client alert | explanatory memorandum

October 2017

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 28 August 2017.

Bills for increase in Medicare levy to 2.5%

The *Medicare Levy Amendment (National Disability Insurance Scheme Funding) Bill 2017* has been introduced into Parliament to implement the Government's 2017–2018 Budget announcement to increase the Medicare levy by 0.5% to 2.5% from 1 July 2019 in order to help finance the National Disability Insurance Scheme (NDIS). Nine other Bills have been introduced to increase the following rates that are linked to the top personal tax rate:

- the FBT rate for the 2019–2020 and later FBT years will be 47.5%;
- the Medicare levy component of the rate of income tax on no-TFN contributions income will be 2.5% for the 2019–2020 and later income years;
- the superannuation excess non-concessional contributions tax rate will be 47.5% for the 2019–2020 and later financial years;
- the Medicare levy component of the superannuation excess untaxed roll-over amounts, and the Medicare levy component of the income tax (TFN withholding tax (ESS)) tax rate will be 2.5% for the 2019–2020 and later income years;
- the family trust distribution tax rate will be 47.5% for the 2019–2020 and later income years;
- the trustee beneficiary non-disclosure tax rate will be 47.5% for the 2019–2020 and later income years;
- the untainting tax rate will be 48.5% for the 2019–2020 and later income years.

Budget changes to foreign resident CGT: draft legislation

Treasury has released draft legislation to implement 2017–2018 Federal Budget measures relating to the CGT liability of foreign residents and these measures are set out in more detail below.

The measures, which will generally apply from 9 May 2017:

- remove the entitlement to the CGT main residence exemption (MRE) for foreign residents that have dwellings that qualify as their main residence; and
- ensure that, for the purpose of determining whether an entity's underlying value is principally derived from taxable Australian real property (TARP), the principal asset test is applied on an associate inclusive basis.

Main residence exemption

- Individuals who are foreign residents at the time a CGT event happens, to a dwelling in which they have an ownership interest, will not be entitled to the MRE.
- A trustee of a deceased estate will not be entitled to the MRE in respect of an ownership interest in a dwelling of a deceased individual if the deceased was a foreign resident at the time of death. A beneficiary of a deceased estate will not be entitled to the MRE in respect of an ownership interest in a dwelling of a deceased individual if the deceased was a foreign resident at the time of death.

The amendments will **not** apply to a capital gain or loss from a CGT event that occurs to a dwelling if the CGT event occurs on or before 30 June 2019:

- if an individual or trustee of a special disability trust held an ownership interest in the dwelling to which the CGT event relates at all times from immediately before the application time until immediately before the CGT event happens; or
- if an individual acquired the property as a beneficiary of a deceased estate and at all times from immediately before the application time until immediately before the CGT event happens to the dwelling that individual, the deceased person, the trustee of the deceased estate of the deceased person, the trustee of a special disability trust on behalf of a principal beneficiary or a combination of these entities held the ownership interest in the dwelling.

Principal asset test

Under the foreign resident CGT regime, a capital gain or capital loss made by a foreign resident in respect of a membership interest will be disregarded unless both the non-portfolio interest test and the principal asset test are satisfied in relation to the interest.

Foreign resident CGT withholding: early recognition of tax credit

The Commissioner has made a determination to modify the time at which the vendor is entitled to a tax credit in respect of an amount withheld under the foreign resident CGT withholding rules.

The modification, applicable in respect of transactions entered into on or after 1 July 2016, ensures that, where a settlement period for a transaction that is subject to Subdiv 14-D covers more than one income year for the vendor, the credit entitlement will be available in the same year as that in which the transaction giving rise to the payment to the ATO is recognised for tax purposes for the vendor.

Example

In February 2017 Ms Nguyen entered into a contract for the sale of her Australian residential investment property for AUD$3m.

Ms Nguyen was not able to obtain a clearance certificate (as she is not an Australian tax resident) or a variation to the withholding tax.

The contract settled in August 2017. At that time the purchaser paid AUD$300,000 in withholding tax to the Commissioner.

Before 31 October 2017 Ms Nguyen lodged her 2016–2017 Australian tax return thereby complying with her tax obligations. She included the capital gain from the sale of the property and any income generated from the property during the 2016–2017 income year.

Without the modification to the crediting provisions, the tax credit for the withholding tax is available in the year in which the withholding tax is paid by the purchaser. This means that Ms Nguyen could not claim the credit in her 2016–2017 tax return in which she is required to include the capital gain. She would have to wait until she lodges her 2017–2018 Australian tax return to claim the credit.

Further guidance for tax losses: new “similar business” test

The ATO has released Law Companion Guideline LCG 2017/D6 on how the ATO will apply the new “similar business test” to supplement the existing “same business test” used for testing whether a company can utilise an earlier year tax loss.

The draft guideline says the similar business test will operate in a way that is comparable to the same business test, and that the overall business of a company must satisfy the similar business test to access losses. In this context, “similar” does not mean similar “kind” or “type” of business. The focus remains on the identity of a business, as well as continuity of business activities and use of assets to generate assessable income. Accordingly, it will be more difficult to satisfy the similar business test if substantial new business activities and transactions do not evolve from, and complement, the business carried on before the test time.

The draft says that the following four factors must be taken into account, weighed up against each other, to establish whether the business satisfies the similar business test:

- The extent to which the assets used to generate assessable income throughout the business continuity test period were the assets used in the business carried on at the test time.
- Comparison of the extent to which the current activities and operations from which assessable income is generated were also those from which assessable income was generated previously.
- Comparison of the current identity of the business with that of the business carried on before the test. Where new activities have not resulted in an identity change the draft says this will suffice.
- An assessment of the extent to which the changes to the business resulted from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the business. In the interests of encouraging innovation, the ATO says such changes will not, in themselves, cause a business to be considered dissimilar.

ATO increases its scrutiny on work-related expenses

Despite wide publicity on the issue, the ATO has reminded taxpayers that it is increasing its attention, scrutiny and education on work-related expenses. Last year over 6.3 million people made a work-related expense claim for clothing and laundry expenses, totalling almost $1.8 billion. Claims for clothing and laundry expenses have increased by around 20% over the last five years.

Common mistakes the ATO has seen include people claiming ineligible clothing, claiming for something without having spent the money, and not being able to explain the basis for how the claim was calculated.

While over 1.6 million taxpayers claim a deduction of exactly $150 for clothing, laundry and dry-cleaning, the ATO expects many of these claims to be legitimate, although the results of random audits show that people are making mistakes.

For example, a public servant made a number of claims including $150 for work-related clothing, laundry and dry-cleaning. When reviewing her claim, the ATO asked for details of the expenses, such as a letter from her employer confirming she needed to wear occupation-specific clothing or a uniform, details of how the laundry cost was calculated, and records to support her other expenses. The public servant's tax agent advised that the claim was a “standard claim of $150” and could not provide any supporting evidence. The claim was disallowed in full because there was no indication the public servant was required to wear a uniform or had spent the money she was claiming as a deduction.

Lodging nil activity statements in advance

The ATO says nil activity statements can be generated early in some cases. Under normal bulk processes, activity statements generally issue from the ATO by the end of the month. However, the ATO says there may be a specific reason for a business to access its activity statements early, including the following:

- if people are going to be absent from their place of business before the end of the reporting period and the business will not be trading during that period;
- if a person is a short-term visitor, eg, an entertainer or sports person and will be leaving the country before generation of the activity statement;
- if the entity is under some form of administration;
- if the business has ceased;
- if a person will be travelling (either within Australia or overseas) and therefore will not be able to obtain their activity statement if generated under normal bulk processes.

Activity statements can be generated for up to six months in advance for either six-monthly activity statements, or two-quarterly activity statements.

Non-concessional contributions funded by downsizing – draft legislation

Treasury has released draft legislation to implement the 2017–2018 Federal Budget announcement to allow people 65 or over to make additional non-concessional contributions up to $300,000 from the proceeds of selling their home from 1 July 2018. The measure will apply to capital proceeds received from the disposal of an ownership interest in a dwelling that is a main residence for CGT purposes and has been held, either by the individual or their spouse, for a minimum of ten years.

The downsizer contribution cap of $300,000 will be in addition to the existing caps. It will also be exempt from the contribution rules for people 65 and older and the restrictions on non-concessional contributions for people with total superannuation balances above $1.6 million.

The downsizer contribution must come from the capital proceeds of the sale price. For example, if a couple sells their home for $500,000, their combined downsizer contributions are limited to $500,000 (in any combination, but no more than $300,000 for either of them). If an individual sells a home for $250,000, the downsizer contribution is limited to $250,000.

The contribution must be made within 90 days after the home changes ownership.

While the family home is totally exempt from the age pension assets test, any sale proceeds contributed to superannuation will count toward the assets test.

GST: simplified accounting for food retailers

The ATO has released a draft determination on the choice available to food retailers to use a simplified accounting method (SAM) to help work out their net amount by estimating their GST-free sales and GST-free acquisitions of trading stock.

There are three SAMs available to assist food retailers to estimate their GST-free trading sales and/or GST-free trading acquisitions:

- the business norms method;
- the stock purchases methods; and
- the snapshot methods.

The Draft SAM is substantially the same as the previous determination it replaces. If a taxpayer was eligible to use a particular SAM specified in the previous determination, they will continue to be eligible to use that SAM under the draft Determination.

Super system reforms: APRA’s approach to enhanced prudential powers

Australian Prudential Registration Authority (APRA) has written to RSE licensees setting out its approach to the Government’s super system reforms aimed at enhancing APRA's prudential powers to improve member outcomes.

APRA Deputy Chairman, Helen Rowell, said the regulator will consult on potential amendments to its prudential framework consistent with the draft legislation released in July and according to the ultimate legislated timetable.

Under the proposed reforms, the current “scale test” (s 29VN of the Superannuation Industry (Supervision) Act 1993) will be replaced with an “outcomes test” requiring MySuper trustees to attest to outcomes promoting the financial interests of members on a broader range of indicators. APRA said it will consider issuing prudential guidance to support RSE licensees to comply with this expanded obligation.

Actuaries blast ATO view on segregated current pension assets

The Actuaries Institute has warned that tens of thousands of self managed super funds (SMSFs) could be at risk of incorrectly claiming exempt current pension income (ECPI) under the ATO's approach to segregated current pension assets.

Essentially, the ATO's view is that funds that are “fully in pension phase” are deemed to have “segregated current pension assets”, and cannot use the proportionate method for all of its assets for the whole of that tax year to determine its “exempt current pension income” (ECPI).

The Actuaries Institute says the ATO's approach is at odds with the long-standing industry practice that, unless a fund is solely in pension phase for an entire income year, the trustee can elect to use either the segregated method or the proportionate method, or both. Except where a fund is solely in pension phase for the whole income year, the Institute says the segregated method is more administratively complex and requires multiple sets of accounts. Given the uncertainty that this is causing, the Institute has also called for the ATO to clarify that it will not require funds to comply with this view for the 2017 and later income years. If the ATO believes that there is no alternative interpretation than its current view, the Institute suggests that the law be amended.

Draft legislation for First Home Super Saver Scheme

Treasury has released draft legislation to implement the 2017–2018 Federal Budget superannuation measures aimed at improving housing affordability by the establishment of the First Home Super Saver Scheme (FHSSS). The FHSSS will allow voluntary superannuation contributions made from 1 July 2017 to be withdrawn for a first home deposit starting from 1 July 2018. The scheme provides for up to $15,000 per year (and $30,000 in total) to be withdrawn from superannuation. Compulsory mandated employer contributions and contributions in respect of a defined benefit interests are not eligible for the FHSSS. Likewise, first home savers cannot withdraw existing pre-July 2017 super savings.

Withdrawals of eligible FHSSS released amounts (and associated earnings) will be allowed from 1 July 2018 onwards. The maximum FHSS releasable contributions amount is:

- 85% of concessional contributions (reflecting the 15% contributions tax paid by the fund); or
- 100% of any non-concessional (after-tax) contributions.

An FHSSS released amount of concessional contributions and associated earnings will be included in the individual's assessable but subject to a 30% tax offset (non-refundable). For released amounts of non-concessional contributions, only the associated earnings are included in assessable income (with a 30% tax offset).

An individual will receive the FHSSS released amounts after applying to the ATO and declaring eligibility to purchase or construct residential premises. The ATO will issue a FHSS determination and release authority specifying the maximum amount to be released to the ATO. The ATO will then withhold an amount of tax before releasing the FHSS amount to the individual. The amount withheld will reflect the ATO's best estimate of the individual's tax payable. If the ATO cannot make an estimate, it will withhold 17% of the FHSS released amount.

FHSSS eligibility

To be eligible to use the FHSSS, a person must be 18 years or over, have not used the FHSSS before and never owned real property in Australia.

A person will have 12 months after releasing the FHSSS amount to sign a contract to purchase or construct residential premises (including vacant land to be built and occupied as a residence). The ATO may extend this period by up to 12 months. It is necessary to occupy the premises as soon as practicable, and for at least six months of the first 12 months after it is practicable to do so. The person will have 28 days to notify the ATO in the approved form after they enter into a contract to purchase or construct residential premises. If the person does not buy a home (or fails to notify the ATO within 28 days of a purchase) they will be required to re-contribute the amount or pay an additional 20% FHSS tax (due within 21 days of an assessment). The GIC will also apply to the unpaid tax.

Example

Eric receives an FHSSS determination from the ATO during 2020–2021. The FHSSS maximum release amount is $28,000, comprised of $25,500 of concessional contributions and $2,500 of associated earnings.

If Eric requests the entire $28,000 to be released in 2020–2021, ($25,500 + $2,500) will be included in his assessable income. Eric will be entitled to an offset of $8,400 (30% of $28,000).

Assuming that Eric is on the 32.5% marginal tax rate (income between $37,000 and $87,000), he will effectively pay $1,400 in tax, being 5% of the $28,000 released amount. The 5% withdrawal tax is based on Eric's marginal rate, plus Medicare levy (2.5% proposed from 1 July 2019), less 30% offset. If Eric was on the 37% marginal rate (income between $87,000 and $180,000) he would pay $2,660 in tax.

Super assets total $2.3 trillion at June 2017

APRA has released its Quarterly Superannuation Performance publication and the Quarterly MySuper Statistics report for the June quarter 2017. As at 30 June 2017, superannuation assets totalled $2.324 trillion (up 10% from $2.113 trillion in June 2016).

Total assets in MySuper products amounted to $595bn (up 25.5% from $474bn in June 2016). Self-managed super fund (SMSF) assets totalled $697bn (up 9.8% from $635bn in June 2016) held in over 596,000 SMSFs, representing 30% of all super assets.

Trustee removal held valid in death benefit dispute – SMSF

In a death benefit dispute, the Supreme Court of Queensland has ruled that a trustee of an self-managed super fund (SMSF) was validly removed, and another trustee was validly appointed, in accordance with the trust deed: *Perry v Nicholson* [2017] QSC 163, Boddice J, 1 August 2017.

Background

The deceased, Mr Maurice, died in March 2017. He was survived by his adult daughter (the applicant) and his adult son. He was also survived by his de facto spouse (the respondent).

The deceased had established a single-member SMSF in September 2009 with himself and the applicant as trustees. In April 2015, the fund's accountants prepared a number of duly signed documents to remove the applicant as a trustee and appoint the respondent. The documents included minutes of a meeting of the trustees, a confirmation of resignation as trustee, an application to become a member and a document giving consent to appointment as trustee.

In January 2017, the deceased signed a binding death benefit nomination directing the trustees to pay 100% of any death benefit to the respondent.

Following the death of Mr Maurice, the applicant sought a declaration that she had not been validly removed as a trustee. This in turn called into question the validity of the nomination and whether it had been given to the trustee in accordance with the SIS Regs.

Decision

The Court held that the applicant was validly removed as a trustee and the respondent validly appointed as trustee. The Court considered that the minutes of the meeting, signed by the deceased, the applicant and the respondent, constituted a removal of the applicant as a trustee of the fund. As the minutes were signed by the deceased, the Court considered that the minutes also recorded that the deceased as the other trustee was advised immediately, as required by the trust deed.

SMSFs looking to accountants for more advice: Vanguard report

The 2017 Vanguard/Investment Trends SMSF Report said the percentage of SMSF trustees who currently use a financial planner has marginally increased this year, while the number of SMSFs using an accountant for investment advice has reached 86,000, up from 73,000 last year. The number of SMSFs using accountants for tax advice only was slightly down to 214,000.

Notably, the number of SMSF trustees reporting that they had unmet financial advice needs continued to grow in 2017, with well over half of all SMSF trustees saying they need further advice.

Planning for tax and contributions strategies and retirement planning continue to be areas of high demand for advice, with 52% of trustees likely to turn to a financial planner for advice, and 48% more likely to use an accountant.

Single Touch Payroll: ATO clarification

The ATO has responded to media reports regarding the implementation of Single Touch Payroll, in particular in relation to changes to the process when an employee starts a job. Under the changes, individuals have the option of completing their TFN declaration and Superannuation Standard Choice forms online using myGov, or through their employer. Rather than being a way of tracking businesses, the ATO asserts its aim is to streamline processes.

The ATO has sought to clarify what it said are some misleading assertions made in the media commentary:

- The ATO said it was incorrect that new employees may be "pressed" to use the online employee commencement form to choose a super fund. The online service is optional.
- The ATO said it was incorrect that new employees could be pushed into nominating a super fund without enough information, and without the reassurance of a default safety net.
- It was incorrect to say that employee commencement forms fail to allow for account consolidation. The ATO says once an employee has successfully entered the information to be sent to their new employer, they are prompted to view and consolidate any existing accounts.

Financial adviser banned for SMSF geared property advice

The Australian Securities and Investments Commission (ASIC) has banned a financial adviser for three years for allegedly breaching the Future of Financial Advice (FoFA) best interests duty by advising clients to purchase property via an SMSF using borrowed funds.

ASIC alleged that the Perth-based authorised representative provided advice to clients to establish a SMSF and use limited recourse borrowing arrangements to purchase real property. In providing this advice, ASIC alleged that the adviser failed to act in the best interests of 4 clients in breach of the *Corporations Act 2001*.

ASIC said it was not satisfied that the adviser had identified the subject matter of the advice, or conducted a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client. Note that the adviser has the right to appeal to the AAT for a review of ASIC's banning order.

TPB recognises cyber security awareness training

The Tax Practitioners Board (TPB) has released updated guidance related to cyber security for all registered tax practitioners.

One way that tax practitioners can protect themselves is to consider whether they should take out additional PI insurance cover to assist with first party losses arising from a cyber-attack. Such losses can include a "denial of service" attack or the costs of rectifying harm done, such as repairing and restoring systems that have been damaged by malicious acts.

The TPB also recognises that cyber security awareness training can assist tax practitioners protect themselves from a cyber-attack. As a result, the TPB now specifically recognises cyber security training for continuing professional education/development purposes.

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