client alert | explanatory memorandum

September 2019

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 23 August 2019.

Warning to watch out for myGov and ATO tax scams

The government's Stay Smart Online website (www.staysmartonline.gov.au/) warns taxpayers that there is a surge in scammers impersonating trusted bodies like myGov and the ATO to trick people into giving them money or personal details. These scams can take the form of emails, text messages and fake myGov login pages.

In June 2019, the ATO received 6,444 reports of tax-time scams that impersonated the ATO. Emails with links to fake myGov login pages were the most widespread email scam in that month.

The trend in scammers demanding 'debt' payments via gift cards is also on the rise, with Australians aged 18–44 years making the majority of iTunes payments to scammers ($94,420 in June alone), closely followed by Google Play cards ($27,993).

If someone is unsure about the validity of a tax-related message or phone call, they can contact the ATO Scam Hotline on 1800 008 540.

Stay Smart Online reminds that:

- myGov will never send anyone a text, email or attachment with links or web addresses that ask a person for their login or personal details. Do not click on links in emails or text messages claiming to be from myGov.
- People should always log into their official myGov account to check their tax, lodge their return and check if they owe a debt or are due a refund. Do this by manually typing https://my.gov.au/ into the internet browser.
- Unfortunately, ATO and other scams continue well beyond the 30 October deadline for tax returns, as scammers know many people are waiting for a refund or debt owed. It's important to watch out for scams throughout the year.

Source: www.staysmartonline.gov.au/alert-service/watch-out-mygov-tax-scams

Tax time updates

ATO has refunded $10 billion so far

The ATO says that $10 billion has been refunded to Australian taxpayers so far this tax time, an increase of over $2 billion from the same time last year, with most returns being processed in under two weeks.

ATO Assistant Commissioner Karen Foat has highlighted that the ATO seeks to process returns as soon as possible, announcing that over four million refunds have already been sent out, compared to over three million refunds issued this time last year.

"Of course, the ATO works around the clock to quickly get refunds in peoples' hands", she said. "However, there are some things that taxpayers should take care with to ensure their return is not unnecessarily delayed.

"Firstly, it's important to check your bank account details are correct, and if you've changed accounts recently, take a moment to update your details.

"When refunds get sent to incorrect bank accounts, redirecting them to your new account will take more time. This tax time, we've seen some people who are really keen to get their refund, having missed this important step."

Another big obstacle getting between some people and their return is forgetting to declare some income. Common things people forget to include are rental income, bank interest and government allowances or payments. This is particularly a risk if your tax return was lodged before the ATO's pre-fill was available.

Source: www.ato.gov.au/Media-centre/Media-releases/$10-billion-back-in-your-hands/.

ATO watching for undisclosed foreign income

The ATO has reminded taxpayers who receive any foreign income from investments, family members or working overseas to make sure they report it this tax time.

New international data-sharing agreements allow the ATO to track money across borders and identify individuals who are not meeting their reporting obligations.

“This year, the ATO has received records relating to more than 1.6 million offshore accounts holding over $100 billion, and is now using data-matching and sophisticated analytics to identify foreign income that has not been reported”, Assistant Commissioner Karen Foat has said.

Under the new Common Reporting Standard (CRS), the ATO has shared data on financial account information of foreign tax residents with over 65 foreign tax jurisdictions across the globe. This includes information on account holders, balances, interest and dividend payments, proceeds from the sale of assets and other income.

“Australians that deliberately move cash overseas in an attempt to hide it should be concerned. Hiding your assets and income offshore is pointless. ‘Tax havens’ are becoming a less effective model as international agreements improve transparency. You can no longer hide money behind borders.”

The ATO also states that apart from a small number of individuals deliberately engaging in tax avoidance, it is concerned about a large number who are unsure of how to meet their obligations.

“If you’re an Australian resident for tax purposes, you are taxed on your worldwide income, so you must declare all of your foreign income no matter how small the amount may be. This may include income from offshore investments, employment, pensions, business and consulting, or capital gains on overseas assets”, Ms Foat said.

Source: www.ato.gov.au/Media-centre/Media-releases/ATO-watching-for-foreign-income-this-Tax-Time/.

Unusual claims disallowed

The ATO has published information about some of the most unusual claims it has disallowed. For example, around 700,000 taxpayers claimed almost $2 billion of “other” expenses including non-allowable items such as dental costs, child care and even Lego sets.

Assistant Commissioner Karen Foat has said a systematic review of claims has found, and disallowed, some very unusual expenses. “These claims add up to a lot of money”, she said. “If the deduction isn’t directly related to earning income, we can’t allow it.”

“A couple of taxpayers claimed dental expenses, believing a nice smile was essential to finding a job, and was therefore deductible. It isn’t!”

“Another taxpayer claimed the Lego sets they bought as gifts for their children. Unsurprisingly, this claim was disallowed.”

The “other” deductions section of the tax return is for expenses incurred in earning income that don’t appear elsewhere on the return – such as income protection and sickness insurance premiums. However, the ATO’s review found some taxpayers were incorrectly claiming a range of private expenses such as child support payments, private school fees, health insurance costs and medical expenses, all of which are not allowable.

“Where people make genuine mistakes, we simply disallow the claim. But when people are deliberately making dishonest claims, particularly for large sums, we will disallow the claim and may impose a penalty”, Ms Foat said.

Finally, the ATO reminds taxpayers that in order to claim an “other” deduction, the expenses must be directly related to earning your income, and you need to have a receipt or record of the expense. If the expense relates to your employment, it should be claimed at the “work-related expenses” section of the return.

Source: www.ato.gov.au/Media-centre/Media-releases/No-smiles-as-dental-expenses-rejected/.

ATO contacting small employers about Single Touch Payroll

From 1 July 2018, employers with more than 20 employees were required to provide real-time reports to the ATO of salary and wage payments, super guarantee contributions, ordinary time earnings of employees and PAYG withholding amounts.

From 1 July 2019, this Single Touch Payroll (STP) reporting system has extended to all employers.

The ATO has announced it will soon write to small employers (those with up to 19 employees) who have not yet started reporting or applied for a deferral, to remind them of their STP obligations.

Small employers have until 30 September 2019 to start reporting or apply for extra time to get ready. The ATO will grant deferrals to any small employer who requests additional time to start STP reporting.

There will be no penalties for mistakes, or missed or late reports, for the first year, and employers experiencing hardship or who are in areas with intermittent or no internet connection will be able to access exemptions.

The basics of STP reporting

- Each employer needs to report their employees' tax and super information to the ATO on or before each payday, or authorise a third party such as a registered agent or payroll service provider to report on their behalf. They need to send the information from STP-enabled payroll software.
- When STP reporting is in place, employers no longer need to provide payment summaries to their employees for the payments reported and finalised through STP. Payments not reported through STP, such as employee share scheme (ESS) amounts, still need to be reported on a payment summary.
- Employers no longer need to provide payment summary annual report (PSARs) to the ATO at the end of the financial year for payments reported through STP.
- Employees can view their year-to-date payment information using the ATO's online services, accessible through their myGov account. They can also request a copy of this information from the ATO.
- Employers need to complete a finalisation declaration at the end of each financial year. The information reported through STP will not be tax-ready for employees or their tax agents until the employer makes this declaration.
- Employers need to report employees' superannuation liability information – as usually provided to the employees on their payslips – for the first time through STP. Super funds will then report to the ATO when the employer pays the super amounts to employees' funds.
- From 2020, the ATO will pre-fill activity statement labels W1 and W2 for small to medium withholders with the information reported through STP. Employers that currently lodge an activity statement will continue to do so.

Sources: www.ato.gov.au/Tax-professionals/Newsroom/Digital-interaction-with-us/Contacting-small-employers-about-STP/; www.ato.gov.au/Media-centre/Articles/Transition-to-Single-Touch-Payroll-for-small-employers/; www.ato.gov.au/stpsolutions.

Disclosing business tax debt information: ATO consultation

The ATO has released a consultation paper, *The ATO's administrative approach to the disclosure of business tax debt information to credit reporting bureaus*.

In its Mid-Year Economic and Fiscal Outlook in 2016–2017, the Federal Government announced that it would change the law so the ATO could report business tax debt information to credit reporting bureaus (CRBs) where a business consistently does not engage with the ATO to manage a tax debt. It is not currently authorised to report information about tax debt avoidance, because the law contains strict confidentiality requirements for ATO-held taxpayer information.

The ATO has said it "recognises the important role businesses play in the Australian economy [but] when an entity avoids paying its tax debts it can have a significant impact on other businesses, employees, contractors and the wider community."

The new paper aims to facilitate the consultation process between the ATO, businesses and CRBs, and focuses on the administrative approach the ATO proposes to take once the legislative changes are in place. It also helps explain some aspects of the changes under the *Treasury Laws Amendment (2019 Tax Integrity and Other Measures No 1) Bill 2019* (which has passed the House of Representatives without amendment and is currently before the Senate) and the draft legislative instrument, the *Draft Taxation Administration (Tax Debt Information Disclosure) Declaration 2019*).

If passed in its current form, the Bill will amend the *Taxation Administration Act 1953* (TAA 1953) to allow taxation officers to disclose information about business tax debts to CRBs when certain conditions and safeguards are satisfied. The business in question would need to have debt of at least $100,000 overdue by more than 90 days, and have not effectively engaged with the ATO to manage that debt.

The consultation paper sets out the following key practical points:

- *Implementation* – Under the ATO's phased implementation approach, the changes will be implemented gradually to ensure that systems, safeguards and processes are robust.
- *Whose tax debt may be reported?* – The ATO will be permitted, but not required, to report tax debt information about an entity to CRBs where it meets *all* of the following criteria:
  - the entity has an ABN and is not an excluded entity (the ABN and excluded entity test);
  - the entity has one or more tax debts totalling at least $100,000, and the amount has been due and payable for (overdue by) more than 90 days (the debt threshold test);
  - in determining whether the entity has debts that meet the debt threshold test, the ATO must exclude tax debt amounts that the entity has engaged with the ATO to manage (the effective engagement test); and
  - the entity must not have an active complaint with the Inspector-General of Taxation concerning the proposed reporting or reporting of the tax debt information.

- *How will businesses be notified?* – If all of the reporting criteria are met and the ATO intends to report an entity's tax debt information to CRBs, the ATO will notify the business in writing at least 21 days before reporting its tax debt information for the first time. This is to allow an additional 21 days for the business to take action (e.g. by engaging with the ATO and/or paying the debt) to prevent its tax debt information from being reported.
- *What will be reported?* – If a business's tax debt information is reported to CRBs, the ATO will provide the CRBs with the following:
  - unique identifiers for the entity, such as the ABN and legal name;
  - the balance of the entity's overdue tax debts at the time of first reporting;
  - regular updates on the balance of the entity's overdue tax debt until the entity no longer meets the reporting criteria; and
  - a notification when the entity no longer meets the reporting criteria.

Source: www.ato.gov.au/General/Gen/Consultation-paper--ATO-s-approach-to-disclosure-of-business-tax-debts/.

Cross-border recovery of tax debts

The ATO has recently updated and reissued Practice Statement Law Administration PS LA 2011/13 *Cross border recovery of taxation debts*. This practice statement outlines the options available in relation to recovering a tax debt where the debtor is outside Australia, and sets out how the ATO deals with requests from other countries for assistance in recovering a tax debt owing to the other country.

It covers:

- the ATO's ability to require payment under Australian tax legislation from debt-holders who are overseas (ie the ATO's garnishee powers);
- trustees' and liquidators' ability to recover debts in a foreign jurisdiction, and how the ATO can assist;
- the ATO's ability to obtain judgment in a foreign jurisdiction to recover debts in that jurisdiction;
- the ATO's ability to request assistance from foreign jurisdictions.

The ATO may use an exchange of information (EOI) to assist domestic information-gathering and decide which recovery method to use. This can be used when:

- the ATO has no visibility over a debtor's offshore affairs, and
- the ATO has exhausted domestic options to source the information or verify the debtor's claims.

The ATO can request assistance from foreign jurisdictions in regard to debt recovery through:

- bilateral treaties with individual jurisdictions that allow for assistance with collection; and
- the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI BEPS), to which multiple jurisdictions are signatories.

The practice statement was originally issued on 14 April 2011, and the updated version is effective from 15 August 2019.

Source: www.ato.gov.au/law/view/document?docid=PSR/PS201113/NAT/ATO/00001.

ATO superannuation focus areas

The ATO has released its presentation to the 2019 Association of Superannuation Funds of Australia (ASFA) National Policy Roadshow outlining emerging superannuation focus areas for 2019–2020. Topics covered included:

- the taxation of compensation received by super funds;
- pension tax bonuses;
- successor fund transfers; and
- the treatment of inactive low-balance accounts.

The ATO also noted the following real-life examples of people interacting with their super in 2018–2019:

- *compassionate release of super* – the ATO processed more 53,000 applications for the early release of super on compassionate grounds to members who required the money for critical purposes such as medical care and treatment, and it released $456 million as a result;
- *Aboriginal and Torres Strait Islander assistance* – ATO representatives visited Darwin, Kununurra and Broome with the First Nations Foundation and helped find $4.37 million in lost super for members of those communities;

- *downsizer contributions* – 4,900 individuals aged 65 and over made super contributions from the proceeds of selling their home, to a total value of $1.1 billion;
- *first home super saver (FHSS) scheme* – in the first year of the FHSS scheme's operation, 3,300 people obtained a release of money from their super to purchase their first home, to a total value of $39.4 million.

Lost super

The ATO noted that at 2 July 2019 it held 5.39 million super accounts worth $3.98 billion. Of this money, the ATO estimates it will be able to reunite $473 million with 485,000 fund members using the Protecting Your Super measures (which have been enacted under the recently passed *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019*).

The ATO encourages fund members to find out about their lost and unclaimed super through ATO Online via myGov. In 2018–2019, fund members consolidated or transferred over 537,000 accounts worth $4.38 billion using myGov.

Pension cap indexation

The ATO flagged that the pension transfer balance cap (TBC) of $1.6 million could increase on 1 July 2020 or 1 July 2021, depending on when the consumer price index (CPI) number reaches 116.9 (its level was 114.8 as at June 2019). The *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* provides that the general TBC is indexed in increments of $100,000 when the indexation rate reaches a prescribed figure (which is calculated using a formula set out in the law).

While the ATO does not expect indexation to occur until at least 1 July 2021, it is important to consider what the TBC increase this may mean for funds and members. Once the indexation takes place, there will no longer be a single personal TBC that applies to all super members with a retirement phase income stream. Instead, there could be a personal TBC for each member, depending on their individual situation and arrangements. The ATO said it will advise as soon as possible if indexation will apply on 1 July 2020.

Source: https://www.ato.gov.au/Media-centre/Speeches/Other/Superannuation---a-system-in-transition/.

Compassionate release of super only available in limited cases

The ATO has recently seen a significant increase in calls from individuals who were encouraged by their super funds to contact the ATO because they were ineligible for compassionate release of super (CRS). However, in the majority of cases, the individuals concerned were ineligible because they were looking to use their super to pay for general expenses. It is important to note that CRS is only an option for the following expense types:

- medical treatment and transport costs;
- palliative care costs;
- a loan payment to prevent the loss of one's home;
- costs of modifying a home or vehicle, or buying disability aids, needed because of a severe disability; or
- expenses associated with the death, funeral or burial of a dependant.

The expense must not yet have been paid (eg using a loan, a credit card or money borrowed from family or friends), and the amount of super a person can withdraw is limited to what they reasonably need. There are a range of eligibility conditions for each expense type, set out in detail on the ATO website. Any amounts released early on compassionate grounds are paid and taxed as normal super lump sums.

Source: www.ato.gov.au/Super/APRA-regulated-funds/In-detail/News/Five-grounds-for-compassionate-release-of-super/; www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-using-your-super/Access-your-super-early/?page=2#Access_on_compassionate_grounds.

Personal services income rules: unrelated clients test

The Federal Court has set aside an Administrative Appeal Tribunal (AAT) decision that income derived by a business analyst through a company was subject to the personal services income (PSI) rules: *Fortunatow v FCT* [2019] FCA 1247 (Federal Court, Griffiths J, 12 August 2019).

Background

The taxpayer was a business analyst and the sole director of Fortunatow Pty Ltd. He provided his services through the company to various large organisations such as government departments, universities, banks and utilities. In the 2012 and 2013 income years, the company disclosed income of approximately $166,000 and $121,000 respectively from the provision of his personal services to eight different clients. The company did not pay him any remuneration and he returned no income in his personal tax returns for those years.

The company transferred income generated by the taxpayer's personal services to a family trust, characterising the amounts as "management fees". These fees were claimed as tax deductions, effectively reducing the company's taxable income to nil. The trust income was offset against the trust's rental losses.

As a result, the taxpayer, the company and the family trust all paid zero tax on the income generated by the personal services the taxpayer supplied as a business analyst in 2012 and 2013.

The ATO concluded that the PSI rules in Div 86 of the *Income Tax Assessment Act 1997* (ITAA 1997) applied to include all of the income received by the company in the taxpayer's assessable income for 2012 and 2013. The taxpayer, however, argued that Div 86 did not apply because the unrelated clients test in s 87-20 was satisfied, and therefore the income was from conducting a personal services business.

Under s 87-20 of ITAA 1997, the relevant services must be provided as a direct result of the individual or personal services entity (PSE) – the company, in this case – making offers or invitations (eg by advertising) to the public to provide the services. The individual (or PSE) "is not treated … as having made offers or invitations to provide services merely by being available to provide the services through an entity that conducts a business of arranging for persons to provide services directly for clients of the entity" (s 87-20(2)).

The AAT (in *Fortunatow and FCT* [2018] AATA 4621) decided, in favour of the ATO, that the work the taxpayer obtained and carried out in the relevant years was through an intermediary. According to the AAT, the taxpayer was not operating a genuine business as an independent contractor because he, in effect, received referrals from intermediaries (recruitment companies) and allowed those intermediaries to take responsibility for obtaining and dealing with customers.

The issues for determination on appeal were whether the taxpayer made any offers or invitations to the public at large or to a section of the public to provide his services (the fourth element of the unrelated clients test) and, if so, whether the services to the unrelated entities were provided as a direct result of the taxpayer making those offers or invitations (the fifth element of the unrelated clients test).

The taxpayer argued he met the fourth element because of his active profile on LinkedIn and his marketing by word-of-mouth at industry functions. Although the AAT accepted that the taxpayer's advertising on LinkedIn constituted the making of an offer or invitation to the public, it concluded that the law operates in a way that means the fourth element (and therefore the fifth element) was not satisfied.

Decision

The Federal Court held that the AAT had misconstrued s 87-20(2) of ITAA 1997 and misapplied its interaction with s 87-20(1)(b). In the Court's view, the exclusion or exception in s 87-20(2) did not apply where there was evidence that the taxpayer (or the company) advertised his services to the public or a segment of the public through a forum such as LinkedIn, and also obtained work through the involvement of an intermediary.

According to the Court, simply because an individual or PSE is able to provide services through an intermediary, such as a recruitment or similar agency, does not constitute the making of an offer or invitation for the purposes of s 87-20(1)(b). More than that is required for the purposes of the unrelated clients test. But that does not mean that the exclusion in s 87-20(2) necessarily applies, as found by the AAT, where an individual or PSE is in fact available to provide personal services through such an intermediary and there is evidence (as in this case) that the individual or PSE has taken other steps to make offers or invitations to the public at large or a section of the public to provide the services.

The Court remitted the matter to the AAT for further reconsideration according to law, as it was not appropriate for the Court itself to resolve the issues remaining in dispute. It said the issues were not straightforward and there was uncertainty about the extent to which the misconstruction may have affected the AAT's fact-finding.