client alert | explanatory memorandum

May 2019

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 18 April 2019.

ATO to ramp up ABN investigations and cancellations

The ATO has advised that over the coming months it will be increasing its focus on the bulk Australian Business Number (ABN) cancellation program, to continue "to ensure the integrity of the Australian Business Register".

The ATO has refined its models to help it identify businesses that are no longer active or whose owners have forgotten to cancel their ABN when they ceased business. Generally, an ABN may be cancelled if:

- the Australian Securities and Investments Commission (ASIC) advises that a company is deregistered;
- the taxpayer advises that they have stopped business in their latest income tax return;
- the business hasn't reported business income or doesn't keep its lodgements up to date; and/or
- the taxpayer lodges a final tax return.

As part of the program, ABN holders or those applying for an ABN in certain industries may be contacted and asked to provide evidence to confirm that they're setting up or operating a business. Evidence may include activities such as:

- advertising, setting up a social media account or a website for the business;
- buying business cards or stationery for the business;
- obtaining business licences or insurance to operate (eg public liability and professional indemnity);
- leasing or buying premises, equipment or stock for the business;
- issuing quotes or bidding for work;
- consulting with financial, business or tax advisers;
- applying for finance; and
- buying a business.

If an ABN is cancelled and the taxpayer is still running a business, or an ABN application is refused, they can object to the decision within 60 days.

Additionally, if an ABN is cancelled and the taxpayer later decides they need it, they can reapply online and will get the same ABN if the business structure has stayed the same. A taxpayer who starts a different business will need to apply online for a new ABN.

Source: www.ato.gov.au/Tax-professionals/Newsroom/Your-practice/Bulk-ABN-cancellations/; https://abr.gov.au/About-us/Our-work/ABR-integrity/.

Fringe benefits tax: rates, thresholds and ATO focus for 2019–2020

The ATO has flagged the following FBT issues that are on its radar this year:

- for motor vehicle fringe benefits:
  - failing to report such benefits;
  - incorrectly applying exemptions; and
  - incorrectly claiming reductions;
- for employee contributions, mismatches between the amounts reported on an FBT return and the income amounts on the employer's tax return;
- for entertainment benefits:
  - claiming a deduction but not correctly reporting the expenses as a fringe benefit; and
  - incorrectly classifying entertainment expenses as sponsorship or advertising;

- for car parking fringe benefits:
  - incorrectly calculating by significantly discounting market valuations;
  - incorrectly calculating by using non-commercial parking rates; and
  - not supporting claims with adequate evidence;
- not reporting fringe benefits on business assets that are provided for the personal enjoyment of employees or associates; and
- not lodging FBT returns (or lodging them late) to delay or avoid paying tax.

The ATO's annual rulings regarding FBT rates, thresholds and other amounts have also been released for the 2019–2020 FBT year (1 April 2019 to 31 March 2020).

Cents-per-kilometre rate: vehicles other than cars

Taxation Determination TD 2019/3 sets out the cents-per-kilometre rates for the 2019–2020 FBT year for calculating the taxable value of a fringe benefit arising from private use of a motor vehicle other than a car. These are:

- 55 cents per kilometre for vehicles with engine capacity of up to 2,500cc;
- 66 cents per kilometre for vehicles with engine capacity of over 2,500cc; and
- 16 cents per kilometre for motorcycles.

FBT record-keeping exemption threshold

Taxation Determination TD 2019/4 sets the FBT record-keeping exemption threshold for the 2019–2020 FBT year at $8,714. This is an increase from the threshold of $8,552 for the 2018–2019 FBT year.

Indexation factors for valuing non-remote housing

Taxation Determination TD 2019/5 sets out the indexation factors for the 2019–2020 FBT year for valuing non-remote housing. These are:

- 1.020 for New South Wales;
- 1.019 for Victoria;
- 0.997 for Queensland;
- 1.008 for South Australia;
- 0.937 for Western Australia;
- 1.043 for Tasmania;
- 0.948 for the Northern Territory; and
- 1.028 for the ACT.

Benchmark interest rate

Taxation Determination TD 2019/6 sets the benchmark interest rate for the 2019–2020 FBT year at 5.37% per annum (this is an increase from the rate of 5.20% for the 2018–2019 FBT year). The benchmark interest rate is relevant to calculating the taxable value of car fringe benefits, for employers using the operating cost method, and loan fringe benefits.

Living-away-from-home allowance: food and drink amounts

Taxation Determination TD 2019/7 sets out the weekly amounts the ATO treats as reasonable for food and drink expenses incurred by employees receiving a living-away-from-home allowance (LAFHA) fringe benefit for the 2019–2020 FBT year. These amounts take into account movement in the consumer price index (CPI) and the 2015–2016 Household Expenditure Survey.

Separate reasonable amounts apply for locations within Australia and for overseas locations. For Australian locations, the reasonable weekly amounts for the 2019–2020 FBT year are:

- $269 for one adult;
- $404 for two adults;
- $539 for three adults;
- $337 for one adult and one child;
- $472 for two adults and one child;
- $540 for two adults and two children;

- $608 for two adults and three children;
- $607 for three adults and one child;
- $675 for three adults and two children; and
- $674 for four adults.

For larger family groupings, add $135 for each additional adult and $68 for each additional child. An "adult" for this purpose is an individual aged 12 years or more as at 31 March 2019.

Source: www.ato.gov.au/Business/Business-bulletins-newsroom/Employer-information/FBT-issues-on-our-radar/.

Guidance on when a company carries on a business

On 5 April 2019, the ATO released its long-awaited final ruling on when a company carries on a business for the purposes of:

- the definition of "small business entity" in s 328-110 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- s 23 of the *Income Tax Rates Act 1986* as it applied in the 2015–2016 and 2016–2017 income years, when a lower corporate tax rate was available to companies that were small business entities. From 2017–2018, a company needs to satisfy the definition of "base rate entity" to qualify for the lower rate.

Taxation Ruling TR 2019/1 finalises Draft TR 2017/D7, which was confined to whether a company carries on a business for the purposes of the *Income Tax Rates Act 1986*. While the final ruling has been expanded and restructured, the ATO's overall approach and conclusions are largely unchanged. In particular, the ATO accepts that a company can be carrying on a business even if its activities are relatively limited and consist of passively receiving investment returns or rent that it distributes to shareholders. However, the ATO cautions that TR 2019/1 only applies to and binds it in relation to the particular sections of the Acts, and that "care must be exercised in applying the reasoning and conclusions expressed in this Ruling when applying other provisions".

As if to prove this point, Draft Taxation Determination TD 2019/D4 was also issued on 5 April 2019. It states that a company carrying on a business in a general sense (as described in TR 2019/1) but whose only activity is renting out an investment property cannot claim any CGT small business concessions in relation to that property.

Carrying on a business "in a general sense"

Taxation Ruling TR 2019/1 considers whether a company incorporated under the *Corporations Act 2001* (other than a company limited by guarantee) carries on a business "in a general sense". Once this is established for a particular company, it is still necessary to consider the scope and nature of that business when determining the tax consequences of the company's activities and transactions (eg whether an amount is income or capital).

The ruling emphasises that it is not possible to state with precision whether a company is carrying on a business. As this is a question of fact, the ATO says that the answer ultimately turns on an overall impression of the company's activities, having regard to the indicators of carrying on a business (as identified by the courts). One key indicator is whether the company's activities have a purpose of profit. The ATO accepts that where a profit-making purpose exists, it is likely the other indicators will support a conclusion that the company carries on a business.

In the case of limited, proprietary limited and no liability companies, the ATO accepts that these companies would normally be carrying on a business in a general sense if they:

- are established and maintained to make a profit for their shareholders; and
- invest their assets in gainful activities that have both a purpose and prospect of profit.

In the case of a corporate trustee, TR 2019/1 only applies in relation to the activities it conducts on its own behalf. In determining whether the company carries on a business, any activities conducted in its capacity as a trustee are ignored. The ruling also notes that "the same profitable activity undertaken by a trustee is less likely to amount to the carrying on of a business, than if it were to be carried on by a company".

The example section of TR 2019/1 concludes that the following companies are carrying on a business in the general sense:

- an inactive company that derives interest income from retained profits – the ATO's preliminary view had been that the company was not carrying on a business;

- a newly formed company investigating the viability of carrying on a particular business, but which derives a small amount of interest income – again, the ATO's preliminary view had been that the company was not carrying on a business;
- a property investment company that lets out a commercial property, and either manages the property itself or engages a professional property manager;
- a share investment company, whether or not it engages a professional investment advisor and manager to manage its portfolio of shares;
- a company that leases multiple boats to unrelated parties;
- a holding company that only holds shares in a subsidiary, where it invests the shares and also manages the company group; and
- a holding company that holds shares in, and provides loans to, a subsidiary, where it invests the shares and manages the group.

The draft of the ruling had included an example of a family company with income consisting only of an unpaid trust entitlement (UPE) which it reinvested. The draft concluded that if the company did not reinvest the UPE or receive its entitlement in cash, it would not be carrying on a business. This example has been omitted from the final ruling.

Taxation Ruling TR 2019/1 applies before and after its date of issue.

CGT small business concessions

Draft Taxation Determination TD 2019/D4, also issued on 5 April 2019, states that a company carrying on a business "in a general sense" as described in Taxation Ruling TR 2019/1 but whose sole activity is renting out an investment property cannot access the CGT small business concessions in relation to that property. This is because a CGT asset whose main purpose is to derive rent is specifically excluded from being an active asset (s 152-40(4)(e) of the ITAA 1997).

When finalised, the determination is intended to apply both before and after its date of issue.

Source: www.ato.gov.au/law/view/view.htm?docid=%22TXR%2FTR20191%2FNAT%2FATO%2F00001%22; www.ato.gov.au/law/view/view.htm?docid=%22DXT%2FTD2019D4%2FNAT%2FATO%2F00001%22.

Super guarantee amnesty not yet law, but $100 million recovered

The ATO has recovered around $100 million in unpaid superannuation from employers since the 12-month super guarantee (SG) amnesty was proposed on 24 May 2018.

At a Senate Economics Legislation Committee hearing on 10 April 2019, ATO Deputy Commissioner, Superannuation, Mr James O'Halloran estimated that there has been a 10–15% increase in the number of employers that have come forward and self-reported unpaid SG liabilities in response to the SG amnesty, despite it not yet being law.

The amnesty was announced by the government on 24 May 2018 to enable employers to self-correct historical underpayments of SG amounts until 23 May 2019 without incurring additional penalties that would normally apply. Importantly, a tax deduction would be allowed for payments of the SG charge made during the amnesty which would normally be non-deductible.

As at 28 February, Mr O'Halloran said 19,000 employers have come forward within the normal super guarantee charge (SGC) process for reporting unpaid SG contributions. Of the 19,000 employers that have come forward, the ATO believes that 73% are microbusinesses with less than $2 million turnover, 21% are medium businesses ($2 million to $250 million turnover), and 4% are not-for-profits. The average number of employees is 36.

For most of the disclosures, 51% of the payments are in the order of $10,000, while 35% are $10,000-$50,000 and the balance (14%) are over the spread. In terms of significant employers (1,000 to 5,000 employers), 12 employers have come forward for the period. However, the vast majority (93%) are small to medium businesses. Around 85% of the total declaration of the non-payment or the payment of SG (including nominal interest) is less than $50,000.

ATO applying existing law

With the Bill to implement the amnesty – the *Treasury Laws Amendment (2018 Superannuation Measures No 1) Bill 2018* – lapsing on 11 April 2019 when the Federal Election was called, the ATO must continue to apply the existing law.

The ATO says that employers who make a voluntary disclosure of historical SG non-compliance will not be entitled to the concessional treatment under the amnesty, unless and until the Bill is enacted into law. If the Bill is eventually enacted, the ATO will apply the new law retrospectively to voluntary disclosures made during the amnesty period.

In the absence of law to implement the amnesty, no-one can claim a deduction for SG payments as it currently stands. The ATO also cannot waive the $20 administration fee. However, the ATO still has a discretion to remit the additional Pt 7 penalty (200%) as part of its normal practice for voluntary disclosures under the current law and practice statement.

Mr O'Halloran also noted that many of the employers that have come forward would not be eligible for the amnesty anyway, primarily because they were still currently under audit by the ATO, or had reported outstanding SG in relation to periods after May 2018 that wouldn't be covered by the amnesty.

TIP: Employers that may be waiting for the amnesty to become law before making a voluntary disclosure should be mindful that they may already be in the ATO's sights. The introduction of the Single Touch Payroll (STP) regime, and event-based reporting obligations for super funds, means that the ATO will increasingly have more data to identify SG non-compliance much earlier than previously.

While employers who make a voluntary disclosure before the amnesty is passed into law run the risk of never receiving the concessional treatment under the amnesty, they could be in an even worse position when the ATO eventually catches up with them.

In this respect, employers with historical SG non-compliance need to be ready to make a voluntary disclosure (even without the protection of the amnesty) before the ATO begins an audit or review. This should at least place the employer in a better position to request the ATO remit some of the penalties, especially the additional Pt 7 penalty (200%) for failing to provide an SGC statement.

Source: https://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/f882a9f9-8b5f-4cd9-8c6a-13c74e92f58d/toc_pdf/Economics%20Legislation%20Committee_2019_04_10_7061.pdf.

Instant asset write-off with Budget changes now law

The *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Bill 2019* – introduced as *Treasury Laws Amendment (Increasing the Instant Asset Write-Off for Small Business Entities) Bill 2019*) – received Royal Assent on 6 April 2019 as Act No 51 of 2019. The Bill was passed by the Senate with 18 government amendments to implement the changes announced in the 2019–2020 Federal Budget. Those amendments were agreed to by the House of Representatives on 4 April 2019.

As originally introduced, the Bill amends the tax law to increase the threshold below which amounts can be immediately deducted under the instant asset write-off rules from $20,000 to $25,000 from 29 January 2019 until 30 June 2020, and extends by 12 months to 30 June 2020 the period during which small business entities can access the expanded accelerated depreciation rules (instant asset write-off). The Senate amendments to the Bill implement the Government's 2019–2020 Budget changes so that:

- the write-off is extended to medium sized businesses (turnover up to $50 million), where it previously only applied to small business entities;
- the instant asset write-off threshold increases from $25,000 to $30,000 – the threshold applies on a per-asset basis, so eligible businesses can instantly write off multiple assets.

Small business entities (with aggregated annual turnover of less than $10 million) will be able to immediately deduct purchases of eligible assets costing less than $30,000 that are first used, or installed ready for use, from Budget night (2 April 2019) to 30 June 2020.

Medium sized businesses (with aggregated annual turnover of $10 million or more, but less than $50 million) will also be able to immediately deduct purchases of eligible assets costing less than $30,000 that are first used, or installed ready for use, from Budget night to 30 June 2020. The concession will only apply to assets acquired after 2 April 2019 by medium sized businesses (as they have previously not had access to the instant asset write-off) up to 30 June 2020.

Rental deductions: ATO audits to double

The ATO has warned that it will double the number of audits scrutinising rental deductions this year. It says some tax agents are still claiming travel to residential rental properties for their clients, but from 1 July 2017 taxpayers (aside from excluded entities) were no longer permitted to claim travel expenses related to inspecting, maintaining or collecting rent for a residential rental property.

Assistant Commissioner Gavin Siebert has said that this year the ATO is making rental deductions a top priority. “A random sample of returns with rental deductions found that nine out of 10 contained an error. We are concerned about the extent of non-compliance in this area and will be looking very closely at claims this year”, he said.

The ATO expects to more than double the number of in-depth audits this year to 4,500, with a specific focus on over-claimed interest, capital works claimed as repairs, incorrect apportionment of expenses for holiday homes let out to others and omitted income from accommodation sharing.

“Once our auditors begin, they may search through even more data including utilities, tolls, social media and other online content to determine whether the taxpayer was entitled to claims they’ve made”, Mr Siebert said.

In 2017–2018, the ATO audited more than 1,500 taxpayers with rental claims, and applied penalties totalling $1.3 million. In one case, a taxpayer was penalised over $12,000 for over-claiming deductions for their holiday home when it was not made genuinely available for rent, including being blocked out over seasonal holiday periods. Another taxpayer had to pay back $5,500 because they had not apportioned their rental interest deduction to account for redraws on their investment loan to pay for living expenses.

If an income-producing asset such as an investment property is damaged or destroyed, the ATO has said the taxpayer will need to work out the correct tax treatment of insurance payouts they receive and their costs in rebuilding, repairing or replacing the assets.

Source: www.ato.gov.au/Media-centre/Media-releases/Tax-office-to-double-audits-of-dodgy-rental-deductions/.

Shortfall penalties reduced under new ATO initiative

The initial results of the ATO’s penalty relief initiative look positive.

Alison Lendon, ATO Deputy Commissioner, Individuals and Intermediaries, has announced that in the first six months of the ATO’s penalty relief initiative, shortfall penalties for “failure to take reasonable care” and “not having a reasonably arguable position” have been reduced by 89.2% for individuals and 83.8% for small businesses. She said thousands of small businesses and individuals have not been penalised for errors on their tax returns or activity statements. Instead, the ATO had shown them what the error was and how they can get it right next time.

The community and tax professionals had told the ATO that people should have a chance when they get their tax wrong, provided there wasn’t a dishonest intent behind their error. Ms Lendon has said the ATO listened and designed “a fair and consistent approach” to certain penalties. With the ATO’s new approach to penalty relief, if it finds an error on a tax return or activity statement during an audit or review, the taxpayer may be eligible for automatic penalty relief. This means the ATO will show the taxpayer where the error was made, won’t apply a penalty and will educate the taxpayer on getting it right.

Examples of use of the initiative include the following:

- An individual incorrectly claimed self-education expenses on their tax return. This error would have usually incurred a penalty of $788.55, but under the initiative, the penalty was not applied.
- A small business owner made an error on their company tax return relating to deductions on motor vehicle and other work-related expenses. Thanks to penalty relief, a penalty of $1,090.13 was not applied by the ATO.

Further information on penalty relief is available on the ATO’s website.

Source: www.ato.gov.au/General/Interest-and-penalties/Penalties/Penalty-relief/; www.linkedin.com/pulse/penalty-relief-experience-lives-up-its-promise-alison-lendon/.

How the ATO identifies wealthy individuals and their businesses

According to the ATO, wealthy individuals are resident individuals who, together with their business associates, control net wealth of $5 million or more. The ATO uses sophisticated data matching and analytic models, drawing on tax returns and referrals from other government agencies or the community, to identify wealthy individuals and link them to associated businesses.

The ATO says it will “engage with” such taxpayers, offering assistance and services to help them “get things right up front”. The ATO can tell them what it knows about them, including its view of their group’s income tax profile, “so you can work with us where needed”.

If the information the ATO holds about a wealthy individual is limited, the ATO says it may contact the individual or their tax adviser to better understand their circumstances, and to confirm or correct its view of the individual’s wealth and group structure. As part of this engagement, the ATO says the individual will “have the opportunity to check if the information we have about you is correct”.

High wealth individuals

Wealthy individuals who control net wealth of $50 million or more are classified as high wealth individuals . Given the importance of this group to community confidence in the tax and super systems, the ATO says it has an ongoing focus on them.

The ATO says if its systems indicate that an individual has effective control of $50 million or more in net wealth, it may ask for validation of the individual's net wealth. The ATO says it will review any information given by high wealth individuals and update its records as required.

Source: www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/What-you-should-know/About-privately-owned-and-wealthy-groups/How-we-identify-wealthy-individuals-and-their-businesses/