client alert | explanatory memorandum

December 2018/January 2019

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 23 November 2018.

Work-related tax deductions down for 2018

The ATO has reported a decline in the overall value of work-related deductions for tax time 2018. In his opening statement to Senate Estimates on 24 October 2018, ATO Commissioner Chris Jordan said taxpayers appear to have taken extra care when claiming work-related expenses in their 2017–2018 income tax returns. This follows recent ATO initiatives to close the income tax gap for individuals, which was estimated at $8.7 billion or 6.4% in 2014–2015. By far the most common driver of the tax gap was incorrectly claimed work-related expenses. A lot of individuals were over-claiming work-related by small amounts, which adds up to a lot, Mr Jordan said. In response, the ATO stepped up its awareness and education efforts to help people get it right for tax time 2018.

Source: https://www.aph.gov.au/Parliamentary_Business/Senate_Estimates/Economics/2018-19_Supplementary_Budget_estimates/treasury.

ATO identifies 26,000 incorrect rental property travel expense claims

The ATO has identified 26,000 taxpayers who have claimed deductions during tax time 2018 for travel to their investment residential rental properties, despite recent changes to the tax laws that disallow such claims. From 1 July 2017, investors cannot claim travel expenses relating to inspecting, maintaining or collecting rent for a residential rental property as deductions, subject to certain exceptions: s 26-31 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Rental property investors should check if their situation matches one of the exceptions to this change before they lodge any claim for rental travel. An exclusion does apply for this restriction on travel expenses if the expenditure is necessarily incurred in carrying on a business for income-producing purposes (including a rental property business), or if it is incurred by an "excluded entity", namely:

- a corporate tax entity,
- a superannuation fund that is not a self managed superannuation fund (an SMSF);
- an approved deposit fund (ADF) or a pooled superannuation trust (PST);
- a public unit trust;
- a managed investment trust; or
- a unit trust or partnership.

If the travel expenditure is incurred by a unit trust or partnership, it will only be deductible if all members of the trust or partnership are excluded entities. See also the ATO website at www.ato.gov.au/rentaltravel and refer to Law Companion Ruling LCR 2018/7 *Residential premises deductions: travel expenditure relating to rental investment properties*.

Note that the restriction only applies to travel expenses in relation to a "residential rental property". As such, it is still possible to claim a deduction for travel expenses in relation to commercial property that falls outside the definition of "residential premises" used as residential accommodation. Of course, the other deduction requirements in s 8-1 of ITAA 1997 must still be satisfied.

Golden rules for deductions

The ATO now uses sophisticated data analytics to assess a range of deductions and claims. Taxpayers must follow three golden rules when claiming a deduction:

- the taxpayer must have spent the money (and not been reimbursed);
- the claim must be directly related to earning the taxpayer's income; and
- they must keep records to prove it.

Small business corporate tax rates Bill is now law

The Treasury Laws Amendment (Lower Taxes for Small and Medium Businesses) Bill 2018 received assent on 25 October 2018 as Act 134 of 2018 and has become law.

This implements the Government's proposal to accelerate the reduction of the corporate tax rate for corporate tax entities that are base rate entities (ie corporate tax entities that derive no more than 80% of their income in passive forms and have an aggregated turnover of less than $50 million). The corporate tax rate for base rate entities will now reduce from 27.5% to 26% in 2020–2021, before being cut to 25% for 2021–2022 and later income years. This means eligible corporate taxpayers will have a tax rate of 25% in 2021–2022, rather than from 2026–2027 as under the previous law.

The new law also increases the small business income tax offset rate to 13% of an eligible individual's (ie unincorporated business's) basic income tax liability that relates to their total net small business income for 2020–2021. This offset rate will then increase to 16% for 2021–2022 and later income years.

The maximum amount of the small business income tax offset does not change – it continues to be capped at $1,000 per individual per year.

Source: https://www.legislation.gov.au/Details/C2018A00134.

GST reporting: common errors and how to correct them

The ATO has reported that some businesses are making simple mistakes reporting their GST, and has reminded taxpayers to avoid the following common GST reporting errors:

- Transposition and calculation errors – can occur when an amount is manually input. The ATO says these errors can be eliminated by double-checking all figures and calculations before submitting a Business Activity Statement (BAS).
- No tax invoice – tax invoices must be kept to claim GST credits on business-related purchases.
- Transaction classification – check what GST is applicable. For example, transactions involving food may be GST applicable.
- Accounting systems – a system with one coding error can classify several transactions incorrectly. Taxpayers can check their business systems using the ATO's GST governance and risk management guide for large businesses.

Correcting GST errors

If a taxpayer finds a mistake made on a previous activity statement, they can:

- correct the error on a later activity statement if the mistake fits the definition of a "GST error" and certain conditions are met;
- lodge an amendment – the time limit for amending GST credits is four years, starting from the day after the taxpayer was required to lodge the activity statement for the relevant period; or
- contact the ATO for advice.

The benefit of correcting a GST error on a later activity statement (where the conditions are met) is that the taxpayer will not be liable for any penalties or general interest charge (GIC) for that error. The ATO says it is generally easier to correct a GST error on a later activity statement than to revise an earlier activity statement. Revising an earlier activity statement that contains an error can incur penalties or GIC.

Source: www.ato.gov.au/Business/Large-business/In-detail/Business-bulletins/Articles/Avoid-simple-mistakes-with-GST-reporting/.

Government announces super refinements

In a media release on 31 October 2018, Assistant Treasurer Stuart Roberts announced that the Government will make technical changes to the superannuation tax law to address some minor but important issues, as part of the ongoing super reforms. The changes are in the following areas:

- comprehensive income product for retirement (CIPR) framework – the start date will be deferred to 1 July 2022;
- innovative income streams – the definition of "life expectancy period" will be amended to account for leap years when determining the maximum commutation amount, and the pension transfer balance cap rules will be amended to provide credits and debits when such products are paid off in instalments;
- defined benefit pensions – the transfer balance cap valuation rules will be amended to reflect certain pensions that are permanently reduced following an initial higher payment;

- market-linked pensions – changes will correct a valuation error under the transfer balance cap rules where a market-linked pension is commuted and rolled over, or involved in a successor fund transfer; and
- death benefit rollovers involving insurance proceeds – changes will ensure these amounts remain tax-free for dependants.

CIPR framework

The Government will defer to 1 July 2022 the start date for superannuation funds to offer a comprehensive income product for retirement (CIPR), and will increase the threshold superannuation balance for offering a CIPR from $50,000 to $100,000.

By way of background: the Government released a discussion paper in December 2016 on the development of a CIPR framework, to be known as MyRetirement products. This followed its response to the Murray Financial System Inquiry in which it agreed to facilitate trustees offering these products to members. The Government has also established a consumer and industry advisory group to assist in the next phase of development. The CIPR framework was originally expected to commence at some time after mid-2019, following consultation on exposure draft legislation and regulations (yet to be released as at 1 November 2018). However, the Government has now deferred the start date until 1 July 2022.

Retirement income strategy covenant

To support the development of the CIPR framework, the Government has previously proposed to introduce a retirement income strategy covenant. Among other things, the covenant will require superannuation trustees to consider members' retirement income needs by developing a retirement income strategy for fund members. The principles underpinning this retirement income covenant, as announced in the 2018–2019 Federal Budget, were set out in a Treasury position paper released in May 2018.

The Government had originally proposed to legislate the retirement income covenant by 1 July 2019, with a start date of 1 July 2020. However, the requirement for funds to offer CIPR products has now been deferred until 1 July 2022.

Innovative income streams

The pension standards for innovative superannuation income streams (regs 1.06A and 1.06B of the *Superannuation Industry (Supervision) Regulations 1994*) allow for retirement income products from 1 July 2017, including deferred lifetime annuities, investment-linked products and group self-annuitisation products that enable the pooling of risk. These types income streams are a precursor to the development of the CIPR framework that will depend on such pooled annuity-type products. Note that the Government has confirmed the social security means test treatment of pooled lifetime retirement income streams.

Mr Robert announced that the Government will amend the definition of the "life expectancy period" for tax-exempt innovative superannuation income streams to account properly for the number of days in a leap year when determining the maximum commutation amount. The amendment will align the definition of life-expectancy with annuity anniversary dates and ensure that individuals with these products are not short-changed in a leap year.

Pension cap credits/debits

The Government will also amend the *Income Tax Assessment Regulations 1997* to provide transfer balance cap credits and debits for innovative superannuation income stream products that are paid off in instalments. The amendments will ensure that innovative income stream products receive appropriate treatment under the pension transfer balance cap.

Defined benefit pensions

Amendments will also be made to the valuation rules for defined benefit pensions under the transfer balance cap to reflect when pensions are permanently reduced following an initial higher payment, such as for some public sector defined benefit reversionary pensions or reclassification of invalidity pensions.

Where an individual receives a capped defined benefit income stream, a credit arises (under s 294-25 of the *Income Tax Assessment Act 1997*) in their transfer balance account equal to the "special value" of the superannuation interest determined under s 294-135 of ITAA 1997. The calculation of the special value is based on the "first income stream benefit payable".

The amendment will seek to address a problem that can currently arise for certain reversionary lifetime pensions. The governing rules of some public sector super schemes require that a reversionary pension is payable to a spouse at the deceased person's standard pension rate immediately following the death, then is reduced to a lesser rate for the surviving spouse. This means the special value of the credit for the transfer

balance account of the reversionary pension beneficiary is based on the higher first pension payment, even though it is only temporary for the surviving spouse.

Source: http://srr.ministers.treasury.gov.au/media-release/030-2018/.

Capital gains tax on grant of easement or licence

Taxation Determination TD 2018/15, issued on 31 October 2018, considers the CGT consequences of granting an easement, profit à prendre or licence over an asset.

In the ATO's view, CGT event D1 (creating contractual or other rights) rather than CGT event A1 (disposing of an asset) happens when any of the following rights are granted over an asset:

- an easement, other than one arising by operation of law;
- a profit à prendre (a right to enter and remove a product or part of the soil from the taxpayer's land); or
- a licence (which does not confer the right of exclusive possession of land).

The consequences of CGT event D1 being the relevant CGT event are that:

- in determining the amount of any capital gain or loss that arises from the grant over the asset, no part of the asset's cost base is taken into account;
- any capital gain from the grant is not a discount capital gain;
- the main residence exemption is not available; and
- any capital gain or loss cannot be disregarded merely because the asset over is a pre-CGT asset. This means, for instance, that CGT event D1 can happen where a right is granted over pre-CGT land – see Examples 1 and 2 of TD 2018/15. In Example 3, however, the ATO concludes that the sale of timber is not subject to CGT if the timber was cut from pre-CGT land and trees.

TD 2018/15 applies before and after its date of issue.

Withdrawn rulings

TD 2018/15 is a "refresh" of Ruling IT 2561 *Capital gains: grants of easements, profits à prendre and licences*, which was withdrawn from 31 October 2018. TD 2018/15 also consolidates the following Taxation Determinations, all of which were withdrawn on 31 October 2018:

- TD 93/79 Capital gains: if a taxpayer owns pre-CGT land and trees and after 19 September 1985 the taxpayer cuts the trees, are there any CGT consequences arising from the subsequent sale of the timber by the taxpayer?
- TD 93/81 *Capital gains: a taxpayer owns pre-CGT land and trees. The taxpayer sells timber according to two post-CGT contracts: over a period of time and remove timber as and when required; and a contract for the sale of the uncut timber. How is the sale treated for CGT purposes?*
- TD 93/235 *Capital gains: how are grants of easements treated for the purposes of the CGT provisions of the ITAA 1936?*
- TD 93/236 *Capital gains: does the principal residence exemption apply to the amount received for the granting of an easement or profits à prendre over land adjacent to a dwelling?*
- TD 96/35 *Capital gains: when does a person, who on or after 21 September 1989 grants to another a right to cut and remove timber from the grantor's land, dispose of the right? Is it when the right is granted or when the trees are felled?*

First Home Super Saver scheme: ATO guidance

On 1 November 2018, the ATO issued Super Guidance Note SPR GN 2018/1 to provide general information about the First Home Super Saver (FHSS) scheme. The guidance note explains who is eligible to use the scheme, the kind of contributions that can be released, how to apply for a FHSS determination and the requirement to purchase a house. Interesting points made in SPR GN 2018/1 include that:

- an individual who holds real property as the trustee of a trust (including a unit trust or self managed super fund) can qualify for the FHSS scheme;
- the eligibility of an individual who is a beneficiary of a trust depends on their particular rights as a beneficiary;
- before the transfer of a deceased person's property, the beneficiary of the deceased estate can apply for a FHSS determination; and
- contributions that are ineligible for release include amounts contributed to superannuation as part of the CGT small business concessions.

Financial hardship

Although the FHSS scheme is targeted at people who wish to buy or build their first home, others who do not satisfy the first home requirement may qualify for the scheme if they are suffering financial hardship. They will first need to apply to the ATO for a financial hardship determination.

The guidance note lists examples of the types of events the ATO will consider to determine whether the financial hardship requirement is met. These include employment loss, natural disaster, bankruptcy, illness, divorce and eligibility for early access to super. Crucially, the person needs to demonstrate a link between the event and the loss of the person's property interest.

Downsizer super contributions: ATO guidance

The ATO issued the following products on 7 November 2018 to provide guidance on the recently enacted downsizer superannuation contributions measure:

- Law Companion Ruling LCR 2018/9, which focuses on the numerous conditions that must be satisfied for a contribution to qualify as a downsizer contribution. This ruling finalises Draft LCR 2018/D4 and contains the same views as the draft.
- Super Guidance Note SPR GN 2018/2, which contains detailed general information and examples for individuals.

Section 292-102 of the *Income Tax Assessment Act 1997* (ITAA 1997) allows individuals aged 65 or over to make a downsizer contribution of up to $300,000 (not indexed) from the proceeds of selling their home. This measure took effect on 1 July 2018 (for contracts of sale entered into from that date).

A downsizer contribution is:

- excluded from the definition of a non-concessional contribution and therefore does not count towards the person's non-concessional contributions cap;
- exempt from the contribution rules for people aged 65 and older;
- exempt from the restrictions on non-concessional contributions for people with total superannuation balances above the general transfer balance cap; and
- not tax deductible.

Ruling LCR 2018/9 notes that although an individual's total superannuation balance will not affect their eligibility to make a downsizer contribution, any downsizer contribution amount will still count towards their total superannuation balance.

Qualifying conditions

The following conditions need to be met for a contribution to qualify as a downsizer contribution:

- The individual must be aged 65 or more when the contribution is made.
- The contribution must be all or part of the capital proceeds from disposing of an ownership interest in a qualifying dwelling in Australia. Ruling LCR 2018/9 confirms that the ownership interest can be an equitable interest or an interest as a joint tenant or tenant in common, and that a person is not prevented from making a downsizer contribution if others hold interests in the same dwelling.
- The capital proceeds must be fully or partially exempt from CGT under the main residence exemption (or, for pre-CGT assets, would have qualified for a full or partial exemption). However, the ATO confirms that it is not relevant how the main residence exemption is calculated or apportioned.
- Just before the disposal, the ownership interest must have been held by the person or their spouse. The ATO says it is not necessary for the dwelling to have been their main residence at the time of disposal.
- A 10-year ownership condition must be met by the person or their spouse (including a former or deceased spouse). The ATO notes this condition is not related to the main residence requirement –the dwelling does not need to have been the person's main residence for a 10-year period, provided an effective partial main residence exemption is available, or would have been available had the person (and not their spouse) held the interest.
- The contribution must be made within 90 days of settlement (or any longer period allowed by the ATO).
- The person must choose to treat the contribution as a downsizer contribution and must notify their super provider of this choice (using the approved form) by the time the contribution is made.
- The person must not have previously made any downsizer contributions from an earlier disposal of a main residence. However, multiple downsizer contributions may be made to one or more funds from the sale of interests in a qualifying dwelling, provided the maximum contribution amount is not exceeded.

The maximum contribution amount must be the lesser of $300,000 or the total capital proceeds that the person, their spouse or both receive from disposing of their ownership interests in the dwelling. The ATO confirms that where an individual uses their spouse's interest in a dwelling to calculate the available maximum contribution amount, the spouse does not need to satisfy the eligibility requirements for making a downsizer contribution. The ATO also notes that a person who uses the capital proceeds to discharge a mortgage can still make a downsizer contribution.

ATO scam alert: fake demands for tax payments

Although tax time 2018 is over, the ATO has warned taxpayers and their agents to remain on high alert for tax scams. Assistant Commissioner Kath Anderson has said scammers are growing increasingly sophisticated and hope to exploit vulnerable people, often using aggressive tactics to swindle people out of their money or personal information. The ATO has noticed an increasing trend of scammers demanding tax payments through Bitcoin ATMs.

People should be wary if someone contacts them demanding payment of a tax debt that they didn't know they owed. The ATO's advice is simple: it will never ask a person to make a payment into an ATM or via gift or pre-paid cards such as iTunes and Visa cards, or ask for direct credit to be paid to a personal bank account.

Taxpayers who lodge through a registered tax agent generally have longer to pay their tax bill, and will be advised by their tax agent if and when any tax payment is due. However, the ATO warned that scammers have been known to attempt to impersonate tax agents too. If people have any doubts about the legitimacy of a phone call or other communication, they can call the ATO (toll free) on 1800 888 540.

Source: https://www.ato.gov.au/Media-centre/Media-releases/Scams-alert-as-tax-bill-due-date-draws-near/.

Government to establish $2 billion fund for small business lending

The Government has announced that it will establish a $2 billion Australian Business Securitisation Fund. Treasurer Josh Frydenberg said small businesses currently find it difficult to obtain finance on competitive terms (unless the finance is secured against real estate). To overcome this, Mr Frydenberg said, the proposed Australian Business Securitisation Fund will invest up to $2 billion in the securitisation market, providing additional funding to smaller banks and non-bank lenders to on-lend to small businesses on more competitive terms. The Australian Business Securitisation Fund will be administered by the Australian Office of Financial Management (AOFM), consistent with its prior involvement in the Residential Mortgage Backed Securities Market in 2008.

The Government is also consulting with the Australian Prudential Relation Authority (APRA) and a number of financial institutions in regard to the establishment of an Australian Business Growth Fund that would provide longer-term equity funding to small businesses. The Australian Business Growth Fund is expected to follow similar international precedents, such as the United Kingdom's Business Growth Fund, which has invested some $2.7 billion in a range of sectors since its establishment in 2011.

According to the Treasurer, such a fund has not emerged in Australia, in part, as a result of the unfavourable treatment of equity for regulatory capital purposes. However, APRA has indicated it is willing to review these arrangements to assist in facilitating the establishment of the Australian Business Growth Fund. To fast-track the process, the Government is hosting a meeting of key stakeholders in Canberra during the final 2018 Parliamentary sitting period (26 November to 6 December 2018).

Source: http://jaf.ministers.treasury.gov.au/media-release/051-2018/.

ATO information-sharing: super assets in family law proceedings

The Government has announced that it will develop an electronic information-sharing mechanism between the ATO and the Family Law Courts to allow superannuation assets held by relevant parties during family law proceedings to be identified swiftly and more accurately. The measure was included as part of a broader financial support package for women announced on 20 November 2018.

Super and family law

Superannuation is often the most significant asset in a separated couple's property pool, particularly for low-income households with few assets. Parties to family law proceedings are already legally required to disclose all of their assets to the court, including superannuation, but in practice parties may forget, or deliberately withhold, information about their super assets. As it stands, where parties to family law proceedings are not forthcoming about their assets, costly and time-consuming information-gathering exercises can be required just to identify superannuation accounts – let alone to establish their balances.

The non-disclosure of super assets can often disproportionately disadvantage women due to a significant disparity in super savings between men and women. A lack of financial disclosure by a former partner can result in a woman receiving a smaller share of property than they would otherwise be entitled to. A recent study by the Women's Legal Service Victoria also found that two-thirds of surveyed clients faced delays caused by a former partner failing to make the necessary financial disclosures.

Assistant Treasurer Stuart Robert said the ATO will receive $3.3 million in funding to develop an electronic information-sharing system for super assets in family law proceedings. Giving the courts access to super information held by the ATO is expected to result in faster and fairer family law property settlements. Getting full visibility of super assets in family law matters can be complex, time-consuming and costly, often requiring parties to go on "fishing expeditions" using subpoenas and other formal court processes, with no guarantee of success, Mr Robert said.

According to the Government, the proposed ATO information-sharing system will make it easier to identify lost or undisclosed super assets. It will help parties in family law proceedings, particularly women, avoid the cost and complexity involved in seeking superannuation information from multiple super funds, or subpoenaing employment records. The Government considers that allowing the ATO to provide this information to the Courts will reduce the need for such exercises and ensure more just and equitable superannuation splitting outcomes.

Source: http://srr.ministers.treasury.gov.au/media-release/040-2018/.

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