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SEPT/OCT
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TAX TIPS

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COMPANY TAX CUTS HIDDEN TRAP

LATEST DEVELOPMENTS

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HIGH ALERT: WORK-RELATED EXPENSE CLAIMS

The ATO has just announced a crackdown on work-related expense claims by individuals. In this first of a continuing series of articles, we take a look at this key area.

KEY DATES

Many key dates are looming for business including those relating to Activity Statements, GST, superannuation, income tax returns, and more.

SEPTEMBER 2017

21 SEPTEMBER
August monthly Activity Statements – due for lodgement and payment.

30 SEPTEMBER
Annual TFN withholding report for closely held trusts where a trustee has been required to withhold amounts from payments to beneficiaries during 2016/2017 – due date for lodgement.

OCTOBER 2017

21 OCTOBER
September monthly Activity Statements – due for lodgement and payment.

28 OCTOBER
Final date for eligible quarterly GST reporters to elect to report GST annually.

28 OCTOBER
Due date for Superannuation Guarantee contributions for July-September to be made to employee funds.

31 OCTOBER
PAYG Withholding Where ABN Not Quoted – Annual Report – due date for lodgement These amounts are also reported at W4 on your Activity Statement.

31 OCTOBER
Due date for 2016/2017 individual tax returns (unless you are lodging via a tax agent and are on their lodgement list by this date).

Where the due date falls on a weekend or public holiday, it is deferred until the next business day,(except in the case of Superannuation Guarantee deadlines).

TAX STRATEGY:
ACQUIRING YOUR SPOUSE'S INTEREST IN THE FAMILY HOME

A popular investment strategy is for a couple to purchase a new family home whilst retaining and renting out the existing principal residence. This case study considers the taxation issues that surround such a transaction, including whether or not the anti-avoidance provisions of the Tax Act apply.

THE STRATEGY

It is quite common for a couple acquiring a new family home to want to hold onto their existing residence and rent the property to tenants.

If such a scenario occurred, any deduction for interest costs would only be allowed for outstanding debt (if any) on the loan that was originally taken out to purchase the former home.

A common misconception is that if the couple were to refinance the existing residence to purchase the new family home, they may be entitled to a deduction for the interest on this refinanced amount. It is vital to note that this is NOT the case, as a tax deduction for the interest cost is only allowable when considering the purpose to which the funds were put (in this instance, the purpose is the purchase of the new family home) and NOT the asset against which the funds were borrowed.

Faced with this situation, the problem often arises where there is little or no remaining debt on the old home, and the couple have to fully fund the purchase of the new home. As the new home is a private asset, then any interest expense that is incurred on the loan to acquire the new home is not considered to be an allowable deduction.

Without this interest deduction, the former home that becomes a rental property will typically return a surplus of net rents over expenses paid, and tax will likely be paid on this amount.

To overcome this, many advisors suggest that the taxpayers sell the existing home and use these funds toward the purchase of their new home and then acquire another rental property. Whilst this is a more tax-effective option, this may also incur additional costs such as legal fees, real estate agent fees, and stamp duty costs.

Instead of incurring these additional legal and real estate costs, an alternative may be for one taxpayer to borrow, in order to acquire the interest in the former residence from their spouse. Care needs to be taken when considering this type of transaction, as there could be some unwanted consequences, including Part IVA of the Income Tax legislation (the tax avoidance provisions). Here is how the transaction works.

Case Study

Harry and Cate have a family home that they own jointly (50/50). The property is valued at $600,000 and is unencumbered. Harry and Cate have three children and have decided to purchase a new family home in a neighbouring suburb for $800,000.

In addition to the purchase of the new family home, Harry also wishes to start acquiring a portfolio of rental properties. Harry went and saw his advisor who suggested that he borrow in order to acquire Cate's 50% interest in the existing family home for its market value of $300,000. Harry will then rent out that home and the $300,000 received by Cate for her 50% interest in the old home will be put toward the purchase of the new family home.

IS HARRY ALLOWED A DEDUCTION FOR INTEREST INCURRED ON THE FUNDS BORROWED TO ACQUIRE CATHY'S SHARE?

Yes.

Harry has used the borrowed funds to acquire a 50% interest in an income producing rental property, he will be entitled to a deduction for any interest incurred in respect of these funds.

DO THE ANTI-AVOIDANCE PROVISIONS OF THE TAX ACT APPLY?

The anti-avoidance provisions of the Tax Act (contained in Part IVA of the legislation) are used by the ATO to deny a deduction where a taxpayer has entered into a scheme for the dominant purpose of obtaining an income tax deduction. When considering the application of Part IVA to a transaction, three questions are relevant:

1. IS THERE A SCHEME?

2. IS THERE A TAX BENEFIT?

3. IS THE DOMINANT PURPOSE TO OBTAIN A TAX BENEFIT?

There is no doubt in this scenario that a scheme has been entered into by Harry to acquire Cate's share of the existing home. To determine whether a tax benefit has been enjoyed by Harry as a result of the scheme is a question of fact. If it was Harry's intention that he establish a rental portfolio and can demonstrate that he would have done so in any event, then there is arguably no tax benefit obtained. This is because had Harry acquired a separate property instead of Cate's 50% interest, then he would have been entitled to a tax deduction for any interest incurred. Therefore, Harry would need to gather sufficient evidence to support this claim.

If the ATO managed to successfully argue that there was a tax benefit, then Harry would need to show that the dominant purpose of him purchasing Cate's interest was for a purpose other than obtaining a tax benefit. To this end, Harry could continue to argue his intentions were to establish a rental portfolio, and that the savings in legal fees and stamp duty that arose as a result of this transaction rather than acquiring a new property was the dominant purpose for entering the scheme.

It is important that taxpayers document the reasoning behind such transactions in order to shore up the tax deductibility of such schemes.

NON-RESIDENT CGT WITHHOLDING RULES... *REBOOTED!*

Are you buying or selling property? If so, you need to be aware of the newly adjusted withholding rules, which are now set to impact a much wider range of property sales.

BACKGROUND

Last year Federal Parliament passed legislation designed to collect capital gains tax (CGT) from non-residents selling certain Australian property from 1 July 2016.

Although the law is targeted at foreign Sellers, given the way the legislation was drafted, all Sellers of property (resident or non-resident) may be impacted. The new law required that for all property sales of $2 million or more, the Buyer was required to withhold 10% of the sale proceeds and remit that amount to the ATO without delay – unless the seller obtains a *Clearance Certificate* from the ATO before settlement.

The legislation doesn't just apply to individuals but also Companies, Trusts and Superfunds. Further to this, it is the buyer that can then be penalised by the ATO for failing to withhold and remit the 12.5% withholding tax.

WHAT'S CHANGED?

In the May 2017 Federal Budget, the Government made the following two changes:

- Increasing the CGT withholding rate for non-residents from 10% to 12.5% from 1 July 2017, and
- Reducing the real property exemption threshold from $2 million to $750,000 from 1 July 2017.

These changes mean that many more taxpayers will be impacted by the new regime. Given this, we now examine the law in detail.

CONDITIONS

The new withholding regime applies to contracts entered into on or after 1 July 2016 where the following three conditions are met:

1. THE BUYER ACQUIRES CERTAIN "TAXABLE AUSTRALIAN PROPERTY"

This includes:

- Real property in Australia – land, buildings, residential and commercial property
- Lease premiums paid for the grant of a lease over real property in Australia
- Mining, quarrying or prospecting rights
- Interests in Australian entities whose majority assets consist of the above such property or interests (e.g. shares in a company or units in a trust) or
- Options or rights to acquire the above property or interest.

2. THE SELLER IS A NON-RESIDENT OR HASN'T PROVIDED A CLEARANCE CERTICATE FROM THE ATO

Note that where there are multiple Sellers in the one transaction, this condition will be met where any of the Sellers is a non-resident.

This condition is the 'kicker'. The rules can catch Australian resident sellers if they do NOT obtain a *Clearance Certificate* from the ATO.

3. NONE OF THE FOLLOWING EXCLUDED TRANSACTIONS ARE THE SUBJECT OF THE SALE

(a) Real property transactions with a market value of less than $750,000 (down from $2 million). As well as sales of real property, this exemption also includes where the transfer of a lease interest is less than $750,000.

(b) Transactions listed on an approved stock exchange (e.g. shares trades on the ASX).

(c) The foreign resident seller is under external administration or bankruptcy.

The reduction of the real property threshold by more than 100% (down to $750,000) means that many more property sales will now be caught by the regime, and necessitate action on behalf of resident Sellers and in some cases non-resident Sellers as follows:

CLEARANCE CERTIFICATE

If you are the seller and a resident and the regime applies, you must obtain a *Clearance Certificate* from the ATO to prevent the 12.5% withholding rate from applying to the Gross Sale proceeds. Thus, the rules treat Sellers as being a non-resident (and thus there

will be withholding) unless and until you have obtained a *Clearance Certificate*. If you, as a Seller, are a non-resident of Australia for tax purposes then you cannot apply for a *Clearance Certificate*.

The seller can apply to the ATO for the *Clearance Certificate* when the asset disposed of is any of the following:

- Real property situated in Australia (including a lease of land)
- A mining, quarrying or prospecting right (not being real property) if the minerals, petroleum or quarry materials are situated in Australia
- Shares in a company that owns land or a building erected on that land, where the ownership of the shares gives a right to occupy that land or building (that is, a company title interest).

The ATO will issue the seller with a *Clearance Certificate* where it has no reason to believe that they will be a non-resident during the period specified in the *Clearance Certificate*. To be clear, it is the Seller's responsibility to obtain the *Clearance Certificate* and provide it to the Buyer before settlement. The ATO has stated that in straightforward cases where they have all required information, *Clearance Certificates* will be provided between 1-14 days. However, where there are data irregularities or exceptions, it could take up to 28 days to obtain a *Clearance Certificate*. (This could arise for example if land title is recorded in maiden names and ATO records are in married names.) To avoid unexpected delays and to ensure the *Clearance Certificate* is valid at the time it is provided to the Buyer, the ATO recommends that Sellers seeking a *Clearance Certificate* should apply using the ATO's online application as early as possible in the sale process. Apply online at www.ato.gov.au (type '*clearance certificate* application' in the search box at the top of the page). Applications can also be made via a paper form obtained from the ATO, however processing will take longer than an online application.

AMOUNT

Where the three conditions are met, and none of the exclusions apply, and a *Clearance Certificate* has not been provided to the Buyer by settlement, the Buyer must withhold 12.5% (up from 10%) of the money paid or required to be paid plus the market value of any other property given or required to be given. This must take account of any adjustments in the purchase price.

Where the Buyer is registered for GST and the transaction is a taxable supply, and the Buyer is entitled to a GST credit, the GST-exclusive price should be used by the Buyer in calculating the withholding. For example, where the property is sold for $880,000 including GST, it is 12.5% of $800,000 that should be remitted.

On the other hand, where a purchaser is not registered for GST, or the supply of the asset is not a taxable supply (e.g. because the seller is not registered for GST or the supply is input taxed such as in the case of residential property that is not new), or the purchaser is not entitled to any GST credit, the GST-inclusive price should be used in calculating the withholding. Following on from the earlier example, it is 12.5% of $880,000 that should be used as the basis of the calculation.

If the CGT asset is a lease, the withholding obligations only arise in respect of 12.5% of the lease premiums paid for the grant of the lease.

VARIATION

Where the Seller is clearly a non-resident and is therefore not entitled to a *Clearance Certificate*, the Seller can apply online for a variation (so that less than 12.5% is withheld) where:

- The Seller will not make a capital gain on the transaction (e.g. because they will make a capital loss or a CGT rollover applies)
- The Seller will otherwise not have an income tax liability (e.g. because of carried-forward capital losses or tax losses)
- A creditor of the Seller has a mortgage or other security interest over the property and the proceeds of sale available at settlement will be insufficient to cover the amount to be withheld and to discharge the property secured
- A creditor acquires legal title to the property as a result of an order for foreclosure and its security would be further diminished as a result of having to comply with the withholding obligations.

Although the Seller can claim the amount withheld back on their tax return at year-end, cashflow problems can be avoided by making a *Variation Application* and thus reducing or eliminating the amount that is withheld initially. The ATO will rule on a seller's variation application within 28 days.

Where the variation is granted, the Seller will receive a notice of variation stating the revised amount that is to be withheld if any. Where there are multiple sellers, each seller must lodge their own variation. Joint applications cannot be lodged.

Apply online for a withholding rate variation at **www.ato.gov.au** (type 'Foreign Resident Capital Gains Withholding Rate Variation Application' in the search box at the top of the page). A paper form can be obtained from the ATO, however processing will take longer than an online application.

REMITTANCE

Withheld amounts must be remitted to the ATO on or before the day of settlement. To do this, buyers should use the *Purchaser payment notification form* to notify the ATO that a transaction has taken place to which foreign resident CGT withholding applies. This form provides the ATO with the details of both parties to the transaction, the asset involved, and the amount of withholding. It too must be completed and lodged with the ATO on or before the day of settlement. The ATO prefers that this form be lodged online **www.ato.gov.au** however a paper version is also available.

Buyers that fail to withhold and remit an amount required to be withheld from the purchase price, must pay the ATO a penalty equal to the amount they failed to withhold. The Buyer will also be subject to the general interest charge on any amounts not paid to the ATO by the required date. The penalty is not a tax deduction, and nor can it be claimed as a tax credit by the Buyer!

CREDIT

Following payment, the ATO will notify the Seller to confirm that an amount has been received. Sellers can then claim this amount as a credit by lodging a tax return. The withheld amount is a non-final tax. Therefore, where a capital gain has been made and there is still an amount owing, the credit will go towards that liability and will not be refunded. Conversely, if the capital gain is exempt from CGT or the amount withheld exceeds the non-resident's tax liability for that income year, the excess CGT withholding amount will be refunded.

CASE STUDY

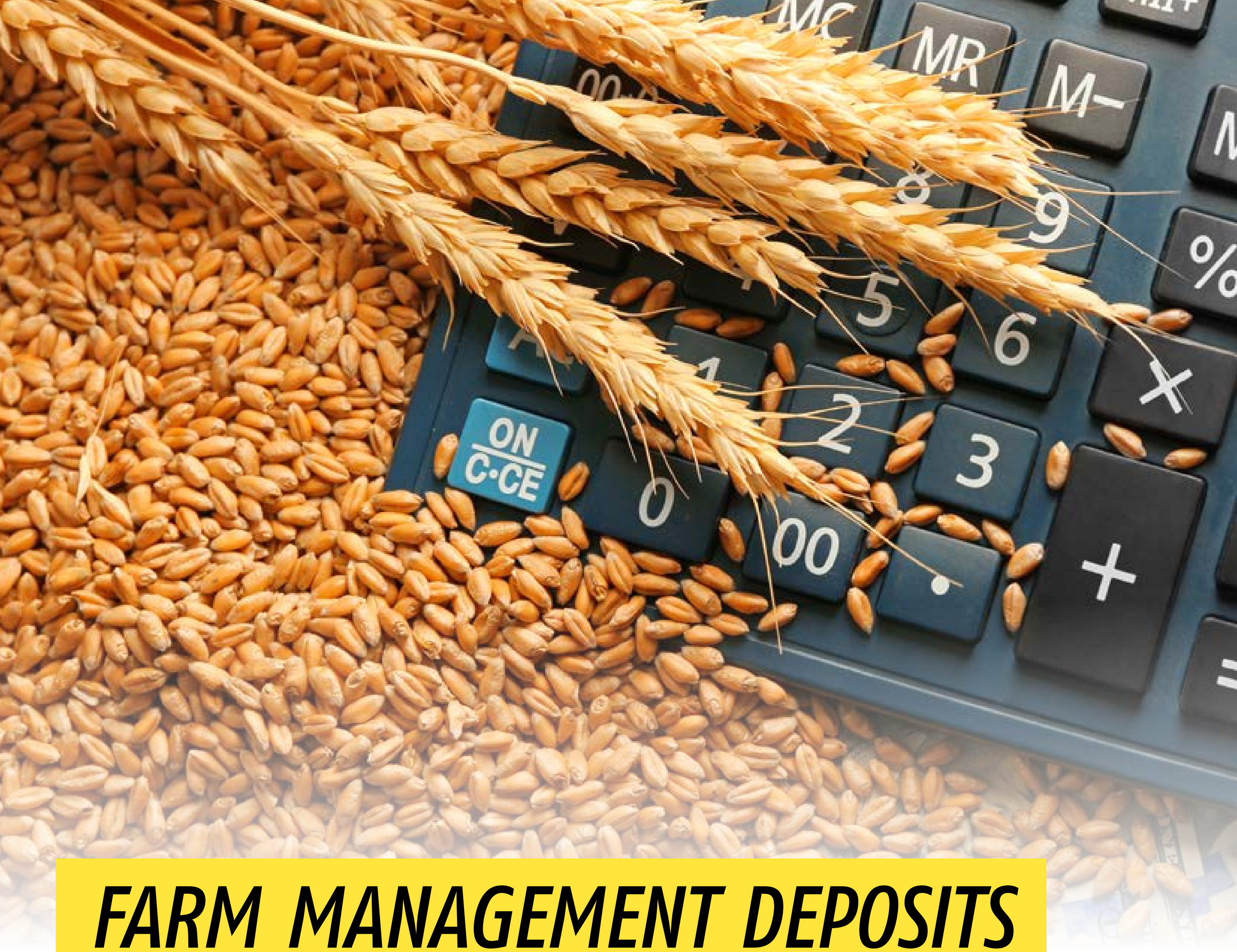
In September 2017, George signs a contract to purchase a residential waterfront property from the current owner Amy worth $800,000, with settlement to occur in December. George does not know whether Amy is a foreign resident. Despite repeated requests from George, Amy does not obtain by the time of settlement a ***Clearance Certificate*** from the ATO to give to George.

As the property is residential property with a market value exceeding $750,000, and a ***Clearance Certificate*** has not been provided before settlement, George is required to withhold $100,000 ($800 000 x 12.5%). No GST was charged as the property was residential and besides, Amy was not registered for GST. George has to remit that amount along with a *Purchaser payment notification form* to the ATO. This is the case even where Amy is a resident for tax purposes.

As it turns out, the house qualifies for the main residence exemption from CGT. Therefore, Amy lodges a tax return at year-end and, assuming no other tax liabilities, the CGT withholding amount is refunded to her.

TAKE HOME POINTS

1. Sellers need to be aware of the regime and the requirement to provide a ***Clearance Certificate*** where you are a resident.
2. The regime applies to private sales as well as business sales.
3. Note the lowering of the residential property exclusion to $750,000.
4. Resident Buyers will be subject to penalties where they fail to withhold when required to do so.
5. The requirement of the Buyer to immediately remit the amount to the ATO may cause cashflow problems, and needs to be taken into account before transactions are entered into.



FARM MANAGEMENT DEPOSITS

Introduced in 1999, Farm Management Deposits are seen to be an important part of risk management for primary producers. What are they and do they work? This article takes a close look at the Farm Management Deposits Scheme, some of the commonly asked questions and works through a case study to determine the answers.

BASICS

In simple terms, the Farm Management Deposit (FMD) scheme is intended to allow Primary Producers the opportunity to shift "before-tax" income to a later year where they may offset losses due to unfavourable climatic or market conditions. FMDs are considered an important risk management tool for the Primary Producer to "even out" what could otherwise be extremely uneven income years.

The scheme works by allowing Primary Producers to claim an income tax deduction for an actual cash deposit into an FMD scheme in the year the deposit is made. As a result, this reduces the Primary Producer's taxable income in the deposit year and hence any income tax payable on the deposit amount.

In a later income year, when the Primary Producer's income may be low due to a downturn in market or climatic conditions, the Primary Producer can apply to the FMD scheme for a withdrawal. The amount is then included in the Primary Producer's assessable income for that year and taxed accordingly.

The scheme is cash-flow driven; in a bountiful year the surplus cash is deposited in an FMD held with a financial institution. In a lean year the cash is withdrawn from the FMD to assist the Primary Producer to pay for business expenses.

ELIGIBILITY

There are some specific terminology and conditions associated with an FMD:

THE OWNER

The owner of an FMD is the person on whose behalf the deposit is made. The owner must be a Primary Producer at the time the deposit is made. The owner cannot be a joint ownership or a Company but, rather, the scheme is restricted to ownership by individuals (including Partners in a Partnership). The only exception to this rule is where a Trustee is acting on behalf of a beneficiary who is presently entitled to a share of the income of a Trust estate, but is under legal disability (for example, a minor under the age of 18 years).

The Primary Producer must also pass an Income Test. Namely, they must have taxable non-primary production income not exceeding $100,000 during the year a deposit is made or $65,000 prior to 1 July 2014.

DEPOSIT-TAKING INSTITUTION

You must make your deposits with an FMD Provider that is an authorised deposit-taking institution or an entity that has a Commonwealth, State or Territory guarantee for deposits. This includes any bank, building society or credit union. You can make deposits with more than one of these institutions.

DEPOSITS

The following conditions are imposed on deposits:

- You must make the deposit with an FMD provider
- The deposit must be on behalf of only one individual
- Deposits are deductible in the income year in which you make them – the minimum deposit or repayment is $1,000
- Generally the FMD must not be withdrawn within 12 months of making it (but see special concessions below)
- The maximum of all deposits you hold at any one time is $800,000 (from 1 July 2016)
- Interest on deposits is assessable in the income year in which it is paid
- The deduction allowable in any income year is limited to the taxable income derived from a business of Primary Production in that year
- You can hold FMDs with more than one FMD provider
- You can't claim a deduction:
  - » For any amount that exceeds the maximum deposit cap
  - » If your taxable non-primary production income is more than $100,000.
- Trustees can only make deposits on behalf of a beneficiary presently entitled to a share of the income of the trust estate who is under a legal disability, for example a minor.
- Deposits by two or more people jointly or made on behalf of two or more people are not recognised as FMDs.

WITHDRAWALS

If you withdraw an amount of your FMD, you include the amount of the deduction you claimed in your assessable income in the income year the deposit is repaid to you.

However, in the event of a Natural Disaster or a severe drought, you can access your FMDs early (i.e. less than 12 months) while still retaining the tax benefits.

NATURAL DISASTER

If you are impacted by a natural disaster, you can access your FMDs within 12 months of making those deposits, without having to cancel your tax deduction. However, you will need to include the deposit as assessable income in the year you withdraw it. To be eligible, you must hold an FMD and meet all of the following requirements. You must:

- Have made a deposit before the relevant natural disaster
- Have received assistance through a Primary Producer Category C recovery grant under the natural disaster relief and recovery arrangements
- Withdraw your deposit after the recovery assistance was first provided (but within 12 months of making the deposit).

SEVERE DROUGHT

If your primary production property is experiencing severe drought, you can access your FMDs within 12 months of making those deposits, without having to cancel your tax deduction. However, the deposit will need to be included as assessable income in the year you withdraw it. To be eligible, you must hold a FMD and meet all of the following requirements. You must:

- Have made a deposit in the previous income year
- Have held the deposit for at least six months
- Be able to demonstrate an area of your primary production property has been affected by rainfall for that six-month period within the lowest 5% of recorded rainfall for the property, and
- Not be involved solely in primary production industries like fishing, pearling, tree felling or tree transporting.

CEASING TO BE A PRIMARY PRODUCER

If you cease to be a Primary Producer during an income year for at least 120 days, then the deposit must be closed and repaid. The deposit is considered to be repaid at the end of this 120 day period irrespective of when the physical deposit was repaid. Therefore, the FMD will be considered to be assessable income in the year in which the primary production activity ceased. You are required to inform the financial institution if you cease to be a Primary Producer.

CASE STUDY

Wayne and his wife Allison operate a wheat farm through a partnership. In 2015/2016, Wayne and Allison had a good season which yielded a taxable profit to the partnership of $276,000.

Late in 2015/2016, Wayne and Allison decided to each open a Farm Management Deposit account and set aside $40,000 each from the profit and deposit it with an eligible financial institution.

Please note that this example is intended to show the impact of the FMD only and does not take into account other tax concessions that may be available such as averaging.

The 2015/2016 income tax position for both Wayne and Allison would be as follows:

Share of Partnership profit $138,000

Deduction for FMD $40,000

Taxable Income $98,000

Income Tax and Medicare levy **$26,167**

A marginal income tax rate of 37%.

Had Wayne and Allison not made use of an FMD, they would have each had taxable income of $138,000 and a tax liability of $41,767.

In 2017/2018, the weather conditions were not kind to Wayne and Allison and the partnership profit resulted in $20,000. Wayne and Allison decided to each withdraw the $40,000 from their Farm Management accounts in May 2018 to assist in maintaining the farm equipment for the following season.

Both Wayne and Allison's income tax position for the 2017/2018 would be:

Share of Partnership profit $10,000

Interest paid on FMD (2017/2018) $1,850

FMD withdrawal sum $40,000

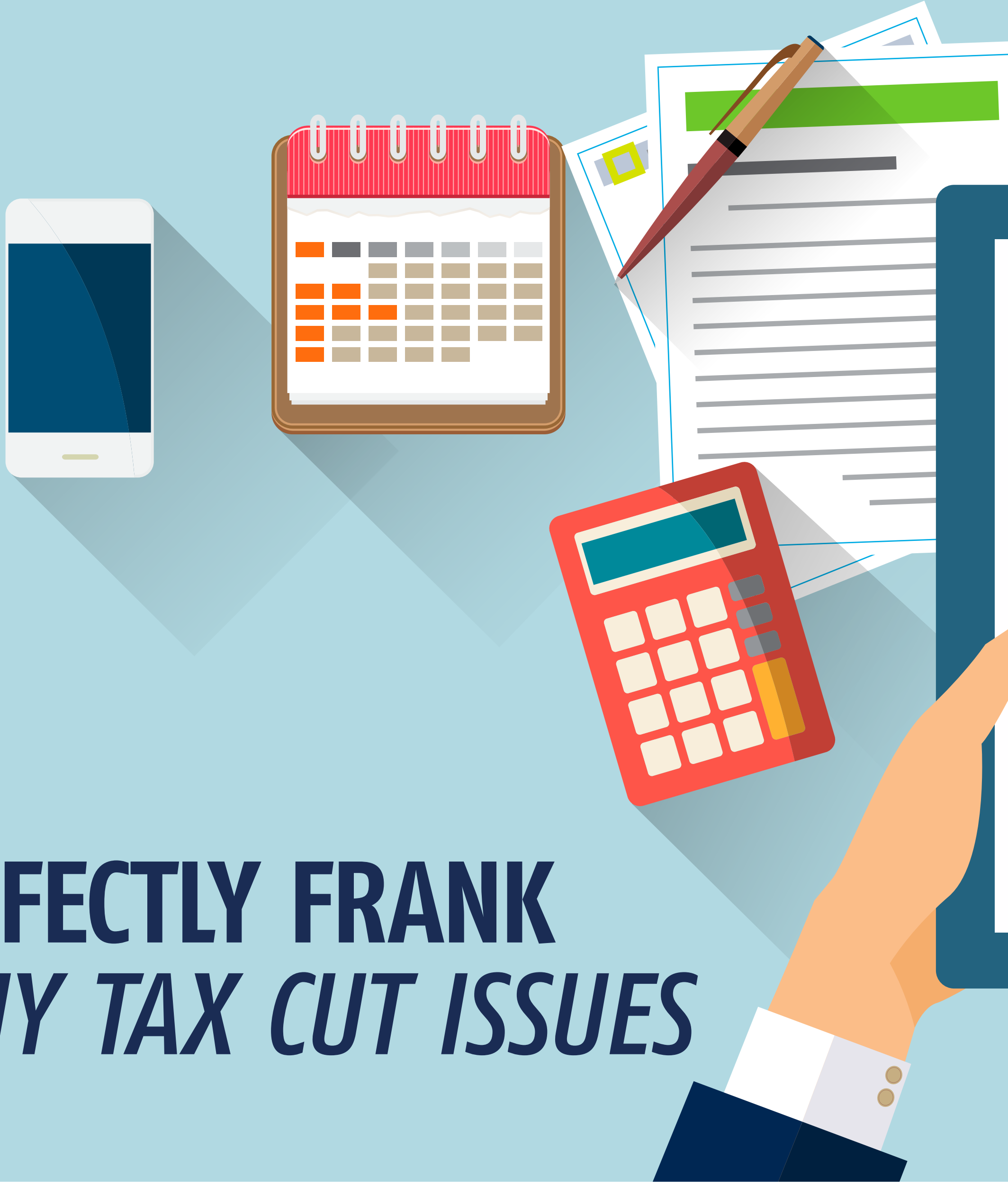
Taxable Income $51,850

Income Tax and Medicare **$9,213**

A marginal income tax rate of 32.5%.

The overall tax saving to Wayne and Allison through the use of the FMD has been $3,600 ($1,800 each) caused by the difference between their marginal rates of tax in the year they made the deposit and the year of withdrawal.

Please note that the use of the Farm Management Deposit scheme should not be considered to be simply a means of saving tax, but rather a means of risk management in order to average income in leaner years.



TO BE PERFECTLY FRANK – *COMPANY TAX CUT ISSUES*

The recent cuts to the company tax rate, have a number of franking credit implications for companies and shareholders alike. This article examines those issues, and advises on the action you may wish to take.

BACKGROUND

On 9 May 2017, the Government passed into law corporate tax cuts. For companies with a turnover less than $50 million, the company tax rate will be progressively reduced to 25%. How quickly this decrease happens depends on a company's level of turnover. Where in the following table your company does not qualify as its turnover is too high, it will be subject to the standard corporate tax rate of 30%:

FINANCIAL YEAR	AGGREGATED TURNOVER LESS THAN	COMPANY TAX RATE
2016/2017	$10 million	27.5%
2017/2018	$25 million	27.5%
2018/2019 to 2023/2024	$50 million	27.5%
2024/2025	$50 million	27%
2025/2026	$50 million	26%
2026/2027 onwards	$50 million	25%

The reductions apply to "corporate tax entities" that are small business entities – that is, corporate tax entities that carry on a business and have an aggregated turnover (including connected entities and affiliates) of less than $10 million. An entity is a corporate tax entity if it is a company, corporate limited partnership, or a public trading trust. As noted in the above table, this tax cut will be extended to other corporate tax entities that are not small businesses progressively.

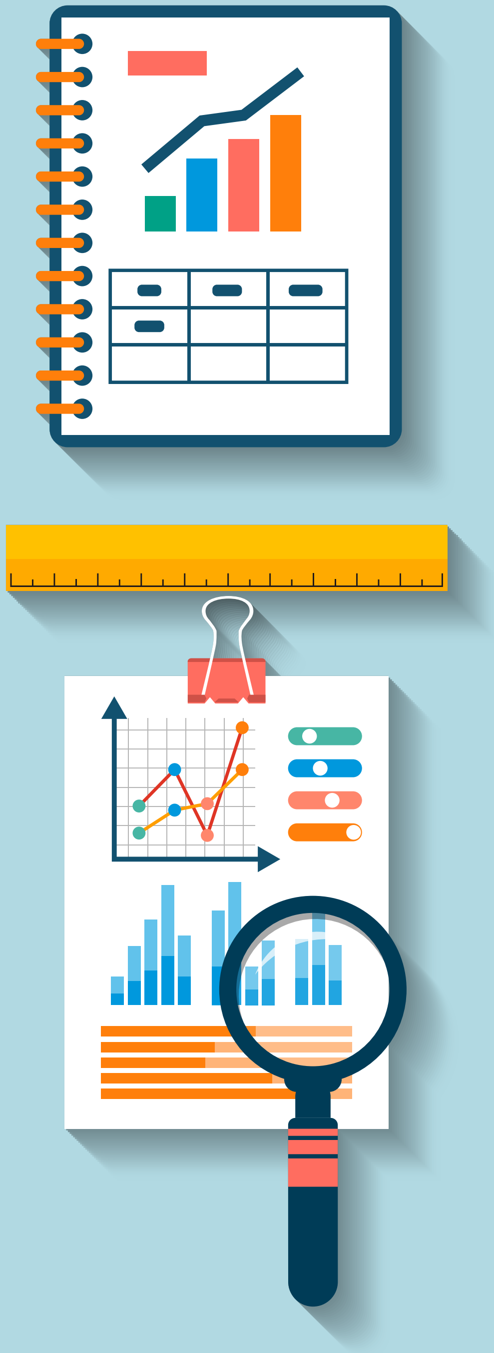
FRANKING CREDIT TREATMENT

A consequence of the new law will be the impact on franking credits. As per the *Explanatory Memorandum* to the legislation, from 2016/2017 the operation of imputation system for corporate tax entities will be based on the company's corporate tax rate for a particular income year, worked out having regard to the entity's aggregated turnover for the previous income year. This is necessary because corporate tax entities usually pay dividends to members for an income year during that income year. However, a corporate tax entity will not know its aggregated turnover for a particular income year (and therefore its corporate tax rate for that income year) until *after* the end of the income year.

This change does not alter the basic operation of the imputation system. Franked dividends paid to shareholders who are domestic shareholders will be grossed up and continue to be ultimately taxed at the shareholder's marginal tax rate with a refundable tax credit for the franking credit .

As a result of this change, for the purposes of applying provisions in the imputation system, corporate tax entities will use the corporate tax rate for imputation purposes. This is generally defined to mean the entity's corporate tax rate for the income year (the current income year), worked out on the assumption that the entity's aggregated turnover for the income year is equal to its aggregated turnover for the previous income year (see following example).

If the corporate tax entity did not exist in the previous income year, the corporate tax rate for imputation purposes will be 27.5%.



EXAMPLE

FROM THE EXPLANATORY MEMORANDUM

In 2015/2016, Company A has an aggregated turnover of $18 million. In 2016/2017, its aggregated turnover increased to $20 million.

Therefore, for 2016/2017, Company A will have:

- A corporate tax rate of 30% (having regard to its aggregated turnover of $20 million in 2016/2017)
- A corporate tax rate for imputation purposes of 30% (based on aggregated turnover of $18 million in 2015/2016), *and*
- A corporate tax gross-up rate of 2.33. That is, (100% - 30%)/30.

As a result, if Company A makes a distribution of $100 in 2016/2017, the maximum franking credit that can be attached to the distribution is $42.86 — that is, $100/2.33.

In 2017/2018, Company A will work out its corporate tax rate for imputation purposes based on its aggregated turnover for 2016/2017 — that is, $20 million. Therefore, for 2017/2018, Company A will have:

- A corporate tax rate for imputation purposes of 27.5%, and
- A corporate tax gross-up rate of 2.64. That is, (100% - 27.5%) / 27.5%.

As a result, if Company A makes a distribution of $100 in 2017/2018, the maximum franking credit that can be attached to the distribution is $37.88 — that is, $100/2.64.

TRAPPED CREDITS

One of the anomalies or downsides of the tax reduction, is that franking credits can be trapped in your company – ultimately resulting in an overall tax increase for the company and its shareholders. This can occur when a company becomes entitled to the lower 27.5% tax rate (because of the increase to the turnover threshold) so they can only frank dividends at 27.5% even if the profits were taxed at 30%. In the absence of the company having some non-taxed income (such as non-portfolio foreign dividends) the trapped franking credits represent a real tax cost for the company's shareholders as it increases the 'top-up tax' that the shareholder will ultimately pay when they receive the amount as a dividend.

SOLUTIONS?

This problem first affected companies with less than $10 million turnover that became entitled to the 27.5% tax rate on 1 July 2016. It then again affected companies on 1 July 2017 where a company has a turnover of less than $25 million. There is now nothing that can be done about these companies that became entitled to the lower 27.5% tax rate on those above dates (unless as stated earlier they have non-taxed income to which the unused franking credits can be applied). Of course, none of this will be a problem if the company intends to keep the funds in the company – however for many family businesses this will not be the case.

Going forward, for companies that will become entitled to the 27.5% rate on 1 July 2018 (i.e. those with a turnover of between $10 million and $25 million) they should consider paying out their 30% taxed retained earnings and current year profits before 1 July 2018. This will enable those companies to frank the dividends at 30% and thus no franking credits will be lost. Bear in mind this "additional" dividend would then be assessable to the shareholders. Thus along with the franking credit it may push their taxable income up to a higher tax bracket. This strategy may not be ideal for all situations and should be discussed with your tax advisor. This is unless of course the company wishes to keep those funds within the company, and this could be necessary if the company has to meet certain lending or licencing criteria.

HELP REPAYMENTS
THE HIDDEN TRAP!

Over the coming months as individuals lodge their 2016/2017 tax returns they may find they have an unexpected bill to pay as a result of their Higher Education Loan Program (HELP, formerly known as HECS) debt. This article informs you of the reasons why this may be the case, and what you can do about it.

THE LOAN

There are a number of loans available from the Australian Government to assist students in further education and training post-school. The most common is the Higher Education Loan Program (HELP, formerly known as HECS) which assists eligible students with their student contribution or tuition fees from either:

- University and other higher education providers
- Approved vocational education and training (VET) providers (a list of which you can find at www.studyassist.gov.au).

COMPULSORY REPAYMENTS

You must commence repaying this loan when your “repayment income” exceeds the following amounts:

REPAYMENT INCOME* 2016/2017	REPAYMENT RATE	REPAYMENT INCOME* 2017/2018
Below $54,869	Nil	Below $55,874
$54,869 – $61,119	4%	$55,874 – $62,238
$61,120 – $67,368	4.5%	$62,239 – $68,602
$67,369 – $70,909	5%	$68,603 – $72,207
$70,910 – $76,222	5.5%	$72,208 – $77,618
$76,223 – $82,550	6%	$77,619 – $84,062
$82,551 – $86,894	6.5%	$84,063 – $88,486
$86,895 – $95,626	7%	$88,487 – $97,377
$95,627 – $101,899	7.5%	$97,378 – $103,765
$101,900 and above	8%	$103,766 and above

**Repayment Income consists of your:*
- *Taxable income plus*
- *Reportable fringe benefits plus*
- *Total net investment loss (which includes rental losses added back) plus*
- *Reportable superannuation contributions plus*
- *Any exempt foreign employment income amounts.*

REPAYING

Compulsory repayments are made through your tax return. That is, when you lodge your return following the conclusion of the financial year, HELP repayments are charged on your notice of assessment (that you receive from the ATO) if your 'repayment income' exceeds the minimum repayment threshold (currently $55,874 – as per the above table). If you are an employee, you can make compulsory repayments through your pay each weekly/fortnightly etc. pay period. This will help to ensure that you do not end up with a large tax bill when you lodge your tax return. To notify your employer, when you commence employment you should tick the 'yes' box on your *TFN Declaration* in answer to the question: do you have a HELP debt? If you have not done this (perhaps you made a mistake initially, or you have later commenced study while working for that same employer), rectify this by completing a *Withholding Declaration* which you can obtain from your employer.

If you did this (i.e. notified your employer) but you still have a tax bill as a result of a HELP liability after having lodged your tax return, this could be for any of the following reasons:

SALARY SACRIFICED SUPERANNUATION

As noted earlier, included in the definition of 'repayment income' is reportable employer superannuation contributions. This includes contributions that you have salary sacrificed to superannuation. When added back in after you lodge your tax return, this can result in a nasty year-end tax bill even though you notified your employer that you have a HELP debt.

EXAMPLE

David is an employee accountant who in 2016/2017 earned $65,000. Nearing retirement, he decided to make provision for his retirement by sacrificing $13,000 of his before-tax salary into superannuation. On this *TFN Declaration* when he commenced his job, David notified his employer that he has a HELP debt, however after he lodged his 2016/2017 tax return he ended up with a tax bill of $2,925 consisting entirely of his HELP liability. David phones the ATO to enquire how this happened.

It is correctly explained to him that because he is salary sacrificing to superannuation, his employer is withholding tax on his post-sacrifice salary ($1,000 per week), not on his gross weekly salary ($1,250 per week). Because the $1,000 is below the minimum threshold for weekly HELP withholding of $1,074 (approximately $54,869 (as per earlier table) divided by 52 weeks) the employer did not, and was not, required to withhold tax towards the HELP liability.

Therefore, because no compulsory HELP repayments were made through David's pay, he must make the compulsory repayment of $2,925 himself from his own savings. As per the earlier table, the repayment rate will be 4.5% ($65,000 x 4.5% = $2,925).

This result should not necessarily deter David – or any other taxpayer in a similar situation – from salary sacrificing to superannuation. Had he not done so, the result overall HELP repayment result will still be the same. That is, David's taxable income would have been $65,000 (instead of $52,000) with $2,925 HELP owing…it's just that his employer would have withheld the amount from David's salary each pay period. Therefore, he would still be paying the $2,925 just in a different way. Getting the amounts withheld directly from your pay however may cause you less cash-flow issues than being billed the amount as a single lump sum after you have lodged your tax return unless of course you put money aside during the year in anticipation of that liability.

FRINGE BENEFITS

If you have been receiving certain non-exempt fringe benefits from your employer throughout the year this may also result in a HELP liability debt following the lodgement of your tax return at year-end. As noted earlier, "reportable fringe benefits" are also included in the 'repayment income' calculation. Reportable fringe benefits are certain non-cash benefits you receive from your employer that must be reported on your Payment Summary. These include: benefits under certain salary sacrificing arrangements (such as sacrificing home loan repayments or repayments for loans taken out to acquire other non-income producing assets), a home phone, use of a car, school fees for your children, health insurance premiums, childcare fees etc. Note that the following fringe benefits you may receive are not reportable on your Payment Summary:

- Car parking fringe benefits
- Remote area housing assistance, home ownership schemes, and repurchase schemes

- If you live in a remote area, costs of occasional travel to a major Australian population centre
- Benefits you receive to ensure your security and personal safety because of your job
- Emergency or other essential health care you receive as an Australian citizen or permanent resident while you are working outside Australia and you cannot claim a Medicare benefit
- Certain benefits provided to you if you are a defence force member or a police officer
- Car benefits coming from your private use of pooled or shared cars.

Even though a reportable fringe benefits amount must be included on an employee's payment summary, it is not included in their assessable income. It is however not only added back to your repayment income but also used to assess an employee's eligibility for transfer payments and other tax concessions as well as an employer's liability to certain levies and surcharges such as:

- Medicare levy surcharge
- Spouse superannuation contributions tax offset
- Superannuation co-contribution
- Child support obligations, and
- Entitlement to certain income-tested Government benefits.

WARNING

Benefits provided to employees by the following employers are exempt from FBT subject to certain conditions including where the grossed-up taxable value is less than either $17,000 or $30,000:

- Registered public benevolent institutions
- Government bodies employing hospital staff
- Public hospitals and ambulance services
- Non-profit hospitals, and
- Registered health promotion charities.

Even though the employer (if certain conditions are met) will not be required to pay FBT, the benefits received by the employee are still reported on their Payment Summary; even where the amounts are below the $17,000 or $30,000 exemption threshold. This will then contribute to any HELP liability that may accrue to the employee when they lodge their tax return.

EXAMPLE

Caitlin is a nurse who is employed by a non-profit hospital. Throughout the year she has been salary sacrificing some of her home loan repayments, and accordingly at year-end has $16,000 of grossed-up fringe benefits. Although this is below the $17,000 exemption threshold for non-profit hospitals (and therefore her employer will not pay FBT), the amount is still reported on her Payment Summary.

Along with her taxable income, assume this takes Caitlin's repayment income amount to $65,000 for 2017/2018; resulting in a HELP liability of $2,925 ($65,000 x 4.5%). As her assessable income was below the minimum HELP repayment threshold of $55,874, Caitlin's employer was not withholding HELP repayments from her salary during the year each pay period. Therefore, Caitlin will need to repay the HELP amount out of her own savings.

This result by itself is no reason for Caitlin to opt out of salary packaging this fringe benefit. If she were to receive the benefit instead as increased salary, it would take her taxable income over the repayment threshold, and thus trigger a HELP liability in any case.

TOTAL NET INVESTMENT LOSS

Also included in 'repayment income' are total net investment losses. In simple terms, this is any overall net loss you make from financial investments in items such as shares and real property. For example, if you owned two rental properties, and:

- Rental income on the first property exceeded deductible expenses (e.g. interest on the loan, rates, repairs etc.) by $800
- Deductible expenses on the second property exceeded rental income by $1,000

Then you would have a total net investment loss of $200. This would then be added back and form part of your 'repayment income'.

SOLUTION

If you are an employee, and because of any of the earlier listed reasons you anticipate that the tax withheld by your employer each pay period may not make full provision for your HELP liability for example you are anticipating that during the year you will:

- Salary sacrifice to superannuation
- Have reportable fringe benefits
- Have a total net investment loss
- Have other taxable income (such as capital gains etc.)

...what can you do avoid getting a large bill at Tax Time? As an employee you can arrange an upward variation of the tax withheld for your salary by entering into an agreement with your employer to vary the rate or amount of withholding. Your request should be in writing, but can be in any format. You can send an email request; or you can use a paper or computer-based form. Working out the extra amount to withhold to make provision for your anticipated HELP liability can be complex, and advice should be sought from your Accountant.

Remember, the total HELP repayment will not change as it is a set percentage of your Repayment Income. It is a cash-flow decision; do you increase your PAYG withholding so there is a little less in your pocket each pay period? Or do you pay one lump sum when the ATO issue your annual Income Tax Assessment?

SIMPLER BAS NOW HERE!

Over the coming weeks, simplified Business Activity Statements will be completed for the first time by many GST-registered businesses. This article examines this new regime, and offers some handy hints.

WHAT IS IT?

Simpler BAS is a Government attempt to simplify GST reporting, and has come about following consultation with tax practitioners and small business. It involves a reduction in the number labels on the BAS itself. Under *Simpler BAS*, eligible businesses now only need to report the following information on their BAS:

- GST on sales (label **1A**)
- GST on purchases (**1B**)
- Total sales (**G1**).

Eligible businesses are no longer required to report Export Sales **(G2)**, Other GST-Free Sales **(G3)**, Capital Purchases **(G10)**, and Non-Capital Purchases **(G11)**. These labels are removed from the BAS altogether. Note that *Simpler BAS* does not affect how you report other taxes such as PAYG Income Tax Instalments or PAYG Withholding. Only GST reporting will change.

ELIGIBILITY

From 1 July 2017, all Small Business Entities (SBEs) including sole traders carrying on a business are eligible for the new *Simpler BAS*. SBE's are defined as businesses with a GST turnover of less than $10 million; including the turnover of connected entities and affiliates. If you or your business meets these eligibility criteria, *Simpler BAS* is compulsory – you do not have a choice to opt out. *Simpler BAS* does not impact your GST reporting cycle (monthly, quarterly or annual). Therefore, if you reported quarterly in the past, you will continue to do so.

Note that although the start date is 1 July 2017, new businesses that have come into existence since 19 January 2017, who are SBEs, have been using *Simpler BAS* since that date.

To summarise, your business's turnover now determines your GST reporting method as follows:

- If your GST turnover is $10 million or more, you report GST using the full reporting method (with all GST labels on the BAS)
- If your GST turnover is less than $10 million, you report GST using the *Simpler BAS* reporting method
- If your GST turnover is less than $10 million and you currently use the GST instalment method (see later for what this is) you generally continue to use it. If the Instalment method is available to your business, a GST Instalment amount will shown on your BAS.

If your GST turnover changes and you reach $10 million or more, you should phone the ATO on **132 866** to update your turnover (or your Accountant should on your behalf). The ATO will then move you out of the *Simpler BAS* regime from the commencement of the following financial year. On the other hand, if your turnover falls below $10 million you should contact the ATO on the same phone number to inform them. The ATO will then either:

- Move you to *Simpler BAS* from the start of your next reporting period (e.g. month, quarter), or
- Move you to GST Instalment reporting if you are eligible and elect to use it (quarterly reporters only). The start date will depend on when you make your election to use it.

TAX TIP

Your business may be eligible for the GST Instalment reporting method. This is where the ATO automatically calculates your business's GST liability for you and prints it on your BAS. You simply then pay the pre-printed amount and are not required to calculate your GST liability or complete the labels on the BAS. As such, the GST Instalment reporting method is the ultimate simplification of GST reporting. You will generally be eligible for GST Instalment reporting where all of the following conditions are met by your business:

- It is an SBE (see earlier)
- It has lodged a BAS for at least two quarters, or for four months if you have previously lodged monthly, and
- It has not been in an overall GST refund position for the previous financial year.

Because of the increased SBE turnover threshold (now $10 million) thousands more businesses will be eligible for GST Instalment reporting. If your business is eligible, the ATO will notify you on your first quarterly BAS (July-September) of the financial year. To take up the option, you must elect to do so on that BAS.

Remember, if electing to use the GST Instalment reporting method the SBE will then be required to lodge an Annual GST Return for the year. This return will also contain the simpler reporting labels.

PREPARATION

Although *Simpler BAS* is quite a big change to GST reporting, in practice you do not need to do anything to prepare for it. If you lodge your BAS electronically (e.g. via the ATO's Business Portal) the ATO will automatically generate the *Simpler BAS* for you to complete (requiring less GST information).

On the other hand, if you lodge paper BAS and are eligible for *Simpler BAS* you only need to complete **G1, 1A** and **1B.**

ACCOUNTING SOFTWARE

The major accounting software companies have been working closely with the ATO to make it easier to classify sales and purchases for GST under *Simpler BAS*. The software companies are taking a variety of approaches with this new regime – some are changing GST tax codes to mirror the three remaining labels (i.e. tax codes of GST on Sales, GST on Purchases, and Total Sales) and allowing you to opt into these labels. Other software providers are leaving their tax codes unchanged. Your software provider may contact you – or if not you can contact them – to advise of any changes (if any) under *Simpler BAS* and how to use the new system.

If your Bookkeeper or Accountant enters your transactions into the software file, you may wish to discuss *Simpler BAS* with them.

BENEFITS

The ATO states that the benefits of *Simpler BAS* are as follows:

> *It reduces the complexity of GST bookkeeping and reporting, and in doing so reduces compliance costs, GST account set-up, ongoing bookkeeping, and BAS preparation and lodgement is simpler. Simpler BAS makes it easier for businesses to do their bookkeeping for transactions that have both GST taxable and non-taxable items.*
>
> *For users of accounting software, it is easier to classify and code GST transactions and prepare and lodge the BAS. Simpler BAS helps you with your GST bookkeeping:*
>
> » *There are fewer complex GST transaction codes, and your bookkeeping moves closer to a simple question of 'does it have GST or not'?*
>
> » *Purchases with both GST taxable and non-taxable items are easier to capture as a single bookkeeping entry*
>
> » *Set-up of accounting software and automation options is simpler.*

However, others within the tax and accounting industries argue that the benefits of *Simpler BAS* may be somewhat overstated. This is because you are still required to determine the status of each transaction – is it GST-free, input taxed, or taxable? That there are now only three labels to report on the BAS does not itself change the complex GST law that sits behind each label. Therefore, it is argued that the time and administration savings may be overstated.

LESS RIGOUR?

With only three labels now on the BAS, there are arguably now less 'checks and balances' when calculating a business's GST liability. This may be of concern to some business. However, understand that *Simpler BAS* is only an ATO reporting mechanism. You can still use the same rigour and processes that you have always used when calculating your GST liability – for instance, still complete the *GST Calculation Worksheet* (with all of the attendant labels) and also use all of the GST codes within your software system that you have always used – it's just that ATO reporting mechanism (the BAS) is now different. The take-home message is that you do not need to reduce your 'checks and balances' when calculating your GST liability if you do not wish to do so.

TAX TIPS

This article details a range of tax tips. Areas covered include: your entitlement to ongoing deductions after your business ceases, undertaking property development within your SMSF, Shareholder and Partnership agreements, and more.

DEDUCTIONS AFTER BUSINESS CEASES

It's sometimes the case that after a business has ceased operating, the business owners themselves will still have liabilities to discharge such as loans, rent payable under lease agreements etc.. The good news is that where an expense arising from a business carried on in a prior income year, is paid in a subsequent income year, it may be deductible in the subsequent year even though the business may have ceased operating. This is provided that the expense was directed towards generating assessable income in the first place.

This general principle has been applied to certain legal expenses incurred in a subsequent year, and also the following expenses and payments.

INTEREST

In *Jones v Federal Commissioner of Taxation 2002 ATC 4135* interest on a loan taken out to purchase business equipment for a Partnership was deductible by the individual Partners when paid in subsequent years following the cessation of the business. This then reduced their tax payable on other income (such as salary and wages) in subsequent years.

The ATO in *Taxation Ruling TR 2004/4* confirmed the deductibility of interest in these circumstances and even where the original loan is refinanced. However, this is subject to one caveat! Generally, no deduction is available if the loan is deliberately kept on foot (not repaid) for taxation or commercial advantage. Therefore, where you have the capacity to pay out the loan but make a conscious decision not to do so, the ATO may deny you a deduction after your business has ceased.

LEASE EXPENSES

Where a business closes, it is sometimes the case that it will do so prior to the expiration of leases (for example, it may have run into financial strife). In the ATO's Interpretative Decision *ATO ID 2002/1091* the ATO give the 'green light' to a subsequent year deduction after the business has ceased operating. In this ATO ID, an individual was operating a business and entered into a fixed-term lease agreement for their business premises. After the business had ceased, they couldn't afford to pay the outstanding rent immediately, and instead paid it out in a subsequent income year. The ATO held that the expense was deductible by the taxpayer in the subsequent income year when paid, as the taxpayer was definitely committed to this recurring expense (i.e. they had signed a lease agreement).

GUARANTEE PAYMENTS

Payments made pursuant to a personal guarantee are also deductible in subsequent years as confirmed by the Administrative Appeals Tribunal (AAT) in *Evenden v Federal Commissioner of Taxation [1999] AATA 731.* To establish a business, the Partners in a Partnership entered into leasing agreements for equipment, borrowed money, gave personal guarantees and mortgaged their home. In the course of its business, it leased assets including a motor vehicle in respect of which the Partners were required to give personal guarantees. Upon the business ceasing trading in mid-1991, the leased assets had been returned to the lessors, and demands were made for amounts outstanding to be settled under the personal guarantees that were given. These guarantee amounts were deductible even in subsequent income years when the business was no longer operational.

PROPERTY DEVELOPMENT AND SMSFS

While some SMSFs invest in property and seek to achieve a steady long-term gain, others take a more active role, seeking to improve the property to make a short-term and hopefully more substantial gain. If you are seeking to do the latter (i.e. property development) the good news is that **(a)** there is nothing in the superannuation legislation that prohibits this and **(b)** from a taxation perspective, SMSFs are the ideal vehicles in which to do it (as opposed to companies etc.). The ATO state *"Self-managed super funds (SMSFs) are not prohibited from carrying on a business, but the business must be allowed under the trust deed and operated for the sole purpose of providing retirement benefits for fund members."* The ATO will look closely at a SMSF carrying on a property development to ensure the sole purpose test is not breached. and the SMSF is following its investment strategy and is being conducted on a commercial arm's-length basis.

In undertaking this strategy there are a number of rules that must be complied with as follows:

BORROWINGS

It's not uncommon for SMSFs that acquire property to do so under a Limited Recourse Borrowing Arrangement (LRBA). This is the only form of borrowing permitted under the superannuation laws. Under an LRBA, the SMSF Trustee takes out a loan from a third-party lender and then uses those borrowed funds to purchase a single asset (or a collection of identical assets that have the same market value) to be held in a separate holding Trust. Any investment returns such as rent go to the SMSF. If the loan defaults, the lender's rights are limited to the asset held in that Trust. When the loan is paid out, the property is transferred to the SMSF.

While LRBAs are useful for acquiring property in the event that the SMSF has insufficient funds, LRBAs are a barrier to property development. An SMSF is prohibited from improving, developing, or subdividing property during the time that an LRBA remains on foot. Thus, in order to commence developing a property in your SMSF, you will need to have paid out the LRBA (perhaps with non-concessional contributions being made by members) or the SMSF will need to have acquired the property outright using its own cash reserves.

CASE STUDY

Gerry and Barb are 55 and have an SMSF which is in accumulation mode. They both work full-time and earn $90,000 per year each. For taxation and asset protection reasons, they decide to purchase vacant land through their SMSF for $600,000 using existing SMSF funds.

Following the purchase, the SMSF has $400,000 remaining. In order to undertake a property development, Gerry and Barb each make contributions of $250,000 using their 3-year non-concessional bring forward cap, which takes the total SMSF funds to $900,000.

The SMSF then engages third-party builders to construct three townhouses for a total cost of $800,000. The development is completed 18 months later, and the couple proceed to rent the townhouses to unrelated parties for $700 each per week. Total net rental income for the financial year is $109,200. The tax payable by the SMSF is on this income is $16,380.

Company

By contrast, if this investment was undertaken through a company structure the tax payable on the rental income would be $30,030 (assuming taxable at the new SBE 27.5% rate). Furthermore, when the properties are sold, no 50% CGT discount would be available and 27.5% tax would be payable on the gain.

Later

Five years later Gerry and Barb are both retired and are in receipt of Account-Based pensions from their SMSF. As the SMSF is now in pension mode, the $109,200 rental income is tax-free.

If the townhouses should later be sold, any capital gain will be tax-free if the SMSF is still in pension mode.

SHAREHOLDER AND PARTNERSHIP AGREEMENTS

There are three broad options to choose from when taking on a business partner: Partnership, Unit Trust or Company. A Discretionary Trust may also work if your business partner is your life partner (but for the sake of this article, we will assume this is not the case).

One of the most important relationships you will ever have is with your business partner(s), thus it is very important that you have consensus with your fellow business partner(s) and that you have this documented. In the case of a Partnership, this will be a Partnership Agreement. With a Company, it will be a Shareholders Agreement. Such an agreement can (and should) be largely bespoke and cover off on those issues that are important to you but typically include entry and exit, remuneration, decision making, valuation etc. A Solicitor will arrange such an agreement for you.

To get started however, you should take the time to sit down with your prospective Partner(s) and build your own Heads Of Agreement. You may even ask a colleague or mentor for their thoughts (ideally someone who knows you) who may also have some valuable suggestions. The Heads of Agreement is a good place to record the principles and working arrangements that you have fundamentally agreed between yourselves. Forget the legalese at this point; your Solicitor will craft these clauses for you. Your Heads of Agreement will do two important things:

1. It will bring to the surface those things that might have been assumed between you as future partners and give you a chance to discuss them up front and gain consensus (better this happens before you start), and
2. Will serve as a useful guide to your Solicitor about the issues that you want to enshrine in your Partnership/Shareholders agreement.

The good news is that professional advice and services from your Accountant or Solicitor in respect of Shareholder Agreements or Partnership Agreements at the time you commence your business is now tax deductible in the year the expense is incurred if your business is a Small Business Entity (generally a turnover of less than $10 million).

DEPRECIATION FOR NON-BUSINESS TAXPAYERS

For individuals not in business, who are preparing their tax return over the coming months, depreciable items you acquire for work purposes can in certain circumstances be claimed outright. This means you get an immediate deduction for the cost of the asset to the extent that you use it to generate assessable income during the income year.

The immediate deduction is available when you start to hold a depreciating asset in an income year and the asset costs $300 or less, and:

- Is used predominantly for the purpose of producing assessable income that is not derived from carrying on a business
- Is not part of a set of assets you start to hold in that year that costs more than $300, and
- Is not one of a number of identical or substantially identical assets acquired in the same year that together cost more than $300.

Examples of depreciating assets which could be eligible for the immediate deduction are:

- Tools of trade acquired by a tradesman
- A briefcase purchased by a salary and wage earner for their job; and
- Furniture purchased for a rental property.

TAX TIME

Speaking of individual tax returns, with Tax Time now in full swing, we offer the following advice.

- If you are self-preparing your return, it is due on 31 October 2017. If you are lodging using a Tax Agent (Accountant) you must be on their lodgement list by this date.
- If you have relatively simple tax affairs, you may wish to consider lodging and preparing your return yourself via ***MyTax***. The ATO describes this lodgement method as the quick, easy, safe and secure way to prepare and lodge your tax return online. ***MyTax*** is web-based, so you do not need to download anything and you can lodge on a range of devices – computer, smartphone or tablet. ***MyTax*** pre-fills information provided to the ATO by your employer, banks, and Government agencies; making it easier to complete your tax return.
- With the ATO's crackdown on work-related expenses this year, ensure you are able to substantiate deductions that you claim on your tax return with receipts and other documentation (subject to the exceptions listed on pages 22 - 23).
- In terms of changes on the individual tax return:

Small Business Income Tax Offset – Eligibility for this offset has changed. If in 2016/2017 you were carrying on a business as a sole trader or you received income from a Partnership or Trust… and that entity had a turnover of less than $5 million (up from $2 million) you may be eligible for the Small Business Income Tax Offset. While the ATO will work out your offset for you, in order to do so, you must record on your tax return your Net Small Business Income that you earned as a sole trader, and/or your share of Net Small Business Income from a Partnership or Trust. Therefore, you must complete label **15** on the tax return.

Working Holiday Maker – From 1 January 2017, working holiday makers on a 417 or 462 visa must pay 15% tax on working holiday income up to $37,000. Their remaining income is taxed according to their residency status. If you held this class of Visa in 2016/2017, you will need to inform the ATO of this on your tax return at label **1**.

HIGH ALERT:

WORK-RELATED EXPENSE CLAIMS

In a July 2017 speech to the National Press Club, the Commissioner of Taxation Mr. Chris Jordan flagged a crackdown/focus on work-related expense claims by individuals. In this first of a series of articles, we focus on the substantiation exceptions to the claiming of work-related expenses. When can you as an employee or individual contractor claim expenses without documentation?

LAUNDRY EXPENSES

Individuals can claim the cost of washing, drying, and ironing eligible work clothes or having them dry-cleaned. To claim these expenses, you must have written evidence (such as diary entries and receipts) for your laundry expenses if both of the following conditions are met:

- The amount of your claim is greater than $150, and
- Your total claim for work-related expenses exceeds $300 – not including car, meal allowance, award transport payments allowance and travel allowance expenses.

If in view of the above conditions if you do not need to provide written evidence for your laundry expenses, you may use a reasonable basis to work out your claim. For washing, drying and ironing that you do yourself, the ATO considers that a reasonable basis for working out your laundry claim is:

- $1 per load (this includes washing, drying and ironing) if the load is made up of work-related clothing, and
- 50 cents per load if other laundry items are included.

In terms of making the claim, as the Commissioner noted in his Press Club speech:

In 2014/2015, more than 6.3 million people made claims against clothing expenses totalling almost $1.8 billion. While many of these claims would be legitimate, I wonder how many people have assumed that they can just claim $150 regardless of whether or not they have spent that amount on the required items.

The key points are that you must have actually outlaid the laundry expenses – claiming up to $150 for money you have not outlaid in this area is against the law. Secondly, even where you have expended this amount, it must be in respect of work-related clothing. For tax deductibility purposes, "work-related clothing" must fall into one of the following three categories:

1. OCCUPATION-SPECIFIC CLOTHING

While you can claim a deduction for clothing (and the accompanying laundry expenses) that is specific to your occupation, it must allow the public to easily recognise your occupation and must not be everyday clothing. Consequently, for example, while a barrister is entitled to claim their robes and wig (as they are distinctive and unique to the legal profession) they are not entitled to claim their black suit pants or business shirt. The pants and business shirt while expected to be worn in court, are not distinctive to legal practitioners and are worn in many occupations and more broadly in non-work-related settings such as when going out to restaurants etc. Other examples of occupation-specific clothing include a nurse's traditional uniform (e.g. cap, white uniform), or a Chef's chequered pants.

2. PROTECTIVE CLOTHING

Clothing and footwear worn to protect yourself from illness and injury that you may be exposed to in your job may be deductible (as well as the accompanying laundry expenses). To be considered 'protective' (and therefore potentially deductible) the items must provide an adequate degree of protection against the risk that is faced. Examples include steel-cap boots, safety glasses / googles, fire-resistant clothing, breathing masks, safety-coloured vests, rubber boots for a concreter, hard-hat etc.

Ordinary clothing that lacks the protective characteristics designed for the risks of your particular job (such as ordinary closed shoes, jeans, socks etc.) is not deductible.

It is worth noting here the ATO include in the protective clothing category claims for sun protection clothing, sun-hats, sunglasses and sunscreen for those employees required to work outdoors in the sun. You can also claim the cost of renting, repairing, and cleaning the protective items.

3. WORK UNIFORMS

Compulsory uniforms (non-conventional

clothing that you are compelled to wear by your employer) such as those worn by police or commercial pilots is deductible. The ATO defines a deductible uniform as a collection of inter-related items of clothing and accessories that is distinctive to a particular occupation or organisation. An employer must have a uniform policy that is enforced.

Non-compulsory uniforms cannot be deducted unless the design of the uniform is entered on the *Register of Approved Occupational Clothing* at the time you incur the expense. The Register is maintained by the Industry Secretary who can only register a design if it meets certain criteria. Your employer is responsible for applying for the registration of their design. Such registered uniforms can also be deducted where they are compulsory.

CENTS PER KILOMETRE MOTOR VEHICLE EXPENSES

Under this method of your car expenses, employees and contractors claim an ATO-set number of cents per kilometres travelled (currently 66 cents) up to a maximum of 5,000 kilometres. The advantage of this method is very little record keeping is required. You do not need any documentary evidence in the way of recepts or log-books etc. However, you do need to be able explain how you arrived at your calculation. For example, you may explain that you are required to travel between different work branches three times each week…and then be required to provide the address of those branches. Also be aware that where your claim is unusually high for your industry or higher than you have claimed in previous years, it will likely attract ATO attention when you lodge your return. Where this is the case, the ATO often contacts employers (before they even contact you) to verify that you have throughout the year been required to undertake significant deductible work-related motor vehicle travel. So be careful not to overestimate your claim.

Even where you travel over 5,000 kilometres, you may still prefer to use the Cents per Kilometre method (and save the hassle on the record-keeping requirements that may be required under the Log-Book method) by capping your claim at 5,000 kilometres. In summary, the Cents per Kilometre method is ideal for those who:

- Have travelled less than 5,000 business kilometres
- Have older vehicles (therefore depreciation and interest costs are low)
- Have not kept, or do not wish to keep, records of expenses or kilometres travelled.

TAX TIPS

- The Cents per Kilometre method is a per-car claim. If you have changed vehicles during the year, nothing stops you from claiming up to 5,000 kilometres for each of the vehicles.
- Considering the price of fuel (and also all the other expenses in operating a motor vehicle) the maximum rate available under this method (currently 66 cents per kilometre) is not particularly generous.
- Where a vehicle is jointly owned by two taxpayers who both use the vehicle for business purposes, each person can make a claim of up to 5,000 kilometres for the same vehicle.

$300 GENERAL DEDUCTION

The general rule is that where you are claiming work-related deductions of more than $300, you must be able to substantiate your claims for deductions with written evidence (e.g. receipts). The records must substantiate the entirety of your claim (not just the amount over $300). This $300 threshold does not include:

- Car and meal allowance expenses
- Travel allowance expenses, or
- Award transport payments allowance expenses.

If less than $300 you will not need written evidence but you may be called upon by the ATO to prove that you did incur the expense. Claiming $290 (or any amount under $300) as a work-related expense in circumstances where no expense has actually been incurred is illegal and may land you in trouble with the ATO.

TAKE-HOME MESSAGE

The above is not intended to scare employees and contractors out of fear into reducing legitimate claims for work- related expenses they have incurred up to the above limits without receipts. If you are genuinely entitled to a tax deduction under the above rules you should claim it in full. However, although documentation may not be required, you must have incurred the expense, and you may very well be required (or your employer may be contacted and be required) to explain the basis of your calculation.

If there is doubt, individuals should seek advice from their Accountant.