client alert | explanatory memorandum

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CURRENCY:

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ATO debts may affect your credit rating

Businesses with tax debts need to be aware that the ATO will now be able to disclose the details of their tax debts to credit ratings agencies, which could potentially affect the ability of the business to obtain finance or refinance existing debt. Generally, only businesses with an ABN and debts over $100,000 and that are not "effectively engaged" with the ATO will be affected. Practically, the ATO is planning a phased implementation which will consist of education before targeting companies, followed by partnerships, trusts and sole traders.

The ATO now has another "stick" in its arsenal to get businesses to engage with it and manage outstanding tax debts. Laws have recently been passed that allow the ATO to disclose tax debt information of businesses to registered credit reporting bureaus (CRBs).

The aim of the laws, according to the government, is to encourage more informed decision-making within the business community by making large overdue tax debts more visible, and to reduce the unfair advantage obtained by businesses that do not pay their tax on time.

The disclosure of these debts has the potential to affect the credit ratings of businesses and their ability to refinance existing debt, but only businesses that meet certain criteria will be subject to this new disclosure rule. The criteria are as follows:

- The business has an ABN and is not an excluded entity (ie is not a deductible gift recipient, registered charity, government entity or complying superannuation entity).
- The business has one or more tax debts, of which at least $100,000 is overdue by more than 90 days.
- The business is not effectively engaging with ATO to manage its tax debt.
- The Inspector-General of Taxation is not considering an ongoing complaint about the proposed reporting of the business's tax debt information.

When a business meets these criteria, the ATO is required to notify the business in writing and allow 28 days for the buisiness to engage and take action before any debt is disclosed. Tax debt information will only be provided to CRBs that are registered with the ATO and have entered into an agreement detailing the terms of reporting.

According to the ATO, an entity's tax debts for the purposes of the disclosure rule includes income tax debts, activity statement debts (eg GST, PAYG withholding), superannuation debts, FBT debts and penalties and interest charges. An entity is considered to be effectively engaged with the ATO in respect of a tax debt if it:

- has a payment plan in place and is meeting the terms of the payment plan;
- has an active objection against a taxation decision to which its tax debt relates;
- has an active review with the Administrative Appeals Tribunal (AAT) or an active appeal to the Court against a decision to which its tax debt relates;
- has an active reconsideration of a reviewable decision which may affect the quantum of a non-complying super fund's tax debt with the relevant regulator;
- has an active review with the AAT of a reviewable decision which may affect the quantum of a non-complying super fund's tax debt; or
- has an active compliant lodged with the Inspector-General of Taxation in relation to the tax debt that is, or could be, the subject of an investigation.

The ATO's practical approach to disclosure of tax debts consists of a phased implementation approach, with the initial phase focusing on raising community awareness of the measure through newsletters, articles, forums and speeches. After the initial phase, it will begin firstly with companies that meet the disclosure requirements before moving onto other entities such as partnerships, trusts and sole traders with ABNs.

Source: www.ato.gov.au/General/New-legislation/In-detail/Other-topics/Disclosure-of-business-tax-debts/; www.ato.gov.au/General/Gen/Consultation-paper--ATO-s-approach-to-disclosure-of-business-tax-debts/.

Crowdfunding: is it income?

Crowdfunding has fast become a go-to strategy for people in need of large amounts of money quickly, but is the money raised considered to be income and therefore taxable?

Campaigns on various platforms range from the shameless (lavish weddings/honeymoons) to ground-breaking (new innovative products), and whether each campaign is taxable depends entirely on the circumstances of each case. Generally, if the campaign is related to running/furthering your business or is a profit-making plan, then any money received would be classed as income.

Crowdfunding is when an individual or business (the promoter) uploads a description of a campaign (eg to fund an activity, a project or a new invention) along with the amount they want to raise to a third-party internet platform such as Kickstarter, GoFundMe, Indiegogo or Pozible. Other people online (the contributors) can then choose to support the campaign or cause by pledging money.

These days it feels like anything can be crowdfunded – you may have heard the ridiculous story of a man who wanted to raise US$10 for a potato salad and ended up with US$55,000 from complete strangers. Or perhaps you've heard of shameless couples who want people to fund their lavish weddings or honeymoons. On the more serious side, crowdfunding can be useful for people like self-publishing authors, musicians looking to produce their own albums, and inventors creating prototype products.

There are several types of crowdfunding, and each may attract different tax consequences for the promoter of the campaign. A large number of campaigns are what can be described as donation-based. This is where a contributor to the campaign pledges an amount of money without receiving anything in return. If you're a contributor in this case, you will not able to deduct an amount contributed in a crowdfunding campaign as a "donation" in your Australian tax return unless the cause you've donated to is an endorsed or legislated deductible gift recipient (DGR). An exception is if you carry on a business and the cost of contributing to the campaign directly falls under your business expenses such as sponsorship or marketing.

Other campaigns can be referred to as rewards-based. In these cases, the promoter provides a reward, such as goods, services or rights, to contributors in return for their payment. For example, differing levels of campaign-related merchandise may be available, depending on the amount pledged by the contributor. Usually, the acquisition of goods or services by the contributor means their payment is considered to be private in nature and not deductible.

As the promoter of a campaign (either donation-based or rewards-based), whether the money you receive is considered to be taxable depends on the circumstances.

In general, if the money received is to be used to further your business or is a profit-making plan, then it is considered to be income. Remember, the hurdle for something to be a profit-making plan is much lower than that for a business. If a promoter launches a crowdfunded project with intention of making a profit, and then carries out the project in a business-like way, the money raised could very well be considered part of their income.

Whether or not crowdfunded money is classified as income can rely on minor details, and will be determined by the facts in each case. For example, money received from crowdfunding the making of a movie may or may not be income for the promoter, depending on factors such as whether the promoter draws a personal salary from the crowdfunded income, whether the promoter will keep any of the funds raised, and whether the movie made will be widely distributed.

Source: https://www.ato.gov.au/business/income-and-deductions-for-business/in-detail/crowdfunding/; https://www.moneysmart.gov.au/managing-your-money/donating.

Non-commercial losses: do the rules apply to you?

If you have a business in addition to your main employment, the non-commercial loss rules could apply to you, which may prevent you from deducting your business losses against your other income. Depending on your business activity, as long as you satisfy certain conditions your business will not be subject to the non-commercial loss rules. If your business does not satisfy these conditions, don't worry – you can also apply to the ATO for an exemption under certain circumstances.

A "non-commercial" business activity in this context is any business where the deductions exceed the assessable income in any particular year. However, the non-commercial loss rules will not apply (that is, you can offset losses from the business activity against other income) under the following circumstances:

- the assessable income from the business for the year is at least $20,000;
- the business made a profit (for tax purposes) in at least three of the past five income years, including the current year;
- the total value of real property (or interests in real property) used on a continuing basis to carry out the business is at least $500,000; or

- the total value of other assets (excluding cars, motorcycles or similar vehicles) used on a continuing basis in carrying on the business is at least $100,000.

These conditions only apply to those with an adjusted taxable income of less than $250,000.

Those with an adjusted taxable income of $250,000 or more are considered "high-income earners" and will have their deductions from the business quarantined to the business activity.

As such, they will only be allowed to deduct the loss when the business makes a profit. However, high-income earners and those that who do not satisfy the conditions described can still make a request to the ATO to allow them not to apply the rules.

The ATO may exercise the discretion to not apply the non-commercial loss rules if:

- the business was or will be affected by special circumstances outside of your control (eg natural disasters, unforeseen major accidents, government restrictions, illnesses affecting key personnel);
- if you are not a high-income earner, and the nature of the business means you will not satisfy the conditions, but the business is objectively expected to make a profit or pass one of the conditions within a commercially viable period for the industry; or
- if you are a high-income earner, the nature of the business is such that it has not and will not produce a tax profit for the year in question, and there is an objective expectation that it will make a tax profit within a commercially viable period for the industry.

The exercise of ATO discretion is based on an assessment of the facts in each case. This means any application you makes should be accompanied by supporting evidence of special circumstances, and/or evidence from independent sources, including industry bodies, professional associations and government agencies, as to what is a "commercially viable period" for the industry.

If you're a primary producer or a professional artist (eg authors, playwrights, artists, sculptors, composers, performing artists and production associates) and your income from other sources that do not relate to the business is less than $40,000 (excluding net capital gains), you can ignore all of this, as the non-commercial loss rules will not apply to you. You will be able to deduct any losses from the business against your other income, but you should beware of the $40,000 threshold which may change from year to year based on your personal circumstances.

Source: www.ato.gov.au/Business/Non-commercial-losses/.

Less tax for some working holiday makers?

A recent Federal Court decision on Australia's "backpacker tax" has received wide-ranging media coverage and been seen by some as a win for all working holiday makers. However, taking a closer look it is clear that the case has a much narrower application than some have reported. It's likely only to apply to certain working holiday makers who are considered to be tax residents of Australia at the time, and are subject to a specific clause in a double taxation agreement (DTA) between their home country and Australia. Coupled with the ATO still considering an appeal, this area of law is far from settled.

The working holiday tax rate (commonly known as the "backpacker tax") has generally applied from 1 January 2017 to individuals that have either subclass 417 (working holiday) or 462 (work and holiday) visas. In essence, the first $37,000 of "working holiday taxable income" is taxed at 15%, and then the balance is taxed at the standard rates applicable to residents.

Thus, working holiday makers are taxed at a higher rate on the first $37,000 than residents, because the holiday makers do not get the benefit of the Australian tax-free threshold ($18,200 for 2019–2020).

The recent case centred on a British citizen (Ms Addy) who lived in Australia for a period of almost two years. Unlike many working holiday makers, during most of her time here she lived in the same share house accommodation in Sydney with a friend, and only left for short stints to travel to other parts of Australia. Essentially, the case came down to whether or not Ms Addy was a resident of Australia and, if she was a resident, whether the non-discrimination clause (Article 25) in the Australia–United Kingdom DTA prevented her from being taxed in a more burdensome way.

The Federal Court answered both of these questions were answered in the affirmative. Due to her lack of transience during her stay in Australia, Ms Addy was found to be an Australian resident for tax purposes. Following on from that, the Court also found that the DTA prevented Ms Addy from being taxed at the higher working holiday tax rate.

The practical significance of this decision seems quite limited. Firstly, the individual would have to be on a specific working holiday visa for the tax to apply. Secondly, most individuals on that visa would not be tax residents due to the transient nature of their stay. For example, another recent case involved a United States citizen who during her stay in Australia worked in more than one city, moved houses relatively frequently and travelled in Australia quite extensively, and thus was not found to be a resident for tax purposes. Finally, not all DTAs have a non-discrimination clause such as the one between Australia and the United Kingdom;

hence, a working holiday maker from a country lacking a DTA, or having a DTA without an anti-discrimination provision with Australia, would still be taxed at the working holiday rate even if they are found to be tax residents.

According to analysis from the ATO, the decision would only apply to working holiday makers from Chile, Finland, Germany, Japan, Norway, Turkey and the United Kingdom. In 2018 only around 36% of the total number of working holiday maker visas were issued to individuals from these countries. Therefore, this decision will only affect a small percentage of individuals, of which an even smaller proportion would be considered Australia tax residents. The ATO has noted that it is still considering the decision of the Court and may appeal, so stay tuned.

Source: www.ato.gov.au/Individuals/International-tax-for-individuals/Coming-to-Australia/Working-holiday-makers/; www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2019/2019fca1768; www.ato.gov.au/Media-centre/Corrections-and-clarifications/Statement-from-the-ATO-on-Addy-v-Commissioner-of-Taxation/.

Tax relief for drought-stricken farmers

With drought sweeping across the country, everyone is doing what they can to help. Farmers have been offered access to concessional loans, grants, and special allowances to help ease the immediate financial burden. While it is difficult to predict when the drought will break, for those who are in the process of navigating their way out of immediate financial strain, there are ways to future proof your farm or primary production business by taking advantage of various tax concessions.

Some of the immediate assistance measures include concessional loans and the farm household allowance, through which lump sum payments of up to $12,000 can be paid to eligible farm households.

The allowance can also be in the form of fortnightly payments for a maximum period of four cumulative years at the same rate as the Newstart allowance. This allowance may be available to both the farmer and their partner, provided certain conditions are met. An activity supplement of up to $4,000 to pay for study, training or professional financial advice may also be available to eligible households.

In addition to the immediate assistance, primary producers can obtain ongoing benefits of various tax concessions, including the instant asset write-off, immediate deductions for fodder storage assets, and income averaging to assist with cash flow.

Instant asset write-off

This financial year (from 1 July 2019 to 30 June 2020) is the last year you can get an immediate deduction for assets you've purchased that cost less than $30,000 (depending on the date of purchase), provided you're classified as a small business. From 1 July 2020, you can only obtain an immediate deduction for assets that cost less than $1,000. Make sure you make the most of this concession, if you're thinking of buying water storage or other drought-proofing assets, it may be wise to bring forward the purchase.

Fodder storage assets

In addition to the other assets you can get an immediate deduction for, any structural improvement, capital repair, alteration, addition or extension to an asset or structural improvement that is primarily and principally used for storing fodder is immediately deductible in the year you incurred the expense. Increasing the capacity or changing the way the feed is stored will almost certainly provide an insurance policy for dry times and lessen the financial strain of having to purchase feed for livestock.

Income averaging

If you're an individual carrying on a primary production business, you can apply income averaging to account for what may be significant fluctuations year on year from environmental and other factors. This ensures that you will not be subject to an unreasonably high marginal tax rate for one year when it is not representative of your income levels over a longer period.

Income averaging does not apply automatically when you start to carry on a primary production business. Some basic conditions must also be satisfied, such as the business being carried on for two or more years in a row, and the basic taxable income in one year being less than or equal to the basic income in the next year.

When using income averaging, tax is still calculated on your actual basic taxable income at the usual rates; however, you will be entitled to a tax offset if the average income is less than the taxable income. Conversely, you may have to pay extra income tax if the average income exceeds the taxable income.

Source: www.ato.gov.au/General/Financial-difficulties-and-serious-hardship/In-detail/Help-for-drought-affected-taxpayers/; www.humanservices.gov.au/individuals/services/centrelink/farm-household-allowance.

Super guarantee opt-out for high income earners

If you're a high-income earner with multiple employers, there's a good chance that you may unintentionally exceed the super concessional contributions cap in any year, which may cause excess contribution issues. To remedy this, laws have recently been passed to allow you to opt out of the super guarantee. All you have to do is apply to the ATO, but it's a good idea to speak to your employers first, as it may impact relevant awards or workplace agreements in place.

Under the superannuation guarantee framework, employers are required to contribute a minimum percentage (currently 9.5%) of their employees' ordinary time earnings into superannuation. Employers that fail to do so will be liable for a penalty called the superannuation guarantee charge, payable to the ATO. If you're a high-income earner with multiple employers, this requirement has the very real chance of inadvertently pushing you over the concessional contributions cap of $25,000.

To avoid this unintended consequence, laws have recently been passed so that eligible high-income earners with multiple employers can opt out of the super guarantee regime. From 1 January 2020, employees with more than one employer who expect their combined employers' contributions to exceed the concessional contributions cap can apply for an "employer shortfall exemption certificate" with the ATO.

Only the employee is able to apply for the certificate – it cannot be applied for by the employer on the employee's behalf.

The certificate will release one or more of your employers from their super guarantee obligations for up to four quarters in one financial year. However, you must still receive super guarantee contributions from at least one of your employers for the year. From the employer's perspective, the certificate means that it will not be liable for the super guarantee charge or other consequences if it doesn't make super guarantee contributions for the period covered.

Applications for the certificate must be lodged with the ATO at least 60 days before the first day of the first quarter the application relates to. That is, you would have needed to lodge a form with the ATO on or before 18 November 2019 if you wanted the certificate to apply for the quarter starting 1 January 2020. For the certificate to apply for the quarter beginning 1 April 2020, the last day to lodge the form is 31 January 2020.

If you're a high-income earner and are considering apply for the certificate, one of the first things to do is to discuss it with your employers, as they can choose to disregard the certificate and continue making contributions. This would negate the effort you put into lodging the form and dealing with the ATO.

Before having discussions with your employer, it may also be prudent to consider whether applying for the certificate may affect relevant awards or workplace agreements in place with your employer. Another thing you may wish to consider is whether you'd like to receive additional cash or non-cash remuneration in place of the foregone super guarantee contributions.

Once you've come to an agreement with your employers, it is important to get the details right, as the certificate cannot be varied or revoked once it's issued. This provides certainty to the employer that the exemption cannot later be withdrawn to their disadvantage. This also means that if you make a mistake, the employer and/or the period that the certificate applies to cannot be changed.

Source: www.ato.gov.au/General/New-legislation/In-detail/Super/Preventing-inadvertent-concessional-caps-breaches-by-certain-employees/; www.ato.gov.au/Individuals/Super/In-detail/Growing-your-super/Super-guarantee-opt-out-for-high-income-earners-with-multiple-employers/.

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