client alert | explanatory memorandum

March 2017

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 10 February 2017.

Re-characterisation of income from trading businesses

On 31 January 2017, the ATO released Taxpayer Alert TA 2017/1 *Re-characterisation of income from trading businesses*.

The ATO said it is reviewing arrangements that attempt to fragment integrated trading businesses in order to re-characterise trading income into more favourably taxed passive income. Its concern arises where a single business is divided in a contrived way into separate businesses. The income that might be expected to be subject to company tax is artificially diverted into a trust where, on distribution from the trust, that income is ultimately subject to no tax or a lesser rate than the corporate rate of tax. Stapled structures are one mechanism being used in these arrangements, but the ATO said its concerns are not limited to arrangements involving stapled structures.

The ATO said it is engaging more closely with taxpayers who have proposed these arrangements to explore the issues of concern and ensure that arrangements of the type outlined in the Alert do not seek to avoid the payment of corporate tax. Taxpayers and advisors who implement these types of arrangements will be subject to increased scrutiny. The ATO said it is continuing to develop its technical position on these arrangements and expects to issue further guidance in respect of its concerns.

Source: ATO, Taxpayer Alert TA 2017/1, 31 January 2017,
https://www.ato.gov.au/law/view/document?DocID=TPA/TA20171/NAT/ATO/00001.

ATO warning: research and development claims in building and construction industry

The ATO and the Department of Industry, Innovation and Science (DIIS) on 9 February 2017 released two new Taxpayer Alerts – TA 2017/2 *Claiming the Research and Development Tax Incentive for construction activities* and TA 2017/3 *Claiming the research and Development Tax Incentive for ordinary business activities* – as a warning to those who are not careful enough in their claims or seek to deliberately exploit the Research and Development (R&D) Tax Incentive program.

The R&D tax incentive encourages companies to engage in R&D that benefits Australia, by providing a tax offset for eligible R&D activities. ATO Deputy Commissioner Michael Cranston said the new alerts relate to particular issues identified in the building and construction industry, where specifically excluded expenditure is being claimed as R&D expenses. The alerts provide clarification for a wide range of businesses that had been incorrectly claiming ordinary business activities against the R&D tax incentive.

The alerts are designed to clarify what can and cannot be claimed, and help businesses to avoid mistakes, Mr Cranston said. He said that while “most do the right thing, we are seeing some businesses in these industries and their advisors improperly applying for the tax incentive where the activities and expenditure claimed don’t match with legislative requirements”.

For example, Mr Cranston said, the ATO has seen an increase in claims for ordinary business activity expenses, or for large parts of projects that do not correspond to the scale or scope of experimental activities. Ordinary business activities are not generally carried out with a purpose of generating new knowledge. He said the ATO often sees issues including claims that encompass whole of projects (where project, management, environmental and commercial risks are mistaken for technical risks) and where the activities use existing knowledge and expertise.

Mr Cranston warned that the ATO is undertaking “a range of compliance activities to address businesses and advisors deliberately doing the wrong thing and will take legal action against those who wilfully misuse the R&D tax incentive”.

Taxpayer Alert regarding construction activities

Taxpayer Alert TA 2017/2 deals with claiming the R&D tax incentive for construction activities. The alert says the arrangements under review concern claimants of the R&D tax incentive who:

- acquire buildings or extensions, alterations or improvements to buildings (the acquirer); or
- whose business it is to construct, extend, alter or improve buildings (the builder).

These types of arrangements exhibit a number of features, including the following:

- A contract is entered into between the acquirer and the builder to construct, extend, alter or improve a building or buildings (construction).
- The contract is a standard construction contract and is not for the provision of R&D services and does not specify that R&D will be carried out by the builder.
- The acquirer or the builder registers one or more activities associated with the construction of the building for the R&D tax incentive, identifying the structure or construction techniques as purportedly involving untested or novel elements.
- Some or all of the activities registered are broadly described and non-specific. For example, whole construction projects may be registered rather than the specific activities which being undertaken.

Taxpayer Alert regarding ordinary business activities

Taxpayer Alert TA 2017/3 deals with claiming the R&D tax incentive for ordinary business activities. The ATO says the types of arrangements under review exhibit some or all of the following features:

- A company registers one or more activities for the R&D tax incentive.
- Some or all of the activities registered are broadly described and non-specific. For example, projects may be registered instead of the specific activities undertaken.
- Some or all of the activities registered are ordinary business activities that are not eligible for the R&D tax incentive.
- Some or all of the activities were undertaken in the course of their ordinary business activities and recharacterised as R&D activities at a later time.
- The company claims the R&D tax incentive for expenditure that is not incurred on eligible R&D activities.

The ATO has observed a number of cases where a company's ineligible ordinary business activities have not been distinguished from any eligible R&D activities. Often, some of the expenses included in the calculation of a R&D tax incentive claim are not for amounts that relate to eligible R&D activities; for example, ordinary production costs of products sold to the market in the ordinary course of business.

The ATO will be contacting companies directly to advise them of concerns about their registered activities and/or their R&D tax incentive claims if:

- "advisors who may apply high risk practices" are involved in the preparation of the registration application and/or claim;
- the registration of R&D activities continues with the use of broad descriptions that fail to distinguish them from ordinary operational business activities; and/or
- the level of expenditure claimed for the R&D tax incentive is high for the industry or stage of the business.

Source: ATO, Early warning for taxpayers making R&D claims, 9 February 2017,
https://www.ato.gov.au/Media-centre/Media-releases/Early-warning-for-taxpayers-making-R-D-claims/;
Taxpayer Alert TA 2017/2, 9 February 2017,
https://www.ato.gov.au/law/view/document?DocID=TPA/TA20172/NAT/ATO/00001;
Taxpayer Alert TA 2017/3, 9 February 2017,
https://www.ato.gov.au/law/view/document?DocID=TPA/TA20173/NAT/ATO/00001.

Intangible capital improvements made to a pre-CGT asset: a separate asset

On 25 January 2017, the ATO issued Taxation Determination TD 2017/1. It provides that for the purposes of the "separate asset" rules in ss 108-70(2) or (3) of the *Income Tax Assessment Act 1997* (ITAA 1997), intangible capital improvements can be considered a separate CGT asset from the pre-CGT asset to which those improvements are made, if the relevant thresholds are satisfied. The thresholds require that the improvement's cost base is more than the improvement threshold for the income year in which the CGT event happened to the original asset, and that the improvement's cost base is more than 5% of the capital proceeds from the event.

The determination also provides an example: where a farmer who holds pre-CGT land obtains council approval to rezone and subdivide the land, those improvements may be considered separate CGT assets from the land itself.

Note: This determination was originally issued as CGT Determination Number 5 in relation to the CGT provisions in the *Income Tax Assessment Act 1936* (ITAA 1936). The current determination updates the ruling for the purposes of the equivalent ITAA 1997 provisions, without any change in substance.

Date of effect

The Determination applies to years of income commencing both before and after its date of issue.

Source: ATO, Taxation Determination TD 2017/1, 25 January 2017, http://law.ato.gov.au/atolaw/view.htm?docid=%22TXD%2FTD20171%2FNAT%2FATO%2F00001%22.

Personal services income diverted to SMSFs: ATO offer to remit penalties extended

The ATO's offer to remit penalties in relation to arrangements involving the diversion of personal services income (PSI) to self managed superannuation funds (SMSFs) has been extended from 31 January to 30 April 2017.

Since April 2016, the ATO has been reviewing arrangements where individuals purport to divert PSI to an SMSF. The arrangements, described in Taxpayer Alert TA 2016/6, involve individuals (typically SMSF members at or approaching retirement age) who perform services for a client but do not directly receive any (or adequate) consideration for the services. Instead, the client remits the consideration for the services to a company, trust or other non-individual entity. That entity then distributes the income to the individual's SMSF, purportedly as a return on an investment in the entity (including an unrelated third party). The SMSF treats the income as subject to concessional tax (15%) or as exempt current pension income.

Other variations of the arrangement include the income being remitted by the entity to the SMSF via a written or oral agreement between the entity and the SMSF, instead of as a return on an investment. The SMSF may also record the income from multiple entities or through a chain of entities. Alternatively, the entity may distribute the income to more than one SMSF of which the individual is a member or the associates are members.

The ATO's view

The Commissioner considers that such arrangements may be ineffective at alienating income such that it remains the assessable income of the individual under s 6-5 of the *Income Tax Assessment Assessment Act 1997* (ITAA 1997) or as PSI. The ATO also warns that the amounts received by the SMSF may constitute non-arm's length income of the SMSF under s 295-550 of ITAA 1997, meaning they would be taxable at 47%.

Other compliance issues include:

- that an amount received by the SMSF may be a contribution and generate excess contributions tax consequences for the individual; and
- superannuation regulatory issues – the arrangement may breach the sole purpose test under s 62 of the *Superannuation Industry (Supervision) 1993* (SIS Act). Such breaches of the SIS Act may lead to the SMSF being made non-complying or the individual being disqualified as a trustee.

Offer to remit penalties extended

The ATO has now extended the due date to contact it in relation to Taxpayer Alert TA 2016/6 from 31 January to 30 April 2017. With all the superannuation changes taking place, including the super reforms legislated in November 2016 and the review of non-arm's length limited recourse borrowing arrangements (LRBAs) due by 31 January 2017, the ATO has acknowledged that people may not have had sufficient time to consider its voluntary disclosure offer.

Individuals and trustees who are not currently subject to ATO compliance action, and who come forward before 30 April 2017 to notify the ATO about PSI diversion arrangements, will have administrative penalties remitted in full. However, shortfall interest charges will still apply.

In most cases where individuals and trustees come forward to work with the ATO to resolve issues, the ATO anticipates that the PSI distributed to the SMSF by the non-individual entity would be taxed to the individual at their marginal tax rate. The ATO says issues affecting SMSFs will be addressed on a case-by-case basis, but it will take individuals' cooperation into account when determining the final outcome.

The ATO can be emailed at: SMSFStrategicCampaigns@ato.gov.au, with "TA 2016/6" in the subject line.

Source: ATO, Diverting personal services income to SMSFs, 31 January 2017, https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News/Diverting-personal-services-income-to-an-SMSF/; Taxpayer Alert TA 2016/6, 29 April 2016, https://www.ato.gov.au/law/view.htm?DocID=TPA/TA20166/NAT/ATO/00001.

Depreciating assets – composite items

Draft Taxation Ruling TR 2017/D1, which was issued on 18 January 2017, sets out the Commissioner's views on how to determine whether a composite item is itself a depreciating asset or whether the component parts are separate depreciating assets.

A "composite item" is an item made up of a number of components that are capable of separate existence. Whether a particular composite item is itself a depreciating asset, or whether one or more of its components are separate depreciating assets, is a question of fact and degree to be determined in the circumstances of the particular case.

The draft ruling states that for a component (or more than one component) of a composite item to be considered to be a depreciating asset, it is necessary that the component is (or components are) capable of being separately identified or recognised as having commercial and economic value. Purpose or function is generally a useful guide to the identification of an item.

The draft ruling lists the main principles to be taken into account in determining whether a composite item is a single depreciating asset or consists of more than one depreciating asset. These include:

- *identifiable function* – the depreciating asset will tend to be the item that performs a separate identifiable function, having regard to the purpose or function it serves in its business context;
- *use* – a depreciating asset will tend to be an item that performs a discrete function; however, the item need not be self contained or able to be used on a standalone basis;
- *degree of integration* – the depreciating asset will tend to be the composite item where there is a high degree of physical integration of the components;
- *effect of attachment* – the item, when attached to another asset having its own independent function, varies the performance of that asset; and
- *system* – a depreciating asset will tend to be the multiple components that are purchased as a system to function together as a whole and which are necessarily connected in their operation. However, where an element of a system is purchased or installed at a different time to the system and has a separate identifiable function, that element may be a separate depreciating asset.

The mere fact that an item cannot operate on its own and has no commercial utility unless linked or connected to another item (or items) tends to indicate that it forms part of a composite item, rather than being a separate depreciating asset. An item that is designed to be functionally interchangeable, or is used in this way, with other items may indicate there are separate depreciating assets.

Other issues considered in the draft ruling include:

- whether a modification or alteration to an existing depreciating asset can itself be a depreciating asset;
- intangible depreciating assets; and
- jointly held tangible assets.

The draft ruling contains 14 examples covering items such as industrial storage racking, a desktop computer package, a mainframe computer, a local area network, a car GPS, rail transport infrastructure, a solar power system and photographic lighting equipment.

Source: ATO, Draft Taxation Ruling TR 2017/D1, https://www.ato.gov.au/law/view/document?DocID=DTR/TR2017D1/NAT/ATO/00001.

Tax risk management and governance review guide released

The ATO has released a tax risk management and governance review guide to help businesses develop and test their governance and internal control frameworks (as they relate to tax), and demonstrate the effectiveness of their internal controls to reviewers and stakeholders.

The guide sets out principles for board-level and managerial-level responsibilities, and examples of evidence that entities can provide to demonstrate the design and operational effectiveness of their control framework for tax risk.

It was developed primarily for large and complex corporations, tax consolidated groups and foreign multinational corporations conducting business in Australia. The principles outlined can be applied to a corporation of any size if tailored appropriately, the ATO says. When appropriate, the ATO says, it assesses the tax governance processes of large business entities that it has under review; however, the aim of this guide is to help businesses understand what the ATO believes better tax corporate governance practices look like, so businesses can:

- develop or improve their own tax governance and internal control frameworks;
- test the robustness of the design of their frameworks against ATO best practice benchmarks; and
- understand how to demonstrate the operational effectiveness of their key internal controls to their stakeholders, including the ATO.

For directors, the guide covers areas such as corporate governance and risk management, justified trust and key controls (eg periodic internal control testing and document control frameworks), the three lines of defence (board-level controls, internal controls testing and managerial-level controls) and directorship responsibilities and liability.

Source: ATO, Tax risk management and governance review guide, 27 January 2017, https://www.ato.gov.au/Business/Large-business/In-detail/Key-products-and-resources/Tax-risk-management-and-governance-review-guide/.

Overtime meal expenses disallowed because no allowance received

A taxpayer has failed in his claim for deductions for overtime meal expenses, because he was not paid an allowance under an industrial agreement.

Background

The taxpayer worked for a building company. His responsibilities included project management, building construction supervision, quantity surveying and occupational health and safety. He worked during the day on building sites and would do paperwork in the evenings. He would often work on weekends.

His pay was set at the start of each income year and included amounts to cover regular overtime, work performed at home and out-of-pocket expenses. For 2011–2012, there was an additional amount to cover work-related car expenses. He was paid a fixed amount weekly and did not receive regular payslips. The taxpayer also received a profit share bonus on the completion of each project.

The taxpayer claimed deductions for work-related travel expenses (for 2012–2013 only) and for other work-related expenses, including overtime meal expenses (for both 2011–2012 and 2012–2013). The deductions totalled $6,636. Following an audit of the taxpayer's tax affairs, amended assessments were issued for both 2011–2012 and 2012–2013 reducing the amounts claimed as deductions. In addition, an administrative penalty of 25% of the shortfall amount was imposed.

Ultimately, the only issues for the Administrative Apeals Tribunal (AAT) to determine were whether the taxpayer was entitled to claim deductions in both 2011–2012 and 2012–2013 for overtime meal expenses ($376 in total), whether the Commissioner was correct to impose a 25% administrative penalty and whether the penalty should be remitted.

Decision

Whether overtime meal expenses were deductible depended on whether the taxpayer had received a food or drink allowance under an industrial instrument, in terms of s 32-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). The AAT agreed with the Commissioner that the taxpayer had not received such an allowance. Indeed, the taxpayer had not received any allowance at all.

Taxation Ruling TR 92/15 (which explains the difference between an allowance and a reimbursement) states that a payment is an allowance "when a person is paid a definite predetermined amount to cover an estimated expense". In this case, there were no estimated overtime meal expenses. The taxpayer was paid the same amount each week, regardless of how much overtime he worked during that week, and was even paid that same weekly amount in relation to times when he was on leave and could not possibly have worked overtime. Accordingly, the AAT agreed with the Commissioner that "it is illogical to suggest that you can predetermine an amount of allowance without having reference to when the employee works overtime".

Turning to the administrative penalty, the AAT concluded that the 25% penalty was the minimum amount that should be imposed, commenting that a 50% penalty for recklessness, or even a 75% penalty for intentional disregard of the law, may possibly have been appropriate.

The AAT also rejected an argument that, in terms of s 284-225 in Sch 1 to the *Taxation Administration Act 1953* (TAA), the taxpayer had voluntarily disclosed information to the Commissioner that would have saved a significant amount of time or resources in the audit. That was not the case, as the taxpayer had in fact increased the amounts claimed as deductions during the course of the audit.

Finally, the AAT decided that there were no grounds to remit the 25% penalty.

Re Kael and FCT[2017] AATA 38, AAT, Ref Nos 2016/0299 and 2016/0300, Dr Popple SM, 20 January 2017, http://www.austlii.edu.au/au/cases/cth/AATA/2017/38.html.

Extension of time to review objection decisions disallowed – again!

The Administrative Appeals Tribunal (AAT) has refused to grant a taxpayer's application for an extension of time to lodge a review application. The taxpayer wished to apply for a review of the Commissioner's decision disallowing his objections to amended assessments (which involved a liability of some $2.7 million). Significantly, the taxpayer had previously made the same application, refused by the AAT in *Re Benjamin and FCT* [2015] AATA 923 and dismissed on appeal by the Federal Court in *Benjamin v FCT* [2016] FCA 1157. Accordingly, the latest matter involved not only the substantive issue of whether the taxpayer's application should be allowed in the light of his new arguments in this case, but also the procedural issues of whether the AAT had the jurisdiction to hear a second application regarding an application it had previously dismissed.

Procedural issues

On the issues of whether the AAT had the jurisdiction to consider the second application, whether the AAT had the power to dismiss such an application and whether the AAT could adopt the decision and its reasoning of the original decision, the AAT came to the following conclusions:

1. The AAT had the jurisdiction to hear the matter, in terms of a taxpayer's right to apply to the AAT for review of a decision under s 25 of the *Administrative Appeals Tribunal Act 1975* (AAT Act), and in terms of the particular decision regarding which review is sought. Specifically, the AAT found that because the Commissioner's reviewable objection decision had not been reviewed by the AAT, the Tribunal had not exhausted its powers in relation to the merits of the decision. Therefore, it had the relevant jurisdiction. The AAT also noted that the application for an extension involved new arguments.
2. An entirely separate decision could be made on a separate application regarding a matter that had reviewed at an earlier time. This was because, while the AAT should not generally allow re-litigation of issues already decided, the doctrines of *res judicata* and *issue estoppel* do not apply to AAT proceedings.
3. The AAT did not have power under s 42B of the AAT Act to dismiss an application for a time extension to lodge a decision review application. Instead, the AAT found that the power under s 42B was limited to the dismissal of applications for review.
4. Where the AAT has jurisdiction to hear a matter in relation to a decision on the same terms as it had previously reviewed, it could adopt the decision (and reasoning) previously made. The Tribunal found this in view of the fact that the AAT is not bound by the rules of evidence and may inform itself on any matter it thinks appropriate when ruling on the issue.

Substantive issues

Before the AAT, the taxpayer made a new argument that his seven-year delay in seeking a review of the disallowed objections were related to his mental health. He said he had struggled with depression and grief from the time of the onset of his late wife's illness until after her death in August 2013. During the time of her illness, he said, they had made many trips to the United States for treatment as well as seeking ongoing treatment in Australia.

However, the AAT found that, despite these new arguments, it was not appropriate to exercise its discretion to grant the extension, for the following reasons:

- It said "that the dictates of fairness" should mean that it "should not reach a conclusion different from that reached" originally by the AAT – especially as the only matter different from that decision was the taxpayer's claim that the delay in lodging the application was due to his state of mind and the effect it had on his ability to manage his taxation affairs, but that otherwise he had not raised any fresh ground and had relied on his previous submissions.
- The health reasons given for his seven-year delay in lodging an application for review of the objection decision were not supported by professional medical evidence of any sort. The taxpayer had been appointed as a director or secretary of at least five companies in that period, with all the accompanying responsibilities, which spoke something of his ability to attend to professional and business matters despite his ill health. The fact that the application for an extension was lodged some two years after his wife's death was also significant.
- The taxpayer provided inadequate evidence of the "merits" of the application, especially as the "mere" assertions and opinions he put before the AAT were not sufficient to conclude that he would have a reasonable prospects of success.
- In terms of the prejudice that would be suffered by the parties if the application was allowed, the AAT noted that after more than seven years the ATO had been unable to locate relevant third-party documents that might be relevant. It also noted that the Commissioner would be able to continue to take bankruptcy action against the taxpayer to recover the debt arising from his objection decision, which was not unfair to him – he had an opportunity to seek review of the objection decision when it was made.

In short, the AAT found that there were insufficient grounds to extend the period in which the taxpayer could apply for a review of the Commissioner's objection decisions.

Re Benjamin and FCT [2017] AATA 39, AAT, File Number 2016/5897–5902, Forgie DP, 19 January 2017, http://www.austlii.edu.au/au/cases/cth/AATA/2017/39.html.

No deduction or capital loss for apparent guarantee liability

The Administrative Appeals Tribunal (AAT) has affirmed that two family trusts that were involved in a building and construction business with other related entities were not entitled to a deduction or a capital loss for $4.3 million. The AAT made this finding on the basis that both the documentary evidence and the oral evidence of the relevant trust controllers was not sufficiently credible to support the bona fides of the alleged guarantee arrangement.

Background

Following the audit of the applicants and their associated entities who were involved in a building business, the ATO had issued an amended assessment in relation to a unit trust for the 2007 income year. The amended assessment reflected the disallowance of a $4.3 million capital loss which the Commissioner concluded, and the applicants accepted, was not incurred by the unit trust. As a consequence, the unit trust had an additional $4.3 million available for distribution to its unitholders. That amount was distributed as 50% to one discretionary trust (controlled by the first and second applicants), and 50% to another discretionary trust (controlled by the third and fourth applicants). From those discretionary trusts, distributions flowed to each of the applicants personally.

The Commissioner then amended the applicants' assessments for the 2007 income year to take account of the additional distributions. Each of the applicants objected against their amended assessment and against the assessment of 50% shortfall penalties for recklessness. They claimed their respective discretionary trusts were entitled either to a deduction or to a capital loss equal to the amount of additional income attributed. Specifically, the applicants claimed that each of their trusts guaranteed a loan that the borrower became unable to service and that, as a result, the lender (a related entity) had called on the guarantors to meet the debt.

Decision

In affirming the Commissioner's decision to disallow the taxpayers' objections to their amended assessments, the AAT found that both the documentary evidence and the oral evidence of the relevant controllers of the trusts was not sufficiently credible to support the existence of the alleged "deeds of guarantee". Specifically, the AAT found that unusual features of the guarantee deed in evidence put into question whether the trusts were genuinely subject to a guarantee obligation. The AAT also expressed concerns about the evidence of the amount of the loan in question, but found it sufficient to decide the matter on the evidence as to the existence of the guarantee.

The AAT noted that the guarantee deed made no reference to what was involved in the guarantors "securing" the debt and did not, as would normally be expected, record an undertaking by the guarantors to perform the obligations of the debtor under the loan agreement should the debtor default. Likewise, the AAT noted that the deed said nothing about the process to be undertaken by the lender to recover from the guarantors in the event of default. The AAT stated that the only director of the debtor on the date the deed of guarantee was made (apart from another party who was not at arm's length from the applicants) said he knew nothing about a guarantee.

In these circumstances, the AAT said there was considerable doubt about whether the applicants "truly did expose themselves to any guarantee obligation under the document in question". The AAT also noted the well-settled principle that "the evidence of witnesses who have an interest in the outcome of litigation needs to be approached critically".

The AAT affirmed the 50% shortfall penalties for recklessness, saying the immediate cause of the applicants' failure to include the distributions in their assessable income was "not only an error of attribution but one of fundamental entitlement as well", and due to "extreme sloppiness … the error was caused by gross carelessness". The AAT found there were no grounds to remit the penalties in these circumstances.

Re Carioti and FCT [2017] AATA 62 AAT, File Nos: 2014/1471, 1474, 1484 and 1485, Frost DP, 25 January 2017, http://www.austlii.edu.au/au/cases/cth/AATA/2017/62.html.

Taxpayer denied deduction for work expenses of $60,000

The Administrative Appeals Tribunal (AAT) has confirmed that a mechanical engineer with a PhD qualification was not entitled to deductions for various work-related expenses of approximately $60,000 that he claimed in the 2014 tax year. This finding was made subject to certain minor deductions that the

Commissioner conceded and several others the AAT allowed. The denied expenses in question were motor vehicle expenses (around $3,000), self-education expenses (around $48,000) and other work expenses (around $7,000).

Motor vehicle expenses

In relation to the motor vehicle expenses, the taxpayer claimed he was required to use his car to travel to meetings with clients and to visit sites, then continue with his work duties at home. He also claimed that he was required to carry "confidential and sensitive documents" to and from work and therefore was entitled to a deduction on this basis. However, the AAT found that the taxpayer did not prove his expenses were work-related rather than private in nature. The AAT noted in particular that the taxpayer's employer did not "'reference" any requirement for him to attend work-related client meetings or make site visits.

In respect of the taxpayer's claim for motor vehicle expenses on the basis that he was carrying "confidential information", the AAT found that, in fact, the information related to patents and other trade secret information which belonged to him and which had nothing to do with his employment or where he was studying. Furthermore, the AAT stated, even if he were carrying confidential information relating to his employer between home and work, he would not be entitled to claim a deduction for his motor vehicle expenses on that basis alone.

Self-education expenses

The taxpayer argued that the self-education expenses he had claimed (for physical products such as instrumentation equipment) related to an invention he was working on to license to another company, and that this was his own business or "industry". In disallowing this claim, the AAT found the expenses had nothing to do with his employment or his university course and therefore there was no requisite connection with any income-producing activity. The AAT also noted that an engineer engaged in developing a device was not engaged in a business, and he had failed to substantiate some of the expenses.

Other work-related expenses

In relation to a range of miscellaneous work-related expenses the taxpayer had claimed (including mobile phone charges, internet costs, professional membership fees, conference fees and depreciation), the AAT found that virtually all were not properly substantiated in any way. Both the Commissioner and the AAT itself were not satisfied that a deduction should be allowed on the basis of the "nature and quality" of any other evidence regarding the incurrence of the expense pursuant to s 900-195 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Shortfall penalty

Finally, the AAT was not satisfied that the Commissioner had incorrectly decided to impose 25% shortfall penalties for failing to take reasonable care. It said this in view of, among other things, the fact that the taxpayer was a very knowledgeable and highly credentialed professional and academic, and the deductions he claimed were "significant" in contrast to his assessable income for the relevant year. Likewise, the AAT found there were no grounds for the Tribunal to exercise its discretion to remit any part of the penalty.

Re Vakiloroaya and FCT [2017] AATA 95, AAT, Ref No 2015/6422, Lazanas SM, 31 January 2017, http://www.austlii.edu.au/au/cases/cth/AATA/2017/95.html.

Thomson Reuters would like to hear from you

Subscribers are invited to submit topics for articles for future publication. Information should be sent to:

Publisher – **Client Alert**

Thomson Reuters (Professional) Australia Limited ABN 64 058 914 668
PO Box 3502, Rozelle NSW 2039

Tel: 1800 074 333

Product Manager – Steven Jones

Email: SupportANZ@thomsonreuters.com

Website: www.thomsonreuters.com.au