was input taxed for the purposes of s 40-35(1)(a). The result would be that GST was payable on the supply of the accommodation.

Decision

The AAT said, "Perhaps the most significant aspect of this case is the fact that the owner of [the hotel] has appointed the operator to act solely as its agent. The owner does not supply the accommodation to an independent intermediary under a discrete agreement. It is, in my opinion, inescapable that the relationship which arises out of that agreement results in a contract entered into for accommodation by the operator with an individual guest legally binding the owner principal. The common law principle of agency must apply in those circumstances."

The AAT concluded that the supply in this case was made by the owner of the hotel (the taxpayer) through its agent, the operator. The AAT held the taxpayer had failed to discharge the onus of proving that, on the balance of probabilities, the tax decision concerned should not have been made or should have been made differently. Accordingly, it affirmed the Commissioner's objection decision.

Re Paul J Castan & Son Pty Ltd ATF Castan Investments Unit Trust and FCT [2016] AATA 298*,* *www.austlii.edu.au/au/cases/cth/AATA/2016/298.html.*

ATO to make new decision on superannuation death benefit

The AAT has ordered the Commissioner to request that a couple (the taxpayers) make an application for another private ruling in relation to a life insurance payout they received after their son's death.

Background

In 2013, the taxpayers' son died in a motorbike accident. He was employed as a pilot and up to the time of his death had lived at home with his parents. As administrators of their son's estate, the taxpayers received a lump sum payment of $500,000 under their son's life insurance policy, which was part of his employer's super scheme. The taxpayers applied for a private ruling that the $500,000 was a superannuation lump sum that was not assessable under s 302-60 of the ITAA 1997. The Commissioner issued a private ruling to each taxpayer that ruled they were not death benefit dependants. The Commissioner disallowed the taxpayers' objection and they then sought review of the objection decisions.

The AAT said it was confined to a consideration of the 12 "facts" in the "scheme" identified in the private ruling in reviewing the objection decision. The AAT also said it was necessary for each taxpayer to have an "interdependency relationship" under s 302-200 immediately before their son's death for each taxpayer to be a "death benefits dependant" under s 302-195(1)(c).

Decision

The AAT concluded that the Commissioner's private ruling was correct. It found the facts comprising the scheme did not satisfy the requirements of an interdependency relationship under subparas (a) and (d) of s 302-200(1)(a), which meant the requirements of a death benefit dependant under s 302-195(1)(c) were not met. The AAT was of the view that, based on the facts comprising the scheme, the family lived together (s 302-200(1)(b)) and that they provided each other with financial support (s 302-200(1)(c)); however, the AAT did not accept that there was a "close personal relationship" (s 302-200(1)(a)) or that they provided each other with "personal care" (s 302-200(1)(d)).

The AAT further found that none of the facts in the scheme satisfied any of the matters in ITA regs 302-200.01(2). Among other things, the taxpayers had asserted that at the time of their son's death, they had just begun to convert their garage at home to a private living space for their son and this should be considered concerning the "the ownership, use and acquisition of property" under subreg 302-200.01(2)(a)(iii). However, the AAT noted the reference to "use" required consideration of the actual use of the property just before death and that the "intended use" of the garage did not fall within this item.

The AAT noted "additional information" provided by the taxpayers, which asserted, among other things, a close personal relationship, and the provision of physical and emotional care, which were not found in the facts comprising the scheme. The AAT said the additional information was "materially different" from the scheme. It said that had the Commissioner been provided with the information before the objection decisions were made, the Commissioner would have requested that the taxpayers make an application for another private ruling under s 359-65(3)(a) of the TAA. The AAT concluded it was administratively more convenient to remit the matter to the Commissioner to request that the taxpayers make another application for a private ruling.

Re TBCL & Anor and FCT [2016] AATA 264*, www.austlii.edu.au/au/cases/cth/AATA/2016/264.html*.