client alert | explanatory memorandum

June 2018

CURRENCY:
This issue of **Client Alert** takes into account developments up to and including 22 June 2018.

Business lending practices in spotlight at Royal Commission

Bank lending practices for small and medium enterprises (SMEs) were in the spotlight when the Financial Services Royal Commission (FSRC) held round three of its public hearings from 21 May to 1 June 2018. This round of hearings focused on the conduct of financial services entities when providing credit to SMEs. The hearings will also explore the legal and regulatory regimes, as well as self-regulation under the Code of Banking Practice.

The Royal Commission is interested in SME lending practices as they are an important sector of the economy – over two million SMEs account for more than 65% of private sector employment. The aggregate value of bank lending to small business (defined as loans of less than $2 million) accounts for around 28% of total bank lending to business. In addition to loan facilities and revolving trade finance, a Financial Services Regulatory Commission background paper notes that other financial products are often provided to SMEs, such as cashflow finance management and access to payments systems for credit cards and EFTPOS. SME owners also often rely on their personal finances and real estate to provide security to obtain access to SME finance.

The Royal Commission considered issues with SME lending practices by reference to case studies involving ANZ, Bank of Queensland, CBA, Westpac and Suncorp. The approach of the banks to enforcement, management and monitoring business loans will be considered by reference to case studies from CBA/Bankwest and NAB.

Remote and regional areas

The fourth round of the Royal Commission's public hearings (25–29 June 2018) is focusing on issues affecting those who live in remote and regional communities, which relate to farming finance, natural disaster insurance, and interactions between Aboriginal and Torres Strait Islander people and financial services entities.

The Royal Commission is expected to provide an interim report by 30 September 2018, with a final report due by 1 February 2019.

Personal tax cuts now law

The Government's seven-year personal income tax reform plan passed Parliament on 21 June 2018 intact after the Senate did not insist on earlier amendments that would have removed the third step from the plan. *The Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018* then received Royal Assent on 21 June 2018 as Act No 47 of 2018.

The personal income tax changes, announced in the 2018–2019 Federal Budget, are as follows:

- *Step 1* will see a new non-refundable Low and Middle Income Tax Offset (LMITO) from 2018–2019 to 2021–2022, designed to provide tax relief of up to $530 per individual for each of those years. The offset will be delivered on assessment after an individual submits their tax return and will be in addition to the existing low income tax offset (LITO). The LMITO will provide a benefit of up to $200 for taxpayers with taxable income of $37,000 or less. Between $37,000 and $48,000, the value of the offset will increase at a rate of three cents per dollar to the maximum benefit of $530. Taxpayers with taxable incomes from $48,000 to $90,000 will be eligible for the maximum benefit of $530. From $90,001 to $125,333, the offset will phase out at a rate of 1.5 cents per dollar.
- *Step 2* will increase the top threshold of the 32.5% tax bracket from $87,000 to $90,000 from 1 July 2018. In 2022–2023, the top threshold of the 19% bracket will increase from $37,000 to $41,000 and the LITO will increase from $445 to $645. The increased LITO will be withdrawn at a rate of 6.5 cents per dollar between incomes of $37,000 and $41,000, and at a rate of 1.5 cents per dollar for income between $41,000 and $66,667. The top threshold of the 32.5% bracket will increase from $90,000 to $120,000 from 1 July 2022.

- *Step 3* will increase the top threshold of the 32.5% bracket from $120,000 to $200,000 from 1 July 2024, removing the 37% tax bracket completely. Taxpayers will pay the top marginal tax rate of 45% for taxable income exceeding $200,000 and the 32.5% tax bracket will apply to taxable incomes of $41,001 to $200,000.

Tax rates and thresholds for 2018–2019 onwards

The following table reflects the now legislated personal tax threshold and rate changes (bold), excluding the 2% Medicare levy.

Rate	2018–2019 to 2021–2022	2022–2023 and 2023–2024	2024–2025 onwards
0%	$0–$18,200	$0–$18,200	$0–$18,200
19%	$18,201–$37,000	$18,201–**$41,000**	$18,201–$41,000
32.5%	$37,001–**$90,000**	**$41,001–$120,000**	$41,001–**$200,000**
37%	**$90,001**–$180,000	**$120,001**–$180,000	**N/A**
45%	$180,001+	$180,001+	**$200,001+**

Source: www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6111.

GST property settlement online forms

Amendments contained in the *Treasury Laws Amendment (2018 Measures No 1) Act 2018* require purchasers of newly constructed residential properties or new subdivisions to remit GST directly to the ATO as part of settlement. This will apply from 1 July 2018.

The ATO says property transactions of new residential premises or potential residential land that involve GST to be paid directly to the ATO on or before settlement will require purchasers or their representatives to use the following online forms:

- Form one, *GST property settlement withholding notification*, is used to advise the ATO that a contract has been entered into for new residential premises or potential residential land that requires a withholding amount. This form can be submitted any time after a contract has been entered into and prior to the settlement date.
- Form two, *GST property settlement date confirmation*, is used to confirm the settlement date and can be submitted at the time of settlement and when the payment has been made to the ATO.

The ATO has provided instructions on how to complete the forms. The forms require the details of:

- the contact person;
- the property;
- the GST withholding amount; and
- purchaser and the supplier (vendor, seller, etc).

Both online forms can be completed and submitted by the purchaser or their representative. Depending on which state or territory the property is acquired in, the purchaser's representative can include a conveyancer or a solicitor. The ATO says property suppliers are not required to submit these online forms.

Major ATO focus on work-related clothing and laundry this tax time

This tax time, the ATO will be closely examining claims for work-related clothing and laundry expenses. Assistant Commissioner Kath Anderson said, "last year around six million people claimed work-related clothing and laundry expenses, with total claims adding up to nearly $1.8 billion. While many of these claims will be legitimate, we don't think that half of all taxpayers would have been required to wear uniforms, protective clothing, or occupation-specific clothing." Clothing claims are up nearly 20% over the last five years and the ATO believes many taxpayers are making mistakes or deliberately over-claiming.

The ATO says that around a quarter of all clothing and laundry claims were exactly $150, which is the threshold above which taxpayers are required to keep detailed records about the expenses. "We are concerned that some taxpayers think they are entitled to claim $150 as a 'standard deduction' or a 'safe amount', even if they don't meet the clothing and laundry requirements", Ms Anderson said.

She said the $150 limit is there to reduce the recordkeeping burden, but it is not an automatic entitlement for everyone. “While you don’t need written evidence for claims under $150, you must have spent the money, it must have been for uniform, protective or occupation-specific clothing that you were required to wear to earn your income, and you must be able to show us how you calculated your claim”, the Assistant Commissioner said.

Ms Anderson also warned that “far too many are claiming for normal clothing, such as a suit or black pants. Some people think they can claim normal clothes because their boss told them to wear a certain colour, or items from the latest fashion clothing line. Others think they can claim normal clothes because they bought them just to wear to work.”

The ATO is concerned that the results from its random audit program show lots of taxpayers over-claiming by a small amount. “We know that some people think $150 is not a large amount and that nobody will notice if they over-claim. But while $150 might not be big individually, when you multiply it over millions of taxpayers, it adds up to a lot. And besides, no matter how small, other Australians shouldn’t be expected to wear your over-claiming.”

Case studies from the ATO

An advertising manager claimed $1,854 for clothing and laundry expenses. Her claim was for clothing purchased at popular fashion retail stores. When the ATO contacted her, she said she represented her company at work functions and awards nights and was required to dress a certain way. The ATO explained that expenses for conventional clothing are not deductible, even if the taxpayer is required to wear them for work, and/or only wear them for work.

A car detailer claimed work related laundry expenses of over $20,000 per year over two years. When questioned, the taxpayer told the ATO he worked out the laundry expense at the rate of $227 per hour, as he valued his personal time. He then made a voluntary disclosure that his claim was excessively high and in no way a reasonable amount to claim. The ATO said the taxpayer’s claims were reduced to $0 in accordance with his voluntary disclosure. As he made a voluntary disclosure before the audit progressed, no penalties were applied.

Advisory Board to help clamp down on the black economy

The term “black economy” refers to people and businesses who operate outside the tax and regulatory systems, or who are known to the authorities but do not correctly report their tax obligations.

The Government is establishing a new Advisory Board to support its reform agenda to disrupt the black economy. The Minister for Revenue announced on 22 June 2018 that Mr Michael Andrew AO, who provided strong leadership to the Black Economy Taskforce last year, will chair the Black Economy Advisory Board.

The Advisory Board will include members of the private and public sector who will provide strategic advice on trends and risks in the black economy. The Advisory Board will also advise the Treasury about implementation of the Government’s decisions attacking the black economy and contribute to a Government report every five years about new threats emerging in the black economy.

The Minister said the Government’s actions to date have included a $10,000 limit on cash transactions, a comprehensive strategy to combat illicit tobacco, reforms to the ABN system, restricting government procurement to businesses that have acceptable tax records, and $315 million in additional funding to the ATO to increase its enforcement activity against black economy behaviour.

Source: http://kmo.ministers.treasury.gov.au/media-release/072-2018/.

Superannuation system: Productivity Commission draft report

On 29 May 2018, the Productivity Commission released a draft report recommending changes to improve the superannuation system by addressing unintended multiple accounts and default funds that underperform.

Deputy Chair of the Productivity Commission Karen Chester said that with default funds being tied to the employer and not the employee, many members end up with another account every time they change jobs. Currently, a third of accounts (about 10 million) are unintended multiples, meaning members pay excess fees and insurance premiums of $2.6 billion every year. According to the Commission, fixing these twin problems of entrenched underperformance and multiple accounts would lift retirement balances for members across the board. The difference in retirement balance could be up to $407,000 for a new workforce entrant when they retire in 2064 (or $61,000 for a 55-year-old today), Ms Chester said. Submissions on the draft report are due by 13 July 2018.

The main recommendations proposed in the draft report are as follows:

- *Defaulting only once for new workforce entrants* – a new mechanism for default funds whereby members would only ever be allocated to a default super fund once, upon entering the workforce. Under the proposal, new employees would be given a choice from a "best in show" list of up to 10 superannuation products identified by an independent and expert panel. If the employee fails to make a choice within 60 days, they should be defaulted to one of the products on the shortlist, selected via sequential allocation.

- *Elevated MySuper authorisation* – an elevated threshold for MySuper authorisation (including an enhanced outcomes test). The draft report recommends that funds should be required at least every three years to obtain independent verification of their outcomes test assessment, comparison against other products in the market and determination of whether members' financial interests are being promoted. In addition, funds should be required to report to the Australian Prudential Regulation Authority (APRA) annually on how many of their MySuper members switched to a higher-fee choice product within the same fund each year. If funds fail to meet these elevated standards for five or more years, they should have their MySuper authorisation revoked, the draft report says.
- *Cleaning up lost accounts* – super funds should be required to transfer all lost and unclaimed accounts to the ATO, with the ATO empowered to reunite balances with a member's active account (unless the member actively rejects consolidation).
- *CGT relief for mergers* – to faciliate fund mergers, the Government should make CGT relief permanent for funds that merge, and require APRA to report annually to the Council of Financial Regulators on the extent to which the MySuper outcomes test is bringing about fund mergers.
- *Insurance* – the Government should legislate to require trustees to cease all insurance cover on accounts where no contributions have been obtained for the past 13 months, unless they have obtained the express permission of the member to continue providing the insurance cover (note that the Government introduced legislation on 21 June 2018 proposing measures to protect low-balance and inactive super accounts from excessive fees and inappropriate insurance).

This draft report from the Productivity Commission has largely been overshadowed by the ongoing work of the Royal Commission into banking and financial services. Nevertheless, the inquiries complement each other. The Productivity Commission's draft report provides an in-depth analysis of the super system, while the Royal Commission is focused on the conduct of those operating in the financial services industry. The Productivity Commission is expected to coordinate its final report with any findings and recommendations from the Royal Commission.

Source: www.pc.gov.au/__data/assets/pdf_file/0003/228171/superannuation-assessment-draft.pdf.

SMSF compliance: don't slip up

With the self managed superannuation fund (SMSF) annual return lodgment deadline upon us, minds should have already turned to meeting compliance requirements. The 2016–2017 financial year includes a few twists and turns which trustees should factor in to avoid late lodgment.

The super changes from 1 July 2017 mean that SMSFs members with a pension balance of more than $1.6 million may need to consider reducing any excess, resetting CGT cost bases and getting actuarial certificates. This is in addition to the usual issues such as calculating taxable income and what expenses are deductible for the SMSF.

With all these changes, the ATO has allowed an extension to lodge returns by 2 July.

Beware the transfer balance cap

If people have a total balance of more than $1.6 million in pension phase as at 30 June 2017 in all of their super funds, they should have already reduced it to no more than $1.6 million by 1 July 2017, otherwise a penalty will apply. The excess can be either transferred to accumulation phase or withdrawn as a lump sum. For anyone in receipt of a defined benefit pension with a value of more than $1.6 million, or a combination of defined benefit and account based pension over that amount, an adjustment of all account-based pensions will be required. Any adjustment for these purposes can allow access to CGT relief, but there are exceptions.

Eligible for CGT relief?

Where a pensioner has reduced the balance of their account-based pension to meet the $1.6 million cap, or they are in receipt of a transition to retirement pension (TRIS), they may have access to the transitional CGT cost base reset. The reset allows a fund to notionally sell the CGT asset at its market price and immediately notionally acquire it to reset the cost base for CGT purposes. The operation of the reset depends on whether the fund calculates its exempt and taxable income on a segregated or proportional basis. If the segregated basis is used, it is possible for the CGT asset to reset its cost base between 9 November 2016 and 30 June 2017, but if the proportional basis is used the market value on 30 June 2017 applies to reset the cost base.

Why would you reset the CGT cost base of the fund? The answer lies in the potential tax benefits. It's not compulsory to reset if you qualify and sometimes, it may be better not to. Don't forget the reset is available only if the amount you have in pension phase on 30 June 2017 is more than $1.6 million or you were receiving a TRIS at that time.

If you decide to reset the CGT cost base of an asset, an election must be made and information is required about the amount of the reset that is deferred at ss 8F and 8G of the fund's Capital Gains Tax Schedule. Once the election is made, it's irrevocable.

Is an actuarial certificate needed?

In some circumstances, an SMSF will be required to obtain an actuarial certificate. The certificate is required if, at sometime during the 2016–2017 financial year, the fund calculated its exempt pension income on a proportional basis. An actuarial certificate is not required if the fund used the segregated basis or the fund was wholly in pension phase throughout the financial year. For the 2017–2018 financial year, an actuarial certificate will also be required for all SMSFs where at least one fund member has a total superannuation balance of at least $1.6 million as at 30 June in the previous financial year.

Keep track of contributions

Keeping track of contributions is something trustees need to do. All contributions should be classified on the basis of their taxation and preservation status. If a fund member decides to claim a tax deduction for personal contributions, they will need to complete an election. It needs to be given to the fund when their tax return is lodged with the ATO, or by the end of the financial year after the contribution has been made, whenever is the latter. Trustees will be required to acknowledge receipt of the election.

Tax deductions for expenses

Deductions for expenses paid by SMSFs depend on a number of situations depending on whether the expense has been incurred in gaining the fund's assessable income. This means that any expenses that relate to exempt current pension income (ECPI) are not deductible, as they are incurred in gaining the exempt income of the fund. A fund that has accumulation and pension members will apportion expenses between those that are deductible and those that are not. There are some expenses which can be claimed in full, whether they are linked to exempt or assessable income of the fund. These expenses include the ATO's supervisory levy and premiums for death and disability cover.

Recordkeeping

Good SMSF compliance hinges substantially on good recordkeeping. But not every fund is necessarily good at it.

What records should be kept, when and for how long? Some SMSFs have resolutions and minutes for every investment transaction while others don't go into much detail at all. But what level of detail is really necessary? The answer lies in the fund's trust deed, investment strategy and what is required by the tax and superannuation legislation.

Every time an SMSF makes or disposes of an investment, the transaction needs to be seen in the context of the fund's investment strategy and the degree to which allowable asset classes, ranges and allocations are specified in that strategy. This will have a bearing on the amount of documentation required.

The legislation does not include specific provisions for recording SMSF investments. This means that investment reporting requirements for all superannuation funds apply to SMSFs as well. In this context, it seems reasonable the more detailed the fund's investment strategy the less likely it is to record investment decisions. However, in contrast, an investment strategy written in very general terms may mean recording of investment transactions more frequently and in greater detail.

For example, a fund with a single balanced option is unlikely to have to meet each time a contribution is made to decide where the money should go. In contrast, if the fund's investment strategy is couched in broad terms and a member wishes to select specific investments as permitted by the fund's trust deed, then documents indicating whether the selection is consistent with the overall investment strategy of the fund are likely to be worthwhile.

There are some areas where best practice seems to dictate that detailed documentation and/or minutes should be prepared, especially where the transaction is linked to specific provisions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and *Superannuation Industry (Supervision) Regulations 1994* (SIS Regs). Examples include:

- acquisition of direct property, which can be owned wholly by the fund or owned jointly with other parties – documents would include those relating to the purchase of the property, rental agreements, agent appointments, plus those relating to service providers to handle repairs and maintenance;
- any collectible or artwork which requires documentation relating to insurance, storage and possible leasing, which may be required due to the legislation;
- loans by the SMSF to related and non-related parties which require a written loan agreement specifying the terms and conditions of the loan;

- any “in specie” contribution or acquisition of an investment, which needs to be tested against the acquisition of assets from related parties and accompanied by a minute stating the transaction is permitted;
- any in-house asset acquisition should be documented, as the 5% testing of the amount needs to be verified at time of acquisition, as well as outlining how the ongoing monitoring of the limit will be conducted; and
- finally, any investment where the trustees act more in the capacity of investment manager, rather than trustee should be documented as the terms and conditions of the investment should be documented.

So it’s important you document all significant meetings and decisions of your SMSF. It’s a legislative requirement and keeping your reporting obligations up-to-date will help see that your fund remains compliant.

Even where an SMSF is involved, minutes and resolutions need to be taken seriously and read carefully before signing. They provide an official and legal record, or evidence of actions and decisions made by the trustees. If the minutes and resolutions are ambiguous and unclear they can lead to possible legal ramifications. Just because an SMSF is small doesn’t change things; minutes and resolutions are just as important as they are for larger funds.

Trustees should affirm the investment strategy at least annually noting whether all current investments are consistent with that strategy. This will then cover any other investment related transactions that do not require specific documentation.

Make sure the investment strategy is reviewed or varied when certain member-related events occur. This would include admission, resignation or death of a new member, or the commencement of a pension benefit or lump sum.

Other good reasons for recording information about the fund’s investments relate to the trustees being challenged. Documenting an investment decision can be used as a legal defence to justify why it was made. Documentation assists auditors in carrying out their responsibilities under the SIS legislation and for reporting to the ATO as regulator of SMSFs.

The superannuation law requires that some records must be retained for various periods. For example, the fund’s accounting records, annual returns and other statements are required to be kept for at least five years. However, minutes of meetings such as reviewing the fund’s investment strategy, changes of trustees, member reports and storage of collectables and personal use assets need to be kept for at least 10 years. Documents like the fund’s trust deed and other essential documents should be retained if the trustees consider the fund may be subject to challenge.

Keeping records for an SMSF serves many purposes to provide a “corporate memory” for the fund which may be required for compliance purposes as well as to protect trustees from any unfounded challenges.

Time to start on SMSF returns

So, if you haven’t got to work on this year’s SMSF return, it’s certainly time to start now in view of the changes to super that have taken place. Don’t forget to make an adjustment if the total of your pension balances are impacted by the transfer balance cap, reset the CGT cost base if appropriate and arrange for an actuarial certificate if required. Then there’s making sure contributions are correctly classified, income is properly accounted for and deductions are correctly classified.

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