bO2 Corporate Essentials

Tax Smart Australia

Issue
#0107

Tax Essentials

Tax Effective Shares & Property Investment

OCTOBER	2020

THE NEWSLETTER

Recent Tax Developments

MICHAEL'S CORNER

Fair Work Act 2009 Changes and What Has Not Changed...?

Article No. 007

SPECIAL BONUS ISSUE

Tax Effective Shares & Property Investment

ANOTHER ESSENTIAL TAX SMART AUSTRALIA RESOURCE · CLARITY · CONVENIENCE · CONFIDENCE ·

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The Newsletter

RECENT TAX DEVELOPMENTS

AMENDMENTS TO FAIR WORK ACT UNDER JOBKEEPER 2.0

As part of the Federal Government's Coronavirus Economic Response Package (JobKeeper Payments) Amendment Bill 2020, new amendments have been made to the Fair Work Act 2009.

This creates two tiers of employers: -

- Employers who meet (or continue to meet) the criteria to receive JobKeeper payments after 28 September 2020 (Qualifying Employers); and
- Employers who previously met the criteria under 'JobKeeper 1.0' to access JobKeeper payments, but who do not quality for such payments after 28 September 2020 (Legacy Employers).

For Qualifying Employers, the proposed amendments generally extend the existing rights and obligations that were available under 'JobKeeper 1.0' in relation to employees who receive JobKeeper payments (Eligible Employers), for the period until 29 March 2021 (with only minor modifications).

The general payment obligations for Qualifying Employers continue to apply, including that such employers much satisfy the 'wage condition' and must meet the 'minimum payment guarantee' for each Eligible Employee.

The new provisions for Legacy Employers stipulate they must hold a valid '10 percent decline in turnover certificate' (Deadline in Turnover Certificate), in order to be eligible to issue or seek JobKeeper enabling directions or agreements, at a particular time.

To hold this certificate, a Legacy Employer must satisfy the '10 percent decline in turnover test' for a quarter (relevantly, the 3-month periods ending on 30 June, 30 September, and 31 December). While adopting the definition used in the JobKeeper Rules, this test only requires a 10 percent reduction of projected GST turnover for the relevant period. Decline in Turnover Certificates must be issued: -

- By an 'eligible financial service provider' (such as registered auditor, tax agent or accountant) who is not associated with the Legacy Employer (unless the Legacy Employer is a small business employer under the FW Act, in which case statutory declaration can be made for the Legacy Employer); and
- For each relevant quarter. New Decline in Turnover Certificates are required to subsequent quarters.

There will be significant penalties for Legacy Employers who purport to give a JobKeeper enabling direction, if they do not satisfy the 10 percent decline in turnover test at the time the direction was given, and the Legacy Employer knew or was reckless to that fact. Penalties also apply for providing false or misleading information to an eligible financial service provider, for the purpose of obtaining a Decline in Turnover Certificate.

In addition, the Federal Court will have powers to terminate a JobKeeper enabling direction or agreement, if a Legacy Employer who holds a Decline in Turnover Certificate did not in fact satisfy the 10 percent decline in turnover test, at the particular time that the direction was issued or agreement was made.

JobKeeper enabling directions

- Eligible Legacy Employers will be able to issue or seek certain JobKeeper enabling directions or agreements, however these will be in more limited form than for Qualifying Employers and subject to additional conditions. Employers should take advice in the key differences between the JobKeeper enabling directions available to Qualifying Employers and Legacy Employers.

COVID-19 AND CAR FRINGE BENEFITS

This ATO guidance is on determining how your FBT obligations relating to work cars may be impacted by the COVID-19 pandemic, and how to calculate your FBT liability.

Key points

- Your fringe benefits tax (FBT) obligations may be affected if your employees have been garaging work cars at their homes due to the impacts of COVID-19.
- Where a car is not being driven at all, or is only being driven for maintenance purposes, it is accepted that you are not holding the car for the purposes of providing fringe benefits. If you elect to use the operating cost method, and maintain appropriate records, you may not have an FBT liability for a car.

- Certain kinds of cars may also be exempt from FBT even where they are garaged at employee homes.
- If an exemption does not apply and a work car is garaged at your employee's home, it will be deemed to be available for private use and you may have an FBT liability.
- You can take into account the impact of COVID-19 on the business use of a car if it is being driven during the period it is garaged at home. This will require you to maintain a logbook (or to have kept a logbook in any of the previous four years) which will enable you to calculate your FBT liability.
- Your logbook-keeping requirements will depend on whether you are already maintaining an existing logbook for the year.
- For any car fringe benefits calculated using the operating cost method, you may adjust your business use estimates to reflect changes in your employees' driving patterns due to COVID-19.

Garaging a car at an employee's home

Generally, a car fringe benefit will arise where you make a car you own or lease available for the private use of an employee. Where your employee is garaging a work car at home, you may be providing them with a car fringe benefit.

For FBT purposes, a car is a motor vehicle (except a motorcycle or similar vehicle) designed to carry a load of less than one tonne and fewer than nine passengers.

If an exemption does not apply, you need to determine the taxable value of the car fringe benefit. It is calculated using either the: -

- **statutory formula method** - the taxable value is a set formula based on the car's cost price
- **operating cost method** - the taxable value is based on the operating costs of the car, reduced by any business use.

Exemption for certain car benefits

In some cases, the use of a car is exempt from FBT. An employee's private use of a taxi, panel van, or utility vehicle designed to carry less than one tonne is exempt from FBT if its private use is limited to: -

- travel between home and work
- incidental travel in the course of performing employment-related travel; and/or
- non-work-related use that is minor, infrequent, and irregular (such as occasional use of the vehicle to remove domestic rubbish).

If a home-garaged car is not being driven

Where a car has not been driven at all during the period it has been garaged at home, or has only been driven briefly for the purpose of maintaining the car, it will be accepted that you don't hold the car for the purpose of providing fringe benefits to your employee.

In these situations, provided you elect to use the operating cost method, there will be a nil taxable value for the car and no FBT liability. You need to elect to use the operating cost method in writing before you lodge your FBT return for the year. You should maintain odometer records to show that, during the period the car is garaged, it has not been driven, or has only been driven briefly for the purposes of maintaining the car.

If you do not elect to use the operating cost method, or do not have odometer records, the statutory formula method applies, and you will have an FBT liability for the year. This is because the car is garaged at the employee's home and is taken to be available for private use.

If a home-garaged car is being driven

If an employee is driving a car for business purposes, and you elect to use the operating cost method, you may be able to reduce the taxable value of the car fringe benefit to take into account this business use. This may include reducing the taxable value to nil if the car is only being used for business travel.

You will only be able to reduce the taxable value if you have logbook records and odometer records for the period in question. If you have not previously maintained a logbook for the car, the logbook will need to be for at least: -

- 12 continuous weeks; or
- until the car stops being garaged at home if this is less than 12 weeks.

Logbook requirements for car fringe benefits

Your logbook requirements will vary depending on whether: -

- you already use the operating cost method and have an existing logbook in place; or
- it is your first time electing to use the operating cost method or it is a logbook year for you.

Generally, if you have used a logbook for the car before, it will be a logbook year if you have not kept a logbook for the car in the previous four years.

If COVID-19 has impacted driving patterns and you have an existing logbook

Where you are already using the operating cost method, you may have an existing logbook in place. You can still rely on this logbook, despite changes in driving patterns due to COVID-19. You must keep odometer records for the year, and these will show how much the car has been driven during the year, including any lockdown period.

You need to make a reasonable estimate of the percentage of business use of the car, taking into account logbooks, odometer records and any changes in the pattern of business use throughout the year, including changes due to COVID-19.

Where your driving patterns and business-use percentage are impacted by COVID-19, you can choose to keep a new logbook provided that the period is representative of your usage throughout the year. This is so, even if it is not a logbook year. This may provide a more accurate base to estimate the business use of the car.

Example 1 - FBT year ended 31 March 2020 - new logbook not kept

An employer uses the operating cost method to value their car fringe benefits. They kept a logbook in the FBT year ended 31 March 2018.

For the FBT year ended 31 March 2020, there is no requirement for the employer to keep a new logbook.

The employees' driving patterns were not impacted significantly by COVID-19 across the 2020 FBT year, with any impact occurring in March 2020, so the employer decides not to keep a new logbook.

They use the existing logbook, odometer records, employee fuel card records, plus client records to estimate the business use percentage for the year.

Example 2 - FBT year ended 31 March 2021 - new logbook kept

An employer uses the operating cost method to value their car fringe benefits and kept a logbook in the FBT year ended 31 March 2018.

For the FBT year ended 31 March 2021, there is no requirement for the employer to keep a logbook.

However, employee driving patterns have been significantly impacted by COVID-19, and so the employer chooses to keep a new logbook as it provides a more accurate base to estimate the business use of the car. Odometer records of the total kilometres travelled during the logbook period and during the FBT year are also kept.

If it is your first time using the operating cost method, or it is a logbook year for the car

Where it is your first time using the operating cost method or it is a logbook year, you must: -

- keep a logbook recording details of business journeys undertaken in the car for a continuous period of at least 12 weeks (the logbook period must also be recorded in the logbook)
- keep odometer records of the total kilometres travelled in the logbook period, and the total kilometres travelled during the year; and
- estimate the number of kilometres travelled on business journeys during the FBT year.

For this estimate, you must consider all relevant matters including logbook and odometer records, any other records, and any variations in the pattern of business use throughout the year.

If the car was not driven for a period due to COVID-19 impacts, it is recommended that you also keep odometer records to show this.

If COVID-19 impacted driving patterns during the period, you were maintaining a logbook

You may have been in the middle of maintaining a logbook for a 12-week period at the time the COVID-19 pandemic impacted driving patterns. You may be concerned that the resulting logbook does not reflect the business use of the car for the 2020 FBT year.

If you are making a reasonable estimate of the business use, you can adjust the use indicated from the logbook to account for the change in driving patterns from COVID-19 impacts.

However, you must ensure that the logbook still records a period of at least 12 weeks - if the logbook does not reflect a 12-week period you cannot apply it to reduce the taxable value to take business use into account.

Example 3 - FBT year ended 31 March 2020 - logbook impacted by COVID-19

An employer uses the operating cost method to value their car fringe benefits, and the 2020 FBT year is a logbook year. They begin maintaining a logbook on 2 February 2020, meaning the logbook must run for at least a 12-week continuous period to 26 April 2020.

However, from early April, in response to the COVID-19 pandemic, the employees' car usage changes significantly, and there are few or no business journeys for the final four weeks of the logbook period.

When estimating the business use for the 2020 FBT year, the employer may adjust their estimate to reflect the business journeys recorded in the period of the logbook before COVID-19 impacted driving patterns, to ensure it is a reasonable estimate of the business use across the FBT year.

Reportable fringe benefits

If the value of certain fringe benefits you provide to an individual employee exceeds $2,000 in an FBT year (1 April to 31 March), you must report the grossed-up taxable value of those benefits on their payment summary or through Single Touch Payroll for the corresponding income year (1 July to 30 June). These are called 'reportable fringe benefits'.

However, where an employee uses a pooled or shared car that results in a taxable fringe benefit, the use of this car is not included for payment summary or Single Touch Payroll purposes.

COMMISSIONER OF TAXATION V FORTUNATOW [2020] FCAFC 139

This case related to personal services income (PSI) rules.

Income is classified as PSI when more than 50% of the income received under a contract is for a taxpayer's labour, skills, or expertise.

The personal services income rules are integrity provisions which ensure individuals cannot reduce or defer their income tax by diverting income for their personal services through companies, partnerships, or trusts. If the rules apply, the individual is taxed on the income directly.

The rules do not apply if at least 75% of the individual's personal services income is for producing a result, where the individual supplies all the required "tools of trade" and is liable for rectifying defects in the work. This is known as the "results test".

To pass the unrelated clients test your PSI must be produced from two or more clients who are not related or connected, and the work must be obtained by making offers to the public or sections of the public.

You pass the test in an income year if you meet both of the following conditions: -

- two or more unrelated clients
- making offers to the public.

You do not pass the unrelated clients test if you source all your work through arrangements such as a labour hire firm.

If you operate through a company, partnership, or trust and you have more than one individual generating PSI, you will need to work out whether you pass the unrelated clients test for each individual. It is possible to be a PSB for one individual but not another.

Making offers to the public

To satisfy this condition, there must be a definite connection between the offer to the public at large and the engagement for the work.

Making offers to the public (or a section of the public) includes maintaining a website, applying for competitive public tenders, or advertising in a newspaper, industry journal or business directory.

The ATO maintains registering with labour hire firms or similar will not meet this condition.

Previously the Federal Court allowed the taxpayer's appeal from an earlier Administrative Appeals Tribunal (AAT) decision. The Federal Court found the ATO and AAT had applied an exception for services provided through intermediaries (e.g. recruitment agencies) too broadly and instead the Court preferred a narrow interpretation of the exception.

The Full Federal Court has allowed the Commissioner's appeal holding that one of the requirements to satisfy the unrelated clients test in section 87-20 of the ITAA 1997 which is that services are provided as a direct result of the individual or personal services entity making offers or invitations to the public (subsection 87-20(1)(b), required a client's decision to obtain the services of the individual/personal services entity be a direct result of the making of offers or invitations.

The Court found a direct causal effect might be shown where it is established that an invitation or offer was comprehended by the client, in the sense of received and digested, and that it had at least some influence on the client's decision to obtain the services. It was found, none of the clients made their decisions to engage the services of Mr Fortunatow as a direct result of any offer or invitation constituted by Mr Fortunatow's LinkedIn profile and thus the unrelated clients test was not met.

R & D TAX INCENTIVES GUIDE TO INTERPRETATION

This document published by the ATO in September is essential reading for entities to establish: –

- whether they are eligible for the incentive
- correctly claiming their just entitlements under the incentive.

Given recent legislative changes, it is important to refer to this, prior to making any claims for the year ended 30.6.2020.

LEGISLATION UPDATE: JOBKEEPER 2.0 BILL NOW LAW

The Coronavirus Economic Response Package (JobKeeper Payments) Amendment Bill 2020 passed parliament with amendments on 1.9.2020 and received Royal Assist just prior to us going to press.

The Bill: -

- Extends the current time limit on payment rules authorised by the Coronavirus Economic Response Package (Payments and Benefits) Act 2020, allowing the JobKeeper scheme to be extended to 28.3.2021.
- Amends the tax secrecy provisions in the TAA to allow protected information relating to the JobKeeper scheme to be disclosed to an Australian government agency for the purposes of the administration of an Australian law; and
- Supports the extended operation of the JobKeeper scheme for a further temporary period by providing employers continued flexibility to respond to the impacts of the Coronavirus pandemic while also assisting employees to remain in employment and connected to their workplaces.

The six amendments include minor technical changes regarding the definition of an eligible financial service provider and the 10 percent decline in turnover certificate.

The Bill does not contain the detailed rules which cover eligibility for the JobKeeper payment during the extension period. The rules will be contained in a legislative instrument that the Treasurer will issue in the near future.

CHANGING BUSINESS STRUCTURES

Many small businesses change their business structure from a sole trader to more complex company or trust structures, especially when the environment changes. This can lead to errors.

Some of the common errors identified by the ATO include:

- reporting income for the wrong entity
- claiming expenses incurred by another entity as business expenses
- personal use of business bank accounts.

If you have incorporated remember that:

- the company is a separate legal entity from you as a shareholder or director
- money that the company earns, belongs to the company
- the company owns its assets, and they cannot treat them as their own
- if a director or shareholder of a company uses company assets for their personal use, it must be properly treated as a benefit to the director or shareholder. The Division 7A or fringe benefits tax (FBT) provisions could apply if not treated correctly.

If you move to a trust structure, be mindful of a trustee's responsibilities, including: -

- holding the trust property (including assets, investments, and income) for the benefit of the beneficiaries
- managing the trust's tax affairs
- paying some tax liabilities.

You should also consider the small business restructure rollover when thinking about restructuring.

THE CRIMES LEGISLATION AMENDMENT (ECONOMIC DISRUPTION) BILL 2020

On 3.9.2020 this was introduced in the House of Representatives. The Bill proposes to: –

- Amend the Proceeds of Crime Act to strengthen and clarify provisions to ensure that law enforcement agencies can restrain and forfeit the profits gained by transnational, serious and organised crime (TSOC) actors.

- Amend the defence of 'mistake of fact' as to the value of money or property, ensuring that potential loopholes in the current defence cannot be exploited.
- Creates an additional tier of offences for the highest-level money launderers, who deal with money or property valued at $10 million or more.
- Clarify the definition of the term 'benefit' under the Proceeds of Crime Act to include the avoidance, deferral or reduction of a debt, loss, or liability.
- Clarify that all courts with jurisdiction under the Proceeds of Crime Act are able to make orders in relation to property located overseas.
- Enhance the ability of law enforcement to enforce compliance with the information-gathering powers in the Proceeds of Crime Act.

FURTHER DELAYS IN SENATE COMMITTEE REPORT ON R&D TAX INCENTIVE BILL

Presentation of the Senate Economic Legislation Committee's report on the inquiry into the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 has been extended again from 24.8.2020 to 12.10.2020.

This after two previous extensions… Following the Senate referral of the provisions of the Bill to the Committee on 6.2.2020, the report was supposed to have been presented by 30.4.2020. This date was extended to 7.8.2020 and then further extended to 24.8.2020.

The Bill which contains the May 2018 Federal Budget measures to reform the R&D tax incentive which was passed by the House of Representatives on 10.2.2020.

TAXATION DETERMINATION TD 2020/7

Income tax: can capital gains be included under subparagraph 770-75(4)(a)(ii) of the Income Tax Assessment Act 1997 in calculating the foreign income tax offset limit?

This Determination is in response to some taxpayers incorrectly including foreign capital gains where no foreign tax has been paid as 'disregarded income' in their calculation of the foreign income tax offset (FITO) limit and therefore over-claiming FITO.

The effect of this is best outlines in the below example.

Example:

In an income year, an Australian taxpayer (the taxpayer) disposed of a number of CGT assets and recognised the following CGT events (assume all capital assets have been held for less than 12 months): -

- a foreign capital gain of $3,000 in respect of which $630 of foreign income tax was paid
- a foreign capital gain of $20,000, in respect of which no foreign income tax was paid
- an Australian capital gain of $10,000; and
- a capital loss of $15,000.

In determining their net capital gain, the taxpayer applies the $15,000 capital loss against the $10,000 Australian capital gain and $5,000 of their foreign capital gain in respect of which no foreign income tax was paid.

The resulting net capital gain is $18,000 which includes $15,000 of foreign capital gain in respect of which no foreign tax was paid and a $3,000 foreign capital gain in respect of which foreign income tax was paid. This net capital gain does not have a source.

The entire $3000 foreign capital gain in respect of which foreign income tax was paid has been included in the taxpayer's assessable income. That $3,000 foreign capital gain will be disregarded under subparagraph 770-75(4)(a)(i) for purposes of the FITO limit calculation in section 770-75.

The foreign capital gain amount of $15,000 in respect of which no foreign income tax was paid that was not absorbed by the capital loss cannot be included under subparagraph 770-75(4)(a)(ii) for purposes of the FITO limit calculation in section 770-75, as it is neither an amount of ordinary income nor an amount of statutory income.

Commentary

The detailed reasoning for this is contained in TD 2020/7. The takeout is that considerable care needs to be taken when claiming foreign tax credits in respect of capital gains. In Issue #101 we covered Burton v Commissioner of Taxation (2019) FCAFC 140 22.8.2019 which set an interesting ATO precedent on claiming foreign tax credits on capital gains made from the sale of overseas investments in the United States. In simple terms if you own an asset in the United States and you pay tax there on the capital gain, then you may not be able to claim all the US tax paid as a credit in Australia. This because of the 50% individual capital gains tax discount in Australia.

SMSF REGULATIONS TO ALLOW SIX MEMBERS UNDER NEW LEGISLATION

In September, the Treasury Laws Amendment (Self-Managed Superannuation Funds) Bill 2020 was introduced. This partially implements the measure to allow an increase in the maximum number of allowable members in self-managed superannuation funds and small APRA funds from four to six. The remainder of the measure will be implemented through regulations. These measures were first mentioned in the May 2018 Federal Budget.

The bill amends the SIS Act, Corporations Act, ITAA1997 to increase members in SMSFs. It also amends provisions that relate to SMSFs and small APRA funds, which will ensure continued alignment with the increased maximum number of members for SMSFs.

SMSFs are often used by families as a vehicle for controlling their own superannuation savings and investment strategies. For larger families, the only real option is to create two SMSFs – in so doing incurring additional costs.

The key differences are shown in the comparison table below and is also detailed in the explanatory memorandum.

New law	Current law
A superannuation fund can only be an SMSF if it has no more than six (6) members.	A superannuation fund can only be an SMSF if it has fewer than five (5) members.
Various provisions that apply to small superannuation funds apply to funds with no more than six (6) members.	Various provisions that apply to small superannuation funds apply to funds with fewer than five (5) members.

In some instances, the number of individual trustees that a trust can have may be limited to less than five or six trustees by state legislation and could prevent some or all members of a fund with five or six members from being individual trustees. In these cases, the members of a fund should use a corporate trustee in order for the superannuation fund to meet, or continue to meet, the amended definition of an SMSF.

Under the updated requirements, a SMSF with one or two directors or individual trustees must have its accounts and statements signed by all of those directors or trustees. For all other SMSFs with between three and six directors or trustees, the accounts, and statements of the SMSF will have to be signed by at least half of the directors or individual trustees.

LEGISLATION PASSES THROUGH THE SENATE TO ALLOW AUSTRALIANS TO CHOOSE THEIR SUPERANNUATION FUND

Legislation giving Australians the power to choose their own superannuation fund, instead of being forced into a fund because of enterprise bargaining agreements passed the Senate on 25.8.2020.

The Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019 will allow around 800,000 Australians to make choices about where their hard-earned retirement savings are invested, representing around 40 per cent of all employees covered by a current enterprise agreement.

The Bill addresses the findings of the Financial System Inquiry and the Productivity Commission Inquiry into the efficiency and competitiveness of the superannuation system which found that this reform was ‘much needed’ and that denying choice of fund can discourage member engagement and lead to them paying higher fees.

This reform is also supported by a recent decision of the Fair Work Commission which found that it was detrimental to employees to restrict them from being able to choose their own superannuation fund. Specifically, the Fair Work Commission determined that extending choice of fund to employees who were previously denied choice will prevent them from unnecessarily ending up with multiple superannuation accounts “with all the inconvenience and additional administration costs that this involves”.

These changes also build on the Government’s earlier reforms which protect superannuation accounts from being eroded through the capping of fees on low balance accounts and requiring insurance to be provided on an opt-in basis for new members under 25 years of age.

With around 16 million Australians having a superannuation account and around $2.9 trillion worth of superannuation savings, the Government maintains it will continue to ensure that the superannuation system is delivering for all Australians.

EXTENSION OF TEMPORARY RELIEF FOR FINANCIALLY DISTRESSED BUSINESSES

The Federal Government will continue its regulatory relief for businesses that have been impacted by the Coronavirus crisis by extending temporary insolvency and bankruptcy protections until 31 December 2020.

Regulations will be made to extend the temporary increase in the threshold at which creditors can issue a statutory demand on a company and the time companies have to respond to statutory demands they receive.

The changes will also extend the temporary relief for directors from any personal liability for trading while insolvent.

These measures were part of more than 80 temporary regulatory changes the Government made designed to provide greater flexibility for businesses and individuals to operate during the coronavirus crisis.

The extension of these measures will lessen the threat of actions that could unnecessarily push businesses into insolvency and external administration at a time when they continue to be impacted by health restrictions.

These changes will help to prevent a further wave of failures before businesses have had the opportunity to recover.

As the economy starts to recover, it will be critical that distressed businesses have the necessary flexibility to restructure or to wind down their operations in an orderly manner.

Government policy is to continue to help businesses successfully adapt and restructure so that they can bounce back on the other side of this crisis.

bO2 READERS QUESTIONS AND ANSWERS..............

Question 1

Could you please confirm that the car depreciation cost limit for the financial year ending 30 June 2020 $57,581 plus GST, in other words I can buy a car up to $63,349.

Answer

That is correct – the motor vehicle deprecation cost limit does not include GST.

Question 2

Your advice on how we account for and tax an employee settlement payment following a dispute.

A quick background and extract from the relevant sections of the settlement agreement:

BACKGROUND

A. The Employee was employed by the Employer from on or about 14 September 2016 until on or about 8 April 2020 (the Employment), on which date the Employment was terminated (the Termination).

B. The Employee has made claims against the Employer alleging, variously, underpayment of wages and entitlements and/or breach of a provision of the Hair and Beauty Industry Award 2020 and/or breach of contract (the Employee's Claims).

C. The Employer denies all the Employee's Claims.

D. Without admission, the parties have agreed to resolve the Employee's Claims and all matters arising from or in any way related to the Employment on the basis set out in this Deed.

3. THE PARTIES AGREE

3.1 In consideration of the Release given by the Employee by virtue of clause 4.1 of this

Deed, within 7 days of the Employee serving upon the Employer a properly executed counterpart of this Deed, the Employer will pay to the Employee by direct deposit to a nominated bank account the sum of $7,550.00, less taxation as required by law (the Settlement Sum), in full and final settlement of all Claims.

Could you please advise:

- Do we process this in MYOB as a single line item backpay payment for $7550?
- How much tax is to be deducted? Our lawyer suggests it is likely to need to be taxed in accordance with the Schedule 5 table as a back-payment. The employee has a tax-free threshold.
- Can you confirm that no superannuation guarantee charge applies to settlement payments?

Answer

1) Yes, this is a MYOB single line item back payment for $7,550
2) Your solicitor is correct – apply the Schedule 5 table as a back payment and ensure adequate tax is deducted.
3) No superannuation guarantee payment applies to this post employment settlement as it does not fall within the definition of ordinary times earnings.

Question 3

What are an employer's obligations regarding employees with student visas?

Answer

If it can be established that they are enrolled to study in Australia on a course that lasts 6 months or more, they may be regarded as an Australian resident for tax purposes.

This means they pay tax on their earnings at the same rate as other residents

So, the normal employer PAYG obligations will apply.

Generally, the terms of the student visa are that they are able to work up to 40 hours a fortnight.

Question 4

This issue is related to the tax deductibility of FY2019 voluntary super contribution for sole trader / individual.

My client is a sole trader owner and made the voluntary super contribution payment (after tax) $25k to ABC complying super fund company with the notice of intent form for FY2019 and claimed for tax deduction in FY2019 income tax return as for the concessional super contribution.

After the lodgement of FY2019 income tax return, client received a letter from ATO that they did not receive the notification from super fund company regarding the above, so tax deductibility of $25k was denied.

The following chronological order of events are based on the information received from complying super fund company (final email received from super fund company at 31st July 2020 after formal complaint was made by my client) and based on the client's records.

1. Client received the letter from the ABC Super fund for the confirmation of receipt of their personal contributions
2. Client was informed by super fund company that client received a small super payment from casual employment during the FY2019. So, my client requested ABC Super fund company to refund $159.05 to avoid higher tax (because total super contribution amount became $25,159.05 for FY2019 including voluntary super contribution $25k). If super fund company notified my client about a small super amount earlier or at initial phone discussion(s), my client would pay only the remained balance to match the $25,000.
3. Client sent the revised notice of intent form with revised amount $24,840.95 (=$25,000 - $159.05) to super fund

company. In addition, ABC complying super fund company never explained my client that refund request was subject to approval.

4. Client fully relied on the acknowledgment letter he /she received on August 2020 about the deductibility of voluntary super contribution ($24,840.95).

5. Client did not receive the letter or any phone call from ABC super fund company that tax deduction of $24,840.95 was reversed.

6. Client received a simple email from ABC super fund company that refund of $159.05 was declined, but it did not mention that tax deduction of $24,840.95 was no longer valid. All I believed was that earlier confirmation of $24,840.95.

7. Client decided to change the super fund company to XYZ Super and finally did so on 12/12/2020.

8. After client received the letter from ATO regarding the denial of tax deduction for FY2019 voluntary super contribution $24,840.95, client asked Super fund company to check and they advised everything is good as above. Again, ABC Super never advised that tax deduction of $25,000 or $24,840.95 was cancelled / reversed in prior communications.

9. XYZ Super fund company is saying that they cannot do anything but telling my client to complain to AFAC. We notified the ATO, but they just advised to contact ABC super fund company.

10. ABC Super fund company accepts their miscommunication (but not specifically) and my client is facing a denial of tax deduction $24,840.95 that she/he made for FY2019 income tax return and at the risk of a big tax bill due to the above.

The Old super fund made a serious mistake/ miscommunication which resulted in not being taken as tax deductible super contribution.

I understand it is complicated because super balance was rolled over to other super fund later time. That is why client is submitting the complaint to AFAC.

If the client wins the case, will or can super fund be made responsible for their mistake and rectify the issue?

Will the ATO do anything regarding the mistake of super fund company?

Is there anything a tax agent can do to support their client in relation to dealing with the ATO?

Answer

The change of super funds is the complicating factor because if:

- The 15% contributions tax was not deducted by the former super fund.
- XYZ super cannot rectify the error as it relates to 2019 because they did not receive the contribution.
- It now is a case of what has actually transpired.
- Was the contribution dealt with by the old super fund as an allowable deduction with 15% tax being deducted?
- If not, then the error and/or miscommunication cannot be rectified.

Not a great outcome for your client and we are very sorry. The ATO is bound by the law.

While we are not willing to speculate on your client's prospects with their complaint to the AFAC … if it is found your client has sustained an economic loss through the negligence of the super fund they may be entitled to receive compensation.

Question 5

As a professional Chartered Accountant in practice I have been asked on many occasions as to the following that there is no real guidance by the material released by Government to the following:

Paying the JobKeeper allowance to employees does this payment attract:

A. Accrual of Holiday Pay

B. Sick Pay

C. Super fund contribution

Also, on the Cash Flow contribution by the Government, what are the true criteria that the Government uses to assess the eligibility?

If I can get some clarification it will be appreciated.

Answer

This taxable payment received by the employer maintains the employment relationship and entitlements such as annual leave and sick leave will continue to accrue. The Fair Work Act JobKeeper provisions mean a qualifying employer can:

- Request an eligible employee to take paid annual leave (as long as they keep a balance of at least two weeks)
- Agree in writing with an eligible employee for them to take annual leave at half pay for twice the length of time.

To make an agreement about using annual leave under the Fair Work Act JobKeeper provisions, a qualifying employer needs to:

- Qualify and enrol in the JobKeeper Scheme
- Be entitled to JobKeeper payments for the employee to whom the agreement applies
- Be a national system employer in the Fair Work system

Agreements under the Fair Work Act JobKeeper provisions can only be made about using annual leave, not other types of leave.

Currently any agreements made under the new JobKeeper provisions end on 28.9.2020. Refer also to the article on page 2.

If an employer asks the employee to take annual leave, the employee has to consider the request. They cannot unreasonably refuse it.

Employees who are on annual leave continue to accrue their usual leave entitlements while they are on leave, and the period of leave counts as service.

Superannuation

For payments (or parts of payments) to employees in excess of an employee's usual wages, superannuation is not required to be paid. This situation may arise where:

- An employee's usual wages are less than $1,500 per fortnight (superannuation would be payable on the part of the $1500 payment necessary to cover the employee's wages, but not on ay windfall balance); or
- Employees have been stood down without pay (superannuation will not be payable on the $1500 JobKeeper payment paid to employee as it is not paid as ordinary times earnings for work that has been undertaken).

Otherwise employees will be entitled to statutory superannuation.

We trust this helps.

Question 6

The facts of the matter are as follows:

- Commercial property owned by SMSF,
- SMSF is in full pension,
- SMSF has engaged a real estate agent for management for the property for a percentage of the rent.

My questions are:

- Is it okay for the lessee to pay the rent into the account of the real estate agent company?
- In other words is it legal for the real estate agent company (engaged by the SMSF) , to collect the money on behalf of the SMSF and once they have taken their commission, they transfer the remaining balance into the account of the SMSF?

Answer

We take it that the Real Estate is not an associated party.

This means any relative or business partner of SMSF's members and/or their families.

On the basis these are arms' length, commercial dealings then there should not be a problem.

Of course, you would want to establish that you are dealing with a properly licenced real estate agent and that their trust account is independently audited annually.

Question 7

JobKeeper Payments - In respect to SGC superannuation, could you please clarify:

- Is it applicable only on the excess wages over and above the $750.00 per week?

OR

- On the hours actually worked.

Naturally, it is assumed that it would not apply to any Top up.

Answer

Superannuation remains payable on ordinary times earnings not the excess over $750 per week.

Using the concept of ordinary times earnings, you are right in saying it is not payable on any top up.

Is superannuation payable on JobKeeper Payments?

Whether superannuation is payable depends on an employee's salary.

Superannuation is payable according to ordinary rules for payments to employees for ordinary time earnings (even if the funds for those payments are received through the JobKeeper Payment scheme). Therefore, superannuation is still payable for payments made to cover an employee's usual wages.

Scenario 1 - ***If an employee ordinarily receives $1,500 or more in income per fortnight (before tax) and is still working:*** The employee will continue to receive their regular income according to their prevailing workplace arrangements. The JobKeeper Payment subsidy will assist the employer to continue operating by subsidising all or part of the income of the employee.

For example, Anne is a full-time employee who ordinarily earns $3,000 per fortnight before tax. As a result of JobKeeper Payment, her employer continues to pay her $3,000 in wages, but will be reimbursed $1,500 from the government. This means the employer will only pay Anne $1,500 of the $3,000 salary from its own pocket.

Using the example of Anne above, because she ordinarily receives a fortnightly payment of $3,000, superannuation will be payable on her entire salary (even though $1,500 of her salary comes from JobKeeper Payment).

However, based on the information to date, superannuation is not payable for payments to employees which are in excess of an employee's usual wages. The Government has said that 'it will be up to the employer if they want to pay superannuation on any additional wage paid because of the JobKeeper Payment'.

Scenario 2 - ***If an employee ordinarily receives less than $1,500 in income per fortnight (before tax):*** The employer must pay their employee, at a minimum, $1,500 per fortnight before tax.

For example, Nick is a permanent part-time employee who earns $1,000 per fortnight before tax. His employer continues to pay him $1,000 per fortnight before tax, plus an additional $500 per fortnight before tax, totalling $1,500 per fortnight before tax. The employer will then receive $1,500 per fortnight before tax from JobKeeper Payment which, in effect, subsidises Nick's entire salary. Nick is $500 better off under this scheme than otherwise.

Using the example of Nick above, the employer will be required to pay the superannuation guarantee on the $1,000 per fortnight of wages he is earning. However, it has the discretion whether to pay superannuation on the additional $500 (before tax) paid under the JobKeeper Payment.

For employees who have been stood down without pay, superannuation is not payable on the JobKeeper Payment.

Question 8

A married couple purchased a house in 1982 (i.e. pre-CGT). In 2008, they moved interstate to look after the husband's mother.

Their home has been rented continuously since 2008, and they continue to live in rented accommodation interstate (i.e. their PPR). They own no other property and the property is not geared.

In 2019, the house remained tenantless for 135 days, and the property manager has warned them to expect worsening rental conditions going forward when the current lease expires at the end of 2020.

The couple would prefer to leave the house vacant, but doing so would mean they would be faced with a $9,000 vacant residential land tax.

The couple are wondering whether they can rent the house to themselves paying at the lower end of the going market rate, leave the house vacant with no personal use, but possible 'free' short term stays by family and friends whilst declaring the rent as income and also continuing to claim depreciation of assets as is being done at present.

Answer

If they rent the house to themselves then there is clearly no landlord/tenant relationship.

In the event this comes to the attention of the ATO, this cannot be effective.

If the property was genuinely on the market for only 15-20% in excess of the standard rent for such a dwelling, then it may not be rented out.

However, it must be genuinely on the market (with evidence available) and there is the possibility a suitable tenant might apply.

In the event of this happening.... It could be viewed as a windfall gain.

In the event the property is not rented out then it is mission accomplished.

Question 9

Here is my case...

GST registered company buys Motorhome for $127,000.

The company intends to rent it partial out or using it to visit clients as the restrictions due to COVID19.

A. Will this stand up for GST/Income TAX purposes?

B. Is there a limit like for Luxury cars?

C. What are the requirements that need to be met e.g. logbook, issuing GST invoices when renting out, what is deductible when using for own company?

Answer

Here you can expect the ATO to be sceptical in the event of an audit. You will be expected to have detailed records outlining the percentage of business use and the commerciality of that business use.

For example, if the motor home travels 900kms to have a short meeting with a prospective small client or existing low $ client at a popular tourist destination, you can expect the claim to be denied.

Clearly an attempt is being made to justify business claims which relate largely to lifestyle decisions.

However, if the travel consistently related to a schedule of well-planned visits showing a full calendar of meetings, demonstrating sound commercial outcomes, there would be a better prospect of success.

Detailed records would need to be kept – ambit claims would be likely to be disallowed.

We note in passing that business has been less mobile during Covid 19 and that zoom meetings have proved highly effective and productive...

You could claim up to the $150k instant asset write-off but it is suggested there would need to be a substantial adjustment for personal use.

Further, unless the enterprise is in the business of renting out motor homes, then rentals would be deemed to be passive income.

There would need to a be a further reduction for the time the motor home was not used for business and was available for rent.

The above comments also apply to the GST claimable on purchase as well as the future outgoings and expenses.

Question 10

I was checking the published information from bO2 site but could not find the content about **summary regarding the "Tax on super death benefits - Paid to estate vs beneficiary"**, which can be very useful.

Would you please advise if you already have this topic covered in any of the past published document? If yes, please forward it to me or advise me which one it is.

If we do not have one, it will be great to have the summary or table explaining regarding the **"Tax on super death benefits - Paid to estate vs beneficiary (i.e. adult)" with current tax rates.**

Answer

This is a very timely and helpful question ahead of bonus issue 108 due in December.

We cover binding nominations, superannuation death taxes and estate planning   on pages 39 and 42-43 in bonus issue 102.

However, we only cover the tax implications of the superannuation benefits going to a dependent (generally nil)) versus a nondependent (generally 17% or 32%).

This rate of tax is determined as to whether the payment is from the taxed element (17%) or untaxed element (32%).

We also outline the opportunity to pay out the benefit to the fund member while he/she is still alive in the event of terminal illness which should not attract tax.

The safest way to avoid death taxes may be to leave your super to your Estate and put a Superannuation Testamentary Trust in your Will.

We think this what you are driving at and we will cover this is in detail in issue 108.

Question 11

A client of mine was a beneficiary in a will of two blocks of land in which his share 50%. Prior ownership was for a considerable time and there was no reliable value put on the land until disposal by my client.

He received $50,000 on disposal.

Are there any capital gain implications?

Answer

Yes, there are potential capital gains tax (CGT) implications.

If the land was purchased by the deceased prior to 19.9.1985, then your client is deemed to have acquired it at market value at the date of death.

If the land was disposed of shortly thereafter then there should not be a problem.

If not, then a reasonable attempt needs to be made to calculate the capital gain – reference could be made to local real estate agents or registered valuers.

If the land was acquired after September 1985 then your client is deemed to have acquired the asset at the amount paid by the deceased on purchase.

This is readily ascertainable from the relevant State Titles Office.

Of course, purchase costs including stamp duty and legals need to be considered when calculating the cost base. Also selling costs.

Question 12

I am seeking some advice regarding the GST implications concerning land that is subdivided and sold.

My clients are a husband and wife partnership and operate a primary production business growing fruit and a secondary enterprise renting commercial properties.

The partnership has an ABN and is registered for GST in relation to both enterprises.

They also hold several residential properties that are rented to tenants.

One of the residential properties has been owned since 1995 and they are considering demolishing the old house and subdividing the land.

They do not intend to sell each subdivided block at the same time and are likely to spread the sales over several years, mainly to spread any CGT issues.

They have substantial borrowings and intend to use the proceeds of sale of the blocks to reduce debt.

This property is not a business asset involved in either of their business activities.

They have not subdivided and sold blocks before. They would not be building any houses on these blocks and then selling them as a land & house package.

I understand that vacant land sold with the "potential" for a new house to be built may be subject to GST.

My question are as follows:

1. Is the sale of vacant land that has the potential for new houses to be built automatically deemed subject to GST?
2. If not, what are the circumstances where GST would not be applicable?
3. As they would be simply re-organising their investment portfolio, does this influence the issue?
4. Does the fact that the land is not a business asset affect the issue?
5. Currently, the commercial rentals received are less than $75,000 pa. Would cancelling their GST registration have any effect?
6. Do you have any suggestions?

Answer

To answer your questions:

Q1 and 2: The ATO in Miscellaneous Tax Ruling MT 2006/1 considers when an isolated property transaction would result in carrying on an Enterprise. This hinges on whether the land was purchased with the intention of resale at a profit – this would constitute an enterprise. As in your case it would appear the land was purchased as a long term holding, we now consider other factors.

Q3 and Q4: Both circumstances assist the argument of being the mere orderly realisation of an asset.

Q5: The fact that the Partnership of husband and wife is registered for GST is a complicating factor. While you have not considered the primary production turnover, it is accepted that this is GST free. Deregistration from GST may be helpful.

Q6: Carefully review MT 2006/1 which provides comprehensive guidance and contains examples - if still in doubt seek a private ruling from the ATO. You may wish to also review the ATO's Register of Private Rulings on the subject which shows views which are inconsistent and arbitrary – this really is a grey area… Note that private rulings only apply to the recipient. In supplying the information to the ATO for the Private Ruling consider case law and the guidelines laid down by the ATO.

Question 13

A client of ours has had an employee quit without any notice. Are they able to withhold 1 weeks' pay?

Answer

They can only withhold 1 week from the employee's accumulated annual leave. It cannot be withheld from wages for time worked.

Question 14

I own a Practice that is on track to be purchased by a corporate entity which will continue the practice name and business as before, while employing myself and my staff under new contracts.

This is planned to occur late August 2020. The corporate purchaser will be listing a new company name and operating it under this company name, with the same public business name it has always had.

My employees will therefore no longer be employed by my old company, but by the different company, owned by a different entity entirely.

My question relates to my ability to reward very long serving employees with a cash payment that is tax-effective both for them and for myself. I believe I may be able to pay them a redundancy payment with a tax-free limit.

This is calculated from a "base amount" of $10,989 plus a "service amount" of $5,496 which is multiplied by years of service.

Genuine redundancy payments are tax deductible to the employer as well as not assessable for the employee.

My question is whether in my circumstance the ATO will regard such a payment as a genuine redundancy payment?

This is a genuine business sale, with my company no longer employing the employees and myself and my employees becoming employed by another company.

But the business itself will still trade uninterrupted and in this case, the ATO may seek to "look through" the change in entity structure.

Can you give me more clarity as to how the ATO may treat my circumstances?

Answer

Taxation Ruling TR 2009/2 provides guidance in this area.

There are four basic conditions to be met:

- The payment being tested must be received in consequence of an employee's termination
- The termination must involve the employee being dismissed from employment
- The dismissal must be caused by the redundancy of the employee's position
- The redundancy payment must be made genuinely because of a redundancy.

All the above would appear to apply here for your arm's length employees.

However, the situation is not so clear for working directors – particularly if your company continues to operate (see example 6 in the ruling).

The figures you suggest are correct.

Question 15

I received the information from client regarding rental property. This was done by previous tax agents for my client.

Building cost (warehouse) is depreciated at 2% using the diminishing method (no other depreciable item). In my understanding, depreciation rate for capital works generally should be either 2.5% or 4%. Do you know any case of 2% (2% for diminishing method - it means 1% for prime method)?

It was not an accounting entry as the same depreciation amount was used for partnership tax return as well.

- Capital works-special build w/off value was depreciated @ 2% (diminishing method)

Client paid the special levy for roof replacement. Shouldn't this be depreciated at 2.5% (prime cost method) from the payment date?

Do you think this is possibly a mistake? I think I should update it to 2.5% for past periods. Am I allowed to add the back-dated depreciation amount in next financial period's tax return?

Answer

The figures you suggest for the capital allowance are correct.

It is possible that you are referring to accounting entries – estimates of useful economic life as opposed to what the Commissioner allows as a tax deduction.

Some entities have two depreciation schedules – one for accounting purposes and one for the tax return with the rates varying on the above basis.

You are right about the roof – a replacement does not constitute a repair and the capital allowance claims should be made at 2.5%.

If the previous roof was listed in the capital allowance schedule this can now be written off.

It is an error and you should go back and make the changes if they fall within the permitted timespan – generally two years from the date of assessment for an individual or four years for a business.

Technically you should go back and amend the relevant tax returns – having said this in practice sometimes these amendments are done in the current year.

Question 16

Scenario: " A client recently purchased an Accounting firm for $250,000 which settled on 4th of June 2020. On the contract of business purchase the following assets are listed."

1. Computer Equipment - $10,000

2. Client List/Books Records - $220,000

3. Goodwill - $20,000

My question:

Is Depreciation/Amortisation claimable for tax deduction purposes for any item of the assets listed above?

The previous owner has already claimed 100% depreciation on the computer equipment and the value of client list/books and records is calculated based on the last year gross fees.

Answer

The computer equipment valued at $10,000 may be written off.

It is irrelevant that the assets have been written off by the vendor.

The remainder is essentially goodwill and there is no tax deduction for this – the entire amount should be capitalised.

Question 17

Our Operations Manager is stepping down from his position due to health concerns. We have offered him a new position in the warehouse which he has accepted. However, a question regarding the value of his accrued holidays has come up.

In moving position, upon transition, his new hourly rate is lower than the current rate he is being paid as Operations Manager.

When the Operations Manager moves to the new position and lower hourly rate, what happens to the value of the accrued leave? Does it transition to the lower rate or is it kept at the higher previous rate when he was employed as Operations Manager?

If the Operations Manager is currently being paid $40/hour and has 10 weeks holidays accrued, at the moment his holidays would be paid at this rate (and paid out at this rate if requested).

Once transitioned to the new position, let us say his new rate is $30/hour, are holidays now paid at this rate or the higher amount?

If the higher amount, would this mean that if he were to take holidays, he would get paid his previous hourly rate, instead of the new lower rate? If holidays were paid out would they get paid at the higher rate rather than the lower rate?

Answer

Annual leave if paid prior to the new role would be subject to the Fair Work Act 2009 or relevant award or JobKeeper provisions but if it is paid out prior to him taking the new role then it is at the higher rate.

His annual leave is paid at the salary/ wage he is on at the time he takes it. So, if he takes annual leave after changing into new role and it only pays $30 per hour then that is all his annual leave is paid on.

Question 18

Regarding the JobKeeper payment, as an eligible business participant. How does the director take the money out from the company? As wages, dividend, or director loan?

If we are to take the money as wages and pay PAYG on it, would that be a problem? Because in the eligibility criteria on ATO website, it states that the business participant must not be employed on 1st March 2020. (does it mean that the director then can be employed by the entity after 1st March 2020?)

Answer

As you rightly point out there is a choice for a business owner/company director.

You need to carefully consider the tax implications of each choice.

In the event the company has tax losses and/or franking credits, dividends could be a good choice.

Directors' loans could be repaid if the company does not need the tax deduction and the company owes the director money i.e. no Div 7A issues.

On the basis the director was not employed on 1.3.2020 but shortly thereafter wages may also be an option.

It is essential that PAYG be deducted from wages.

Question 19

Am trying to find out for my client about the latest on the above mentioned, (X Ltd) – all I can find is that it seems that someone is trying to sue the Estate of the founder.

Client wants to cement a capital loss for use against a potential capital gain this year.

It is my understanding that they need a final letter from the Liquidator before they can do this.

Any advice/direction on finding out the latest on this would be most appreciated.

Answer

The Responsible Entity, X Limited is still under external administration.

The status of your client's investment may depend upon the year the client invested.

PWC are the administrators and if you are able to get a letter from them declaring the shares or financial instruments are worthless or have negligible value, you may be able to claim the capital loss in 2020-21.

Refer to the PWC website.

Question 20

I have a question regarding sick leave during annual leave.

If during annual leave, an employee becomes sick or needs to care for someone, does the leave stay as annual leave or should it be changed to sick leave?

Answer

It becomes sick leave and not annual leave.

Question 21

Personal Leave

1. Previously sick leave was 8 days per year and if the sick leave what not used within the year it dropped off. We have workers that have been with the company at least 10 / 15 years. Can you please advise when Personal Leave actually started accruing? I can only find the Fair Work Act 2009 where it says it "can" accrue not "must".

   1.1. So, if I must go back and calculate the personal leave accrual, what start date will it go from?

2. Is there a "Cap". Previously I thought there was a maximum number of days that Personal Leave can accrue to (i.e. 3 / 6 months). Is there a maximum number of Personal Days?

3. Is there a maximum number of Personal Leave time that can be taken in succession? (please assume the worker has been with the company for at least 15 years).

   3.1. If so, can the worker then use the remaining days the following year?

Casuals

4. Are Permanent Casuals entitled to Long Service Leave? Again, we have casuals with permanent hours that have with the company 10 / 15 years. Will I have to calculate LSL for these workers?

   4.1. If so, can you see any ramifications if I transfer them to Part Time employees, which will drop the hourly rate, but be entitled to HP & PL. Can I then calculate the LSL on the hourly rate at time of employment being the Part Time rate?

Answer

Personal Leave

Q1. If they were covered by Federal Awards it was in 1996 that sick leave went to 10 days, if they were covered by Queensland state awards it was 2009 that sick leave increased to 10 days.

Q1.1. 01 January 2009 for state based and 30th June 1996 for federal employees.

Q2. No cap from 1996 Federal/2009 state, the state was a maximum of 13 weeks before 2009.

Q3. They can take as much leave as they have accumulated as long as they have a medical certificate.

Q3.1. Yes.

Casuals

Q4. Causal employees are entitled to LSL since 30 March 1994. For accumulation see link:

https://www.business.qld.gov.au/running-business/employing/employee-rights/long-service-leave/entitlements

Q4.1. If the employees wish to transfer to part time by mutual agreement that is fine then they are entitled to be paid whatever rate of pay they are on when they take the leave, but accumulation would need to be done as per the link in question 4.

Question 22

My question relates to compensation payment for land resumed by government.

We own a holiday unit (not main residence) in a residential building. The government resumed a portion of the common land of the body corporate to widen the main road. The land resumed was part of the swimming pool/recreation area. All owners received payment as compensation with the statement "for loss of amenities".

My query is - is the compensation amount taxable to us? If so, is it capital gains- declared in the year received?

Answer

You are correct. It is a taxable capital gain assessable in the year of receipt.

Given there can be no replacement asset, there is no prospect of a rollover to defer the liability.

As there may be other issues at play, I would check this with the Body Corporate as they would have received advice on this.

Question 23

Is there any tax or stamp duty payable If a trading company is sold while the shareholders keep its subsidiary?

If you sell the business and the name of the trading company (but keep the shares) can you under such conditions keep the subsidiary (which own properties) without having to pay CGT or S/D, because if not then you would pay these tax & duty to buy something you indirectly own.

Answer

If you sell the shares in the trading company then you lose the subsidiary because it is the head company that holds the shares in the subsidiary.

It is for this reason that we think you are referring to the sale of the business by your head/trading company and not its shares.

This is the only way the shareholders keep its subsidiary.

Stamp Duty applies as the sale of a business is a dutiable transaction and the rate will depend on the state in which the business is located.

As long as all of the things required for the continued operation of the business are sold, then GST may not be chargeable under the going concern exemption.

A subsidiary company owned by the holding or trading company continues to own the properties.

The trading company continues to own the shares in the subsidiary so there are no concerns with a change of ownership in "land rich" corporations.

The sale of the business is irrelevant.

It is clear there has been no change in beneficial ownership and there are no stamp duty concerns.

As this is a major transaction, it is essential you get legal advice on these issues.

Question 24

My client purchased their principal place of residence property all-in for $600,000 in 2014 with $450,000 of bank debt.

The value has increased since 2014 and they have refinanced the bank debt to $750,000.

All the bank debt refinance top-up proceeds have been deposited into an offset account as have all additional savings. Consequently, my client has $700,000 cash in their offset account which they now intend to reinvest into another property asset.

They live in the current property as their principal place of residence.

I have advised my client not to use the funds from the offset for the next investment. Instead, I believe they should split the current loan into a $700,000 limit and $50,000 limit and pay $699,900 into the redraw of the $700,000 limit then redraw these funds to buy a new property, as the interest would then be permitted to be deducted against the income of the new investment.

Please can you confirm my understanding is correct? If my client were to subsequently move out of the current property and no longer use it as his PPR would this have any tax implication on the deductibility?

Answer

The fundamental test for deductibility of interest as consistently applied by the Courts is the "use test" i.e. the use to which the funds have been put.

The asset used for security or the flow of funds out of a carefully chosen account does not overcome this.

In this instance at least $450,000 of the initial money has been used to purchase the principal place of residence (PPR) which is not tax deductible.

The ATO will go back and trace transactions in situations such as these.

There can be real problems with split loans in these cases.

However, if there is $700k in available funds that is solely used for the purchase of the investment property, then we suggest the interest is deductible.

To answer your question... if the clients moved out of the existing PPR and rented it out, the interest relating to your original purchase would be tax deductible.

However, interest on funds drawn down for private purposes such as holidays, lifestyle items is not tax deductible.

Michael's Corner

Article 007

FAIR WORK ACT 2009 CHANGES AND WHAT HAS NOT CHANGED...?

This article discusses an important change to sick leave following a high court appeal decision, also we want to remind you all what has not changed during COVID-19 and the Fair Work Commission stance when the Fair Work Act 2009 is not followed.

The High Court Appeal of:

Mondelez Australia Pty Ltd and Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union Known as The Australian Manufacturing Workers Union (AMWU) & Ors [2020] HCA29.

This landmark decision was handed down 13 August 2020 in which the following three High Court judges, Chief Justice Susan Kiefel, Justice Geoffrey Nettle and Justice Michelle Gordon disagreed with the Unions view on sick leave that took into account the history of sick leave.

The High Court's decision overturns a controversial decision made by the Full Federal Court in August 2019.

The Mondelez Decision in 2019, where shift workers working 3 x12 hour shifts were awarded 120 hours of personal and carers leave per year and their colleagues who were working 38 hours per week on a 7.6h basis were left with 76 hours personal and carers leave per year, shocked all industry. Businesses were facing unknown leave balances and uncertainty on how to account for part time employees' entitlements, particularly when hours are varied regularly.

The 'working day' construction adopted by the majority in the Full Court (and urged by the union parties in this Court) is not consistent with the purpose of s96, to protect employees against loss of earnings or the stated objectives of the Fair Work Act of fairness, flexibility, certainty and stability," said Chief Justice Kiefel and justices Nettle and Gordon in handing down the Decision.

Some keys points from the decision

The "working day" construction would lead to inequalities between employees with different work patterns, and so would be unfair. An employee whose hours are spread over fewer days with longer shifts would be entitled to more paid personal/carer's leave than an employee working the same number of hours per week spread over more days.

"The expression '10 days' in s 96(1) of the Fair Work Act 2009 (Cth) means an amount of paid personal/carer's leave accruing for every year of service equivalent to an employee's ordinary hours of work in a week over a two-week (fortnightly) period, or 1/26 of the employee's ordinary hours of work in a year. A 'day' for the purposes of s 96(1) refers to a 'notional day', consisting of one-tenth of the equivalent of an employee's ordinary hours of work in a two-week (fortnightly) period."

What does this mean for my business?

Full time employees working a 38-hour week will accrue 76 hours of sick leave which is 10 days. Each day a person takes off sick means they are paid 7.6 hours for the day regardless of what they are rostered.

Part Time employees working less than 38 hours per week will still be entitled to 10 days sick leave but based on their average hours. E.g. a Part time employee works 25 hours a week their sick leave would be 50 hours per year. As per the above part time example each day a person takes off sick means they are paid 5 hours for the day regardless of what they are rostered.

The Decision allays confusion and frustration from businesses who struggled to understand how such a ruling could be considered fair or be implemented in practice and affirms the widely held construction that 10 days paid personal leave is equivalent to 2 ordinary weeks work/pay/hours.

These changes should make payroll much easier.

Do not forget your obligations still exist under COVID especially when it comes to consultation and failure to do so can be costly to a business.

FAILURE TO CONSULT RENDERS REDUNDANCY NON-GENUINE

Matthew Browne v MySharedServices Pty Ltd [2020] FWC 4445 (26 August 2020)

The Fair Work Commission ruled that an employer's failure to consult and consider ways to avoid retrenchment rendered the redundancy non-genuine.

Commissioner Bisset accepted that the role performed by the consultant was no longer required due to changes in the company's operational needs and therefore met the requirements of the Fair Work Act's s389(1)(a).

As the company did not comply with the obligations or follow all the requirements of the consultation clause under the Clerks Award , where the employer is required to consider any matters raised by employees in relation to the change, it meant the redundancy was not genuine as per the Act.

The following information is from the decision of Commissioner Bisset

She said the company "to engage in any discussion" with the employee and the other two workers it dismissed at the same time.

The consultation omission "is telling" as "there may well have been opportunities for [the employee] to be redeployed".

The commissioner said that it "cannot be known what might have come out of a proper consultation process with all of the staff affected by the change".

"It may be that staff would have proposed a reduction in hours or some other steps that may have kept the employee in employment.

"It cannot be known what proposals may have put forward as a means of securing his employment.

"He may, for example, have offered to take leave with or without pay until the situation was better understood, or until it was known how JobKeeper, having been announced on 30 March 2020, would operate and if the company would be eligible for it.

"As it was, none of this occurred."

Commissioner Bissett accepted that when the company dismissed the consultant "the nature of the operation of JobKeeper was not known", as it had only been announced the previous week.

"However, [the employee] is right, the purpose of JobKeeper was to ensure employees and their employer maintained a relationship, to minimise job loss and minimise redundancies.

"Whilst the company may not have understood its operation on 8 April 2020 neither did many other employers who managed to maintain employees until such time as the JobKeeper payments came through."

She accepted that the dismissal was not genuine and said she would order compensation after the parties provide further submissions.

Copy of complete decision: http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FWC//2020/4445.html

Please note that this is general advice for information only and any application of legislation and/or Industrial Relations or contractual requirements may require professional advice to suit your individual circumstances. If you have any questions for Michael's team send us an email info@bO2.com.au

Special Bonus Issue

TAX EFFECTIVE SHARES & PROPERTY INVESTMENT

WHAT'S NEW IN 2020?

- Tighter Laws for vacant land tax deductions – ATO guidance on what constitutes vacant land with implications for property investors.
- We provide further guidance on the tax implications of renovating and then selling your principal place of residence.
- New ATO guidance on capital/ revenue in property developments.
- Large isolated losses on the sale of shares – taxpayer prevails in the Full Federal Court. Greig v Commissioner of Taxation ATO issues Decision Impact Statement on Greig.
- Foreign Residents selling the former family home. No Capital Gains Tax exemption from 30.6.2020.
- We expand our discussion on "one-off' property transactions and whether an enterprise is being conducted.
- Airbnb – Data Matching and GCT issues.

DENIAL OF TAX DEDUCTION FOR VACANT LAND LEGISLATION RELEASED

The Federal Government has passed legislation to enact the May 2018 Federal Budget denial of tax deduction for vacant land integrity measures.

Property developers, property investors and primary producers should review the landholding usage, contractual arrangements, and business plans to ensure tax deductions are not denied from 1.7. 2019.

These changes aimed to address concerns that deductions are being improperly claimed for expenses, such as interest costs, related to holding vacant land, where the land is not genuinely held for the purpose of earning assessable income. It also reduces tax incentives for land banking, which deny the use of land for housing or other development. This measure applied from 1 July 2019.

Denied deductions are able to be carried forward for use in later income years. Expenses for which deductions will be denied that would ordinarily be a cost base element (such as borrowing expenses and council rates) may be included in the cost base of the asset for capital gains tax (CGT) purposes when sold. However, denied deductions for expenses that would not ordinarily be a cost base element would not be able to be included in the cost base of the asset for CGT purposes.

This measure will not apply to expenses associated with holding land that are incurred after: -

- a property has been constructed on the land, it has received approval to be occupied and is available for rent; or
- the land is being used by the owner to carry on a business, including a business of primary production.

This measure will apply to land held for residential or commercial purposes. However, the 'carrying on a business' test will generally exclude land held for commercial development.

From 1.7.2019 income tax deductions to taxpayers (other than corporates, non-SMSF superfunds, MITs, or PUTs or their subsidiary unit trusts or partnerships) are denied for losses and outgoings incurred in holding vacant land (without an independent substantial and permanent structure in use or available for use (ignoring lawfully occupied residential premises that are not leased/hired/licenced or available for lease/hire/licence)), regardless of when acquired, to the extent the land is not at the time of incurring the expense or outgoing (sec. 26-102 ITAA 1997):-

1. used or held available for use by the entity in the course of carrying on a business in order to earn assessable income; or
2. used or held available for use in carrying on a business by: -

- an affiliate, spouse, or child of the taxpayer; or
- an entity that is connected with the taxpayer or of which the taxpayer is an affiliate.

Key points:

- Deductions are denied from 1.7. 2019 regardless of when the land was acquired (no grandfathering).

- The land is assessed on each separate title.
- Apportionment of deductions is required for mixed business use and vacant use land.
- The structure must be independent (separate and not incidental purpose to other structures), substantial (size, value, or importance) and permanent (fixed and enduring).
- The structure must exist at the date the holding costs (rates, land tax, repairs) or expense (finance interest) is incurred or is referrable.
- A structure is not required where the land is used or held for use in carrying on a business (property development business or primary production business) by the owner or an affiliate or connected entity.
- Land is vacant until the structure is lawfully able to be occupied and used or available for use (e.g. no deduction during construction).
- Land is vacant if the structure is not actively leased/hired/licenced or available for lease/hire/licence.

It is possible that deductions may be denied for property developers where the land is recorded as capital or is not subject to a future development program because the land must be actively used or held ready for use in a property development business.

This affects land banking where a tract of land is held long term for development at a later date.

For property investors, deductions may be denied prior to construction, issue of the certificate of occupancy and the premises are listed for lease/hire/licence or subject to a lease/hire/licence or agreement for lease/hire/licence.

For primary producers, deductions may be denied where primary production activities (that do not constitute a primary production business) such as agistment, hobby/lifestyle farms or small-scale farms (and possibly share farming) are being conducted.

The following examples may be useful.

Example 1: Vacant land no substantial and permanent structure

Jess purchased a block of land in Brisbane in July 2018 and intends to build a rental property on it. Jess engaged an architect to develop plans and erected some temporary fencing to stop illegal dumping. As the land does not yet contain a substantial and permanent structure Jess can't claim deductions for the costs of holding the land.

Example 2: Residential premises with no permanent structure

Chelsy owns a residential block of land on which she intends to build a rental property. Although the block of land is fenced and has a retaining wall, it does not yet contain any substantial and permanent structures. This means the block is vacant land and Chelsy cannot deduct any holding costs she may incur in relation to the land.

As the property is residential, property deductions will be limited until such time as the property contains residential premises that are both: -

- lawfully able to be occupied
- rented or available for rent.

Example 3: Substantial renovations

Mary-Anne, a builder, acquires a dilapidated bungalow that has three bedrooms and one bathroom. Mary-Anne intends to renovate and rent the bungalow.

Mary-Anne adds an upstairs extension which creates a new bedroom and a bathroom. As part of the extension, she replaces the roof of the bungalow and all ceilings on the lower level. The renovations to the lower level include rewiring, repairing cracked walls by removing and replacing all the gyprock and cement rendering the exposed bricks in the combined family room and kitchen. The installation of stairs necessitated the removal of two walls and replacement of the floor in two of the ground floors rooms. Mary-Anne also does some cosmetic work by repainting, polishing floorboards, and replacing all the fittings in the kitchen and bathroom.

The work undertaken by Mary-Anne constitutes substantial renovations. All the rooms in the house are affected by the work and several of the rooms have undergone structural renovation work. A substantial part of the bungalow is removed and replaced in undertaking the renovation work. The cosmetic work has not been taken into account when deciding whether substantial renovations have occurred.

Mary-Anne must disregard the bungalow in determining whether there is a substantial and permanent structure on her land, as the bungalow is being substantially renovated. Mary-Anne's land is considered vacant and she cannot claim deductions for holding cost expenses incurred during the substantial renovations and until the renovated bungalow is rented or available for rent and lawfully able to be occupied.

Example 4: Farmland not vacant – substantial structure

The AB family trust holds a single title parcel of farmland on which two family members grow grain. The land contains a number of silos used to store the grain. Expenses related to holding the land such as interest costs and council rates are not affected by this measure because the land is not vacant as there is a substantial permanent structure on that land (the silos).

Example 5: Farmland not vacant – family homestead

John and Mary have a large parcel of farmland. The land contains a homestead that has been on the land for more than a century and is the family home. John and Mary are not affected by this change as the land is not vacant; the land contains a substantial structure (the homestead).

John and Mary's ability to claim deductions for their holding cost expenses will depend on whether any of the land is also being used to generate assessable income.

Example 6: Rental property constructed on vacant land – apportionment of expenses

In January 2019, Kylie purchased a block of land in Yass to build a property for rent. In October as construction nears completion Kylie advertised for a tenant, and on 30 November 2019 she receives the certificate of occupancy.

Kylie cannot claim deductions for expenses incurred before 30 November 2019. Where the expenses are for a period that applies before and after the property is ready for use, the expense can be apportioned, and a deduction claimed for the period that the property is available for use.

For example, Kylie's council rates for the year ended 30 June 2020 are $2,000. Kylie apportions the council rates according to when the property became available for use.

Holding expense × portion of year property was available = deductible amount

Kylie can claim a deduction against her rental income of: -

$2000 × (214 ÷ 366) = $1169

Kylie would also be able to claim a deduction for expenses incurred for advertising for a tenant as this is not considered a cost of holding vacant land.

LONG-TERM CONSTRUCTION CONTRACTS

In past issues we have mentioned IT 2450 which set out guidance on the recognition of income from long term construction contracts. This has now been superseded by T.R. 2018/3. In the past 31 years, a number of related tax determinations have been issued and new accounting standard AASB 15 revenue from contracts with customers has come into effect. TR2018/3 took effect from 1 January 2018.

Fundamentally this Ruling does not change the ATO's view. TR 2018/3 expands ATO guidance to cover the treatment of expenses and makes reference to new accounting standard AASB 15. The key difference for business now appear to be with the fundamental differences that can now exist between the income tax treatment and AASB 15.

Key points of the ruling include: -

- 'Long-term' construction contracts are contracts where construction work extends beyond one year of income. Accordingly, a construction contract of less than twelve months may still be 'long term' if it straddles two income years.
- A deferral of the recognition of profits and losses until completion of the contract remains unacceptable.
- There continues to be two methods which may apply in recognising the income derived and expenses incurred under a long-term construction contract for income tax purposes – the basic approach and the estimated profits basis.
- Under the basic approach, all progress and final payments received in an income year are assessable with deductions allowed for expenses incurred and permitted under law. This may result in upfront payments being assessable in the year of receipt and differences from the accounting treatment adopted.
- Where taxpayers adopt the estimated profits basis, it is acceptable to recognise the ultimate profit or loss over the term of contract, provided the method of accounting for the long term construction contract is in accordance with accepted accounting practices and has the effect of allocating the profit or loss on a fair and reasonable basis. However, this does not necessarily mean the tax treatment will mirror the accounting treatment. Certain tax adjustments are still required under the estimated profits basis as AASB 15 does not necessarily bring into line the accounting recognition of revenue with tax law which requires income to have been derived. Similarly, expenses will only be deductible where they are identified as likely having been incurred over the period of the contract. Estimations of costs are likely to be required each year and estimations will need to be well documented.

- The allocation of notional taxable income adopted for a contract must reflect the progress of the contract and the particular method used will depend on the nature of the contract. The method adopted must be applied consistently for all years of the contract.

ATO POSTS REVIEW FOR ONLINE RENTALS

The Australian Taxation Office (ATO) has launched an extensive data-matching program to identify taxpayers receiving income from short term rentals. Information from online platform sharing sites for around 190,000 Australians will be examined to identify taxpayers who have left out rental income and over-claimed deductions.

A & A Property Developers Pty Ltd v MCCA Asset Management Ltd

This case clearly shows how failure to clarify the GST issues that arise in relation to a conveyancing transaction before contractual relations are created can lead to substantial and costly disputes.

A potential GST liability of $290,000 was involved. While a detailed discussion of this case is beyond the scope of this publication, there is a clear take out… where GST is involved in a transaction do not skimp on legal advice – it is money well spent.

In past editions we covered the below property cases in some detail. These have been removed to our website.

- Commissioner of Taxation V MBI Properties Pty Ltd (2014) HCA 49
- Vidler V FCT: Residential Property
- Vacant Land and GST – A Tap Is Not Enough
- Corymbia Corporation Pty Ltd V Commissioner of Taxation (2010) AATA 401
- Sunchen Pty Ltd V Commissioner of Taxation (2010) FCA 21
- Commissioner of Taxation V Gloxinia Investments Ltd ATF Gloxinia Unit Trust
- A F C Holdings Pty Ltd V Shiprock Holdings Pty Ltd (2010) NSWSC 985
- Cyonara Snowfox Pty Ltd and Commissioner of Taxation (2011) AATA 124
- Aurora Developments Pty Ltd V Commissioner of Taxation (2011) FCA 232 15 August 2011
- ECC Southbank Pty Ltd as Trustee for Nest Southbank Unit Trust V Commissioner of Taxation (2012) FCA 795 31 July 2012
- Craddon and Commissioner of Taxation (2011) AATA 790
- Margin scheme and GST anti-avoidance – the Taxpayer and Commissioner of Taxation (2010) A.A.T.A. 497
- Share trader or investor - Hartley and Commissioner of Taxation (2013) AATA 601

NO DEDUCTION FOR TRAVEL EXPENSES

From 1 July 2017, the government disallowed deductions for travel expenses related to owning a residential investment property. This is an integrity measure to address concerns that such deductions are being abused.

This will rein in a high growth deduction item and improve taxpayer confidence in the negative gearing system.

RENOVATING PROPERTIES

Personal property investor

If you're considered a personal property investor, your net gain or loss from the renovation (proceeds from the sale of the property less the purchase and other costs associated with buying, renovating and selling it) is treated as a capital gain or capital loss respectively.

CGT concessions such as the CGT discount and the main residence exemption may reduce your capital gain.

You are not conducting an enterprise of property renovation for GST purposes and are not required to register for GST. But if you are registered in some other business capacity you do not pay GST on the proceeds from the sale of the property or claim GST credits for related purchases.

The following example illustrates the characteristics of personal property investing.

Example: Personal investor

Doug is a sales representative. He obtains an investment loan and purchases a property that he intends to rent out. He would not consider selling the property unless the price appreciated markedly.

The property requires renovation to attract desirable tenants. Doug renovates the property after work and on weekends. Over the period of the renovation, the real estate market booms and Doug decides to sell the property.

Doug would not be considered to be in the business of property renovation because: -

- His intention when he bought the property was to gain rental income rather than make a profit from buying, renovating, and selling it.
- Doug did not rely on the income to meet regular expenses because he has income from his job.
- His renovation activities were not carried on in a business-like manner.
- Doug did not buy the property with a view to selling it at a profit and did not carry out a one-off profit-making activity.

So, Doug is regarded as a personal investor.

However, if Doug, because of his success with this renovation (either in his own right or with another or others) was to then undertake another renovation similar to the first with a view to achieving the same profit levels, he will be regarded as being in the business of property renovation.

Profit-making activity of property renovations

If you're carrying out a profit-making activity of property renovations also known as 'property flipping', you report in your income tax return your net profit or loss from the renovation (proceeds from the sale of the property less the purchase and other costs associated with buying, holding, renovating and selling it).

You are entitled to an Australian business number (ABN) and you may be required to register for GST if the renovations are substantial.

The following example illustrates the characteristics of a profit-making activity of property renovations: -

Example: Renovation as a profit-making activity

Fred and Sally are married with two children. They renovated their home, substantially increasing its value. After watching many of the home improvement shows and seeing how other people have bought, renovated, and sold properties for a significant profit, they decide to investigate the purchase of another property to renovate and make a profit.

They consider many properties, costing out the renovations, the costs of buying and selling and timeframes to complete the renovations. Their research shows that they could also make a significant profit.

Fred and Sally sell their current home and purchase a new property, which they move into while completing the renovations. They plan out the renovation in stages, including the costs and any contractors needed to complete the work. The renovation runs to schedule and, when completed, they list the property for sale, and it sells for a profit.

Because the property renovation activities were planned, organised and carried on in a business-like manner, the purpose of buying the property was to renovate it and make a profit, and the renovations were carried on in a similar manner to other property renovation businesses, Fred and Sally have entered into a one-off profit-making activity.

Business of renovating properties

If you're carrying on a business of renovating properties or 'flipping' properties, the purchased properties are regarded as trading stock (even if you live in one for a short period) and the costs associated with buying and renovating them form part of the cost of your trading stock until they're sold.

You calculate your business's annual profit or loss in the same way as any business with trading stock.

CGT does not apply to assets held as trading stock, and CGT concessions such as the CGT discount, small business concessions and main residence exemption do not apply to any income from the sale of the properties.

You are entitled to an Australian business number (ABN) and you may be required to register for GST if the renovations are substantial.

The following example illustrates the characteristics of a business of renovating properties.

Property renovating as a business or profit-making activity

Whether you are in the business of property renovating, property flipping or undertaking a profit-making activity in regard to property renovation, is a question of fact. The following information will help you work out if you are in a business or profit-making activity.

Some of the questions you need to ask about your property renovating activities are: -

- Are they regular and repetitive?

- What is their size and scale?
- Are they planned, organised and carried on in a business-like manner?
- Are they carried on for the purpose of making a profit?
- Do you rely on the income received to meet your and your dependents' regular expenses?
- Are they of a similar kind and carried on in a similar manner, to the activities of other property renovating businesses?

In reaching a conclusion, no single factor is necessarily decisive, and many may be interrelated with other factors. The importance given to each factor varies depending on individual circumstances.

However, you are likely to be entering into a profit-making activity if you acquire a property with the intention of renovating and selling it at a profit and go about it in a business-like way.

Example: Renovation business

Tony is a carpenter. After reading the Investors Club News, he decides to purchase a property. He thoroughly researches the real estate market, attends investment seminars, and records the information he has found.

The property Tony purchases is in a good location, but he pays a reduced price because it needs extensive renovation. Using his knowledge and contacts within the building industry, Tony quickly completes the renovations.

He then sells the property and makes a generous profit.

Using the proceeds from the sale of the first property, Tony purchases two more houses that require renovation.

Tony sets up an office in one of the rooms in his house. He has a computer and access to the internet so he can monitor the property market. Tony's objective is to identify properties that will increase in value over a short time once he has improved them. He leaves his job so he can spend more time on his research and renovations.

Tony's activities show all the factors that would be expected from a person carrying on a business. His property renovating operation demonstrates a profit-making intention; and there is repetition and regularity to his activities. Tony's activities are also organised in a business-like manner.

Therefore, Tony is regarded as being in the business of property renovation.

This can be a lineball situation with the ATO having real difficulty in proving subjective intention. It is not wise to immediately place a home on the market, with an aggressive marketing campaign when renovations are complete then crow about it on social media. If it is a quick turnaround then you may be asking for trouble.

TIPS FOR DEVELOPERS EXPECTING LARGE GST REFUNDS

These can be held up by the ATO seeking documentation and verification of input tax credits.

- Be clear on your tax position and if in doubt seek expert advice – if you wrongly claim large credits, serious penalties may apply.
- If a large refund is expected, invariably the ATO will ask for supporting documentation.
- Anticipate this by placing this documentation on the tax agent's portal.
- If this is not possible have the documentation ready for forwarding to the ATO.

Recently the inspector of taxation found the ATO was doing a generally good job in forwarding GST refunds. However, some of us have had a very different experience and we advise developers not to expect the ATO, refund to be available in the normal cycle – it may well be held up and you should have contingency plans for this.

CHANGES TO DEPRECIATION ON SECONDHAND PROPERTIES

In the 2017 budget, the Government confined plant and equipment depreciation deductions for items that can be easily removed, such as carpets and dishwashers and only to those expenses actually incurred by investors.

This no longer allows subsequent owners of property to claim deductions on items purchased by the previous owners of the property.

There was some concern that such assets were being depreciated in excess of their actual values by successive investors. In effect this is an integrity measure.

These changes apply on a prospective basis, with existing investments grandfathered. Plant and equipment forming part of residential investment properties as of 09/05/2017 continue to give rise to deductions for depreciation until either the investor no longer owns the asset, or the asset reaches the end of its effective life.

Investors who purchase plant and equipment for their residential investment property after 09/05/2017 are able to claim a deduction over the effective life of the asset. However, subsequent owners of a property are unable to claim deductions for plant and equipment purchased by a previous owner of that property.

CHANGES TO CGT RULES FOR NON-RESIDENTS AND TEMPORARY RESIDENTS

The capital gains tax (CGT) rules have been changed to reduce the risk that foreign investors avoid paying CGT in Australia, including by no longer allowing foreign or temporary tax residents to claim the main residence CGT exemption, and by expanding the scope of the CGT withholding system for foreign residents.

TOP NINE TIPS FOR INVESTMENT PROPERTIES

Start thinking about these issues now not just prior to tax year end being 30 June.

1. The Importance of Good Records

Keep all documentation summaries of all your rental income and expenses. This documentation should be kept for at least 5 years.

2. Depreciation

Generally, only registered quantity surveyors are authorised to prepare eligible depreciation schedules for purchases of new property. Builders and cost schedules are also allowable.

In the event you are doing a renovation a quantity surveyor can produce a scrapping schedule, which puts a value against all items to be discarded. Also refer to our article on demolitions. This value is expensed in the year of expenditure. The new items are then depreciated in a new depreciation schedule.

Also note that each investor has their own depreciation cost limit – currently $300.

This is relevant where properties are owned by more than one person.

3. Interest Expenses

Only interest expenses on borrowed funds used to invest in an asset that produces assessable income can be deductible. This is known as the 'use' test as consistently applied by the Courts.

A split line of credit should be considered when a loan is used for both investment and private purposes.

If capitalising interest on the investment line of credit, the ATO may require evidence of correct documentation and intention.

In this area you will need to seek specialist advice. However, split loans have their place to avoid the merging of personal (non-deductible) and investment (deductible) debt.

4. Pre-pay Expenses

If you have a geared investment, consider pre-paying next year's interest to gain an immediate tax deduction. You could prepay insurance and bring forward expenditure.

5. Home Office

Consumables used as you work on your investment property may be a tax deduction. The ATO provides an hourly rate for energy costs. Also, you may claim a modest percentage of internet costs along with printing and stationery costs. Telephone calls relating to these activities are also deductible.

6. Apply for a PAYG Variation

If you have purchased a negatively geared investment you may have your PAYG deductions reduced to allow for the losses being incurred.

You can request the ATO to provide a PAYG variation certificate to give to your employer for reduced PAYG deductions. Alternatively, you will receive the refund of the additional tax paid on lodgement of your income tax return.

7. Minimise Capital Gains

Taxable capital gains realised during a tax year may be minimised by an offset against capital losses or trading losses incurred during that same tax year.

To reduce a capital gain generated on sale of property or other assets during the year, consider disposing assets which have lost value and have a bleak future.

The 50% discount on capital gains is available where an asset is held for longer than 12 months so carefully consider the timing of any sale, noting that relevant dates for calculating capital gains and eligibility for the discount is the contract date, not the settlement date.

8. Record those Capital Losses

Capital losses incurred in a given year may be indefinitely carried forward to future years if there are insufficient gains to absorb it in the current year.

Note however, capital losses may not be offset against normal income such as salary or business trading income. In the event you have made a capital gain, review your share and property portfolio to consider realising a capital loss to offset the gain.

Capital losses cannot be carried back to prior years. Refer to Issue #103 February 2020 tax tip #20 which outlines the importance of a CGT Asset Register.

9. Trusts

The use of a trust improves asset protection, estate planning and allows increased flexibility for property investors – see Issue #106 August 2020 pages 30-35.

Ensure the Trust has been formed correctly to ensure you do not lose interest deductibility, normally fully allowable by the ATO providing the requirements are met.

GST "CHANGE OF USE" ADJUSTMENT RULES RELEVANT TO PROPERTY DEVELOPERS

An adjustment is a change that increases or decreased your net GST liability for a reporting period. There are two types of adjustments: -

- **Increasing adjustments** – these increase your net GST liability for a reporting period.
- **Decreasing adjustments** – these decrease your net GST liability for a reporting period.

You may need to make an adjustment on your activity statement in relation to GST credits you have previously claimed if you use your property differently from the way you originally planned – for example, if you have rented out a residential premises that you planned to sell. You would need to make an adjustment in these circumstances as the GST credits you have previously claimed in relation to the construction or development of the residential premises you may have been too much based on your actual use.

You will also have an adjustment if you originally planned to rent but have sold residential premises that form part of your business or enterprise.

Information you need to work out change in use Adjustments

To be able to calculate change in use adjustments, you will need certain information including: -

- When you made your purchase.
- The GST-exclusive market value of each of your purchases.
- What GST credits you claimed when you made the purchases.
- The tax period in which you claimed the GST credits on your purchases.
- Any previous adjustments you have made relating to the purchases.
- Any details of you holding or marketing the property for sale (for example the listing agreement with your real estate agent or advertising material).
- A reasonable estimation of the selling price (if the property has not sold).
- What you have used the residential property for, including the period for which you have rented the premises or used the premises for private purposes.
- The amount of any rent you received (if they have been rented).
- The date when you sold the property, and the amount you sold it for.

INCREASING ATO FOCUS ON PROPERTY DEVELOPERS

Recently the ATO has been using more ways of detecting goods and services tax (GST) avoidance on property sales, including property data matching from the Office of State Revenue and Land Titles Data. The ATO is also using data matching and analysis to ensure property developers are correctly reporting GST on property sales.

The ATO makes it clear that this activity has and will be continued throughout 2019-20 & 2021 with increased focus on their enhanced data matching capacities.

PROPERTY DEVELOPERS – THRESHOLD ISSUES

We have covered "the Accidental Developer" elsewhere in this edition. The issue of isolated transactions is also considered.

COMMON GST ERRORS FOR DEVELOPERS

In a typical development where full input tax credits are claimed we see four common mistakes.

1. A Failure to Adjust for a change in 'Creditable Purpose' from Selling to Renting

This is not an uncommon situation where the developer is not able to dispose of stock units at the desired price. A choice may be made to rent out some units.

Note, income tax credits have been claimed on the basis the units were to be sold, refer to Division 129 of the Act.

The fundamental question Division 129 asks is ‘was the GST position applied to earlier transactions reflective of how the acquisition was put to use.’

See above “change of use” adjustments on page 30.

Clearly adjustments will be required for premises that have for a period derived income from rent. More than ever ATO data matching techniques are increasingly identifying these situations.

This has become a topical issue with the glut of inner-city units that developers are finding hard to sell.

2. **In the event an adjustment is made there is failure to consider a potential dual use application**

Where Division 129 adjustments are made by the Taxpayer there is sometimes a failure to consider a dual use application. We refer you to GSTR 2009/4 and the formula outlined in Paragraph 83.

This could result in substantial savings.

In order to sustain a dual use intention a taxpayer must on an objective assessment of the facts and circumstances demonstrate that there was and still is a genuine intention that relevant properties be sold.

Paragraph 45 of GST 2009/4 outlines some relevant factors.

3. **Incorrect Interpretation of the 5 year ‘Residential Accommodation’ use ‘Carve Out’ from the definition of New Residential Premises**

If you have taken advantage of a dual use application to minimise the input tax credits clawed back, then you cannot expect to have your cake and eat it too.

Refer to section 40-75 (2) ‘Meaning of New Residential Premises for the 5-year rule.’ Once again GSTR 2009/4 provides guidance on the Commissioner’s view which is where dual use premises are involved, then the premises will have been used for a purpose other than input taxed residential premises. The ATO view is that where the dual use of the premises continues, then the 5-year rule cannot apply.

4. **A failure to take into account the Application of Division 135 to an Acquisition**

Division 135 is an integrity measure which provides for an adjustment to ensure a proper accounting for GST that is in proportion to the private or input taxed use of the property that is acquired.

This may happen when a bundle of residential premises is acquired such as a residential complex (refer to MBI Properties).

Another example would be the acquisition of a retirement village.

The message here when claiming input tax credits on making adjustments is that big dollars equals big risk particularly where the accountant or the business owner enters unchartered waters – seek professional advice.

NEW RESIDENTIAL PREMISES AND GST

The ATO have advised that if you are registered for GST and have constructed new residential premises that you originally intended to sell but have since rented out, you may need to make an adjustment in your next Business Activity Statement.

If you constructed new residential premises which you intended to sell as part of your business, then the premises have been constructed for a creditable purpose – GST credits can generally be claimed on things which are acquired for a creditable purpose.

If your use of the property changes – for example, you rent instead of sell – so does the creditable purpose. The renting of the premises is input taxed and is not for a creditable purpose.

If you have a change in creditable purpose, you will need to make an adjustment to the amount of GST credits originally claimed. An increasing adjustment will increase your GST liability for the tax period, while a decreasing adjustment will reduce your GST liability.

Adjustments for the change in creditable purpose are often made over a number of years and are generally recorded in June activity statements.

If you find you have creditable purpose adjustment for property transactions that you did not report, you should complete a Voluntary disclosure.

If you review your activity statements and report any mistakes voluntarily, you will not have to pay any shortfall penalties, and any general interest charges (GIC) will be reduced to the base rate.

FOREIGN RESIDENT CAPITAL GAINS TAX WITHHOLDING

Since 1 July 2016, the foreign resident capital gains tax withholding regime has been in force.

From 1 July 2017, the withholding rate that a buyer must pay to the Australian Tax Office on purchase of real estate assets from a foreign resident seller increased from 10 percent to 12.5 percent. The threshold values at which the laws apply have also reduced from $2 million to $750,000.

This regime impacts not only upon purchasers of real property but also purchasers of shares in non-listed property rich companies and purchases of units in unlisted property trusts.

The definition of property includes both residential and commercial real property, leasehold interests, and mining, quarrying and prospecting rights.

Property Acquisitions

If you are a purchaser of property for more than $750,000 then you must withhold unless the vendor shows you a clearance certificate or a variation certificate. An exemption is available where the vendor is in financial distress as defined (e.g. administration) but in such cases specialist advice should be sought.

Any Australian Vendor of property should apply online to the ATO to get a clearance certificate immediately a sale of relevant property is contemplated. The clearance certificate is not property specific and lasts 12 months.

Foreign vendors may apply to the ATO for a variation on the grounds that the tax they expect to pay on the gain (if any) will ultimately amount to less than 12.5% of the purchase price in order to reduce the withholding required to nil or some other amount. This could apply if the property is being sold for a loss, the vendor has carried forward tax losses or roll-over relief is available.

Such a variation is property specific and should be applied for as early as possible as the application may take up to a month to process.

As this is a non-final withholding measure, the foreign vendor should file an Australian tax return disclosing any gain. The amount withheld by the purchaser is a tax credit to the amount otherwise payable by the vendor – so in the event withholding is made where the vendor has no tax liability, the vendor be entitled to a full refund on filing an Australian tax return.

If the purchaser fails to withhold then the ATO may impose a penalty of the amount of tax which would have been withheld.

Those purchasing shares or units may also have to withhold – but the procedure in order to escape withholding is different. In this case there is a declaration mechanism that can be used by both Australian and foreign vendors.

THE FOUR-YEAR CONSTRUCTION RULE

Extending the Main Residence Exemption

When a taxpayer builds a new home on land, or repairs or renovates an existing house, the main residence exemption will usually only apply from the date the completed dwelling becomes the taxpayer's main residence. It then follows when the house is eventually sold, only a partial main residence exemption will apply. In this case, the taxable portion of any capital gain is calculated under s.118-185.

However, there is relief under s.118-150 which allows a taxpayer to choose to treat the completed dwelling and the land as their main residence for a period of up to 4 years before it actually becomes the taxpayer's main residence. The taxpayer then applies the main residence exemption to the whole property during the period the dwelling is being constructed, repaired, or renovated, for a period of up to 4 years.

This choice can **only** be made when the following conditions are met: -

- The completed dwelling becomes the taxpayer's main residence as soon as practicable after it is completed; and
- The dwelling continues to be the taxpayer's main residence for at least 3 months.

Once the choice is made to apply s.118-150, **no other** dwelling can generally be the taxpayer's main residence during the same period.

The 4-year exemption under s.118-150 may be a very useful planning tool in maximising the main residence exemption for taxpayers who build a new home or repair or renovate an existing house that will become the taxpayer's home. When applying this concession, a distinction should be made between the following common categories of taxpayers: -

- Those taxpayers who buy land and then either build a new home or repair or renovate an existing house on the land, before moving in.
- Those taxpayers who buy an existing house which is then occupied (e.g. by tenants) before either a new home is built, or the existing house is repaired or renovated; and
- Those taxpayers who demolish their existing main residence to build a new home.

The following case study may be helpful…

Purchase of vacant land to build new home

Tony acquired a block of land on 1 April 2000 and built a new house which was completed on 12 September 2002. Tony moved into the house on 15 September 2002 and lived there until the house was sold on 15 March 2009. The sale generated a capital gain of $180,000.

Tony's new house will be considered his main residence from the time he moved into it until it was sold (i.e. from 15 September 2002 to 15 March 2009). If Tony chooses to apply s.118-150, his house will also be considered his main residence from the time the land was acquired until it became his main residence (i.e. from 1 April 2000 to 14 September 2002).

If a dwelling is occupied by tenants for a period of time before it is re-built, repaired or renovated, the main residence exemption will not apply for this period.

Where an existing house is demolished to build a new home there are a number of scenarios and valuable guidance is contained in ATO ID's 2003/322, 20003/466 and 2006/185.

ENCROACHING SUBURBIA AND FARMLAND

ATO finds sale of farmland a 'mere realisation' ID 2002/700

With encroaching suburbia particularly in regional towns this may be very relevant.

Here the ATO considered whether the sale of farmland was assessable income under s.6-5.

In the 1970's the taxpayer purchased farming land. Several types of farming were attempted and found unprofitable over an extensive period. Due to the unprofitability of the farming business the taxpayer rezoned and subdivided the land.

Roads were constructed, underground power was installed, and trees were planted. Little of the subdivision work was planned by the taxpayer who relied on town planners, engineers, contractors, and consultants to design, plan, and sell the allotments.

The taxpayer had not conducted any other activities relating to property development.

Holding the profit derived from the subdivision was only a mere realisation, the ATO cited the following reasons: -

- **Unprofitability of land** – the sale of the subdivided land was triggered by the land's unprofitability.
- **Initial purpose NOT land development** – the initial purpose of purchasing land was farming.
- **Land was farmed** – the land was used for farming purposes for a long period of time before subdivision.
- **Taxpayer outsourced subdivision** – the taxpayer only performed a small part of the subdivision. The taxpayer relied on town planners, engineers, contractors, and consultants to design, plan, and sell the allotments; and
- **Taxpayer was not a developer** – the taxpayer had no other business relating to property development.

TRUSTS MISCHARACTERISING PROPERTY DEVELOPMENT RECEIPTS AS CAPITAL GAINS

Taxpayer Alert 2014/1 released on 28.07.2014 describes arrangements where property developers use trusts to return the proceeds from property development as capital gains instead of income on revenue account.

This Taxpayer Alert describes an arrangement whereby a trust (commonly a special purpose or new trust) undertakes property development activities as part of its normal business. The developed property, which could be either commercial or residential in nature, is subsequently sold and the proceeds are returned on capital account, resulting in access to the general 50% capital gains discount.

The proceeds are not returned as ordinary income under section 6-5 of the Income Tax Assessment Act 1997 (ITAA 1997), either on a gross basis (as part of a business of property development, where the underlying property constitutes trading stock for the purposes of section 70-10 of the ITAA 1997) or on a net basis (as part of a profit making undertaking).

Description

This Taxpayer Alert applies to arrangements which display all or most of the following...

An entity with experience in either developing or selling property, or in the property and construction industry, establishes a new trust for the purpose of acquiring property for development and sale.

In some cases, the trust deed may expressly state that the purpose of the trust is to hold the developed property as a capital asset to generate rental income. In other cases, the trust deed may be silent as to its purpose.

Activity is then undertaken in a manner which is at odds with the stated purpose of treating the developed property as a capital asset. For example: -

- Documents prepared in connection with obtaining finance for the development may indicate that the dwellings constructed on the land are to be sold within a certain timeframe and that the proceeds are to be used to repay the loan.

- Communication with local government authorities overseeing building approvals may describe the activity as being the development of property for sale.
- Real estate agents may be engaged early in the development process, and advertising to the general public may indicate that the dwellings/subdivided blocks of land are available to be purchased well in advance of the project's completion, including sales off the plan.

The property is sold soon after completion of the development, where the underlying property may have been held for as little as 13 months.

The trustee treats the sale proceeds as being on capital account, and because the trustee acquired the underlying property more than 12 months before the sale, it claims the general 50% capital gains tax discount (in other words, it treats the gain/profit in respect of each sale as a discounted capital gain).

The ATO considers that arrangements of this type give rise to various issues relevant to taxation laws, including whether: -

- The underlying property constitutes trading stock for the purposes of section 70-10 of the ITAA 1997 on the basis that the trustee is carrying on a business of property development.
- The gross proceeds from sale constitute ordinary income under section 6-5 of the ITAA 1997 on the basis that the trustee is carrying on a business of property development.
- The net profit from sale is ordinary income under section 6-5 of the ITAA 1997 on the basis that, although the trustee is not carrying on a business of property development, it is nevertheless involved in a profit-making undertaking.

The ATO has commenced a number of audits and has made adjustments to increase the net income of a number of trusts. Audit activity will continue.

If you have entered into a similar arrangement to that described in this alert, you may wish to seek independent professional advice. If you would like to correct something in your tax return, more information is available on the ATO website ato.gov.au and search for Correcting your tax return or activity statement.

CAPITAL V INCOME "INVESTORS" BEWARE!

August - V - Commissioner of Taxation (2013) FCAFC 85

This case confirms the importance of property investors seeking advice at the time of acquiring a property and also making their intentions clear if they wish to remain on 'capital account' and within the CGT regime.

This was an interlocutory application to adduce further evidence prior to hearing of a further Appeal to the Full Federal Court following the decision of Nicholas J in August v Commissioner of Taxation (2012) FCA 682. In rejecting the application Siopis, Besanko and McKerracher JJ have set out in detail the Nicholas J findings and firmly rejected the challenge to the conclusions "of the trial judge" on evidentiary issues.

The Full Court confirmed the ATO view that the sales of the relevant properties were not on capital account and formed part of ordinary income under Section 6-5. This effectively denied the 50% discount that would have been available under the CGT provisions.

In the absence of any contemporaneous documents evidencing the Augusts' purposes or intentions when the shops were acquired, the Full Federal Court held that whether or not the properties had been purchased for the purpose of engaging in a scheme of profit-making by sale must be determined with regard to all the surrounding circumstances and the parties evidence as to their own purposes and intentions.

The Full Federal Court upheld the decision of the judge at the first instance that the acquisitions by the Augusts' investment trust were to be treated as part of a profit-making scheme rather than as long-term investments.

The reason for the Court's conclusion was that the circumstances surrounding the acquisitions showed that the shops had been purchased with the intention or purpose of developing and tenanting them and selling them for a profit. The development and tenanting of properties and their subsequent sale was regarded by the Court as a scheme or commercial transaction.

It is essential property investors obtain professional legal, financial and taxation advice when making property acquisitions. It is vital to keep sound records, particularly if they wish to have favourable tax treatment of capital gains. In assessing the tax implications of a particular property transaction, the ATO and courts will consider not only an investor's evidence as to their intentions at the time of the purchase but will also look to evidence such as contemporaneous records and take into account the circumstances surrounding the transaction (e.g. finance methods, whether any improvements are made to the property and the existence of any tenancies).

Be warned! This is definitely on the ATO's radar as our discussion of Taxpayer Alert 2014/1 reveals.

August – Ongoing Implications

What lessons can be learned from Taxpayer Alert 2014/1 and the August case?

Advisers and clients alike need to be clearly aware of the dangers of believing because they have a special purpose trust, set up for one enterprise, that they can automatically access the CGT 50% individual discount if they have held at asset for more than 12 months.

In our Capital Gains Tax bonus edition #104, we dealt with the "Accidental Developer" but here the situation is often very different.

One scenario is business savvy principals of a trust who through their own or associated entities are actively engaged in property development. However, the premise used to access the CGT discount is that the trust is an investor with their adviser's confining their analysis to the CGT provisions of the Income Tax Assessment Act 1997 (ITAA).

However, as the August case clearly shows, it is not necessary for the entity to be conducting a business. Rather, if a profit-making intention can be adduced, then the ATO will take the view it is income according to normal concepts.

Here it is crucial to objectively review the manner in which the taxpayer acquired, dealt with and then subsequently disposed of the property in question – refer to the above in August.

In any cycle of the property market there is plenty of this going on for both residential and commercial. The ATO is likely to take the view that activities which are highly commercial in nature, resulting in renovations, new leases/tenancies and relatively quick turnover are fully assessable.

Do not just look at the CGT provisions, consider the following: -

- scale of operations
- background of participants
- evidence pointing to their 'subjective intention'
- whether a profit-making intention can be adduced.

As mentioned in the past these can fall either side of the line.

MAXIMISING DEPRECIATION CLAIMS ON RENTAL PROPERTIES

From 1 July 2001 the immediate deduction for depreciating assets costing $300 or less has been restricted to assets in use to produce assessable income from activities that do not amount to carrying on a business. This of course includes rental properties.

So, when applying the $300 immediate write-off we should consider owned rental property assets. Here each joint owner's interest in the asset is effectively treated as a separate asset for depreciation purposes under S. 40-35.

This means where the cost of a joint owner's interest in an asset is not more than $300, an immediate write-off can be claimed by the joint owner under S. 40-82(2) (if all other conditions are met), even if the overall cost of the asset exceeds $300.

For example, if a rental property is jointly owned by two or more persons, an asset costing up to $600 where the property is owned by two people may be written-off in the year of purchase under S. 40-80(2).

Therefore, the $300 immediate write-off concession will generate better initial cash flow benefits for jointly owned properties compared with rental properties which have only the one owner.

Many tax accountants miss this concession. An asset in a jointly owned property that has an overall cost of more than $300 - but no more than $300 for each individual joint owner will mean the asset can still be written-off in the year of purchase providing the other conditions in S. 40-80(2) are met. In comparison, the same asset in a rental property that is owned by one person must be depreciated over the asset's effective life (subject to the low-value pool method of depreciation – see below).

In similar fashion to the $300 write off, the advantages of allocating jointly owned assets to a low-value pool are often overlooked where properties held in joint names.

Under the low-value pool rules (refer to S. 40-425 to S. 40-460), a landlord can generally choose to depreciate the following two categories of assets as part of a low-value pool: -

- **a low-cost asset** – this is an asset acquired during the current year, costing less than $1,000 (except an asset that is eligible for the $300 immediate write-off concession noted above); and
- **a low-value asset** – this includes an existing asset already written down to less than $1,000 under the diminishing value (DV) method.

In a low-value pool, all assets are usually depreciated using a DV rate of 37.5%. The only exception is for low-cost assets which are depreciated using a DV rate of 8.75% (i.e. half the full rate of 37.5%) in their first year.

Once a choice has been made to set up a low-value pool, all low-cost assets acquired in that year and in later income years must be allocated to the pool. However, it is possible to allocate low-value assets at the taxpayer's discretion under S. 40-430.

COMMON RENTAL PROPERTY MISTAKES

According to the ATO, some common errors made by rental property owners include: -

- claiming rental deductions for properties not genuinely available for rent
- incorrectly claiming deductions for properties only available for rent part of the year such as a holiday home
- incorrectly claiming structural improvement costs as repairs when they are capital works deductions, such as re-modelling a bathroom or building a pergola; and
- overstating deduction claims for the interest on loans taken out to purchase, renovate or maintain a rental property.

ATO Crackdown on Rental Property Tax Claims

Recently the ATO announced it was targeting taxpayers who rent out their holiday homes for only a few weeks during the year but claim a full year's worth of deductions returns.

The ATO will pay close attention to rental property owners, especially those who own a holiday home who incorrectly claim these deductions. Taxpayers who have recently acquired rental properties will also be targeted.

Homeowners should be aware that it is not just holiday homes that are under focus by the ATO.

A common mistake that has risen among rental property owners is claiming for deductions for initial repairs to rectify damage, defects or deterioration that exists at the time of purchasing the property.

Taxpayers should be aware they are not entitled to claim a deduction for any repairs made to their rental property for issues that exist at the time of purchase even if the repairs were carried out to make the property suitable for rent. The cost of these repairs should be capitalised.

CASH FLOW BENEFITS FOR JOINTLY OWNED ASSETS IN A LOW-VALUE POOL

There are two cash flow benefits arising when depreciating a rental property asset as part of low-value pool, compared with depreciating the same asset over its effective life, as follows: -

1. **Depreciation for low-cost asset in first year** – in the first year (i.e. the year of purchase), low-cost assets are depreciated at a flat DV rate of 18.75% for the full year, regardless of when the asset is purchased during the year – there is no requirement to apportion the asset's depreciating claim on a day in the year basis.

   This means a low-cost asset can be purchased on the last day of an income year and still be depreciated at 18.75% for that income year. However, if the same asset was being depreciated over its effective life and not as part of a low-value pool it could only be effectively depreciated for one day in the income year which would result in a negligible tax deduction.

   Clearly for low-cost assets that are acquired towards the end of the income year; there are significant cash flow benefits of depreciating these assets as part of a low-value pool rather than depreciating them separately over their effective life in the first income year (i.e. the year of purchase).

2. **Depreciation for pooled assets after first year** – In general, depreciation claims for an asset (in its earlier years) will be greater in a low-value pool (compared with depreciating the same asset over its effective life), where the asset has an effective life of more than 4 years. Invariably this is usually the case with rental property fixtures, fittings, and furnishings.

Joint owners of a rental property can gain greater access to the potential cash flow benefits of using a low-value pool. This is because the low-value pool rules are applied to each joint owner's interest in the asset, and not to the asset as a whole. This means if the cost of a joint owner's interest in an asset is less than $1,000, the joint owner's interest will qualify as a low-cost asset and can be allocated to a low-value pool even if the overall cost of the asset is more than $1,000.

For example, if a rental property is jointly owned by two individuals, an asset costing up to less than $2,000 could be depreciated as part of a low-value pool.

Joint owners of a rental property will therefore have a greater number of assets that are eligible to be depreciated as part of a low-value pool compared with taxpayers who own a rental property solely in their name.

Consequently, the potential cash flow benefits of using a low-value pool will generally be greater in respect of a jointly owned rental property, compared with a rental property that is owned only by one person.

Be mindful however, that depreciation is only one expense and there may well be sound overall tax reasons for having the negatively geared property in the name of only one high income earning spouse. The above two examples are included to maximise claims in the event the property is held in joint names.

INVESTMENT IN RESIDENTIAL PROPERTY – SAVING ON GST

The leasing of residential premises is input taxed under the GST law unless the premises have the character of commercial residential premises.

It follows that a lessor of residential premises would not be entitled to obtain an input tax credit for an acquisition made in respect of residential premises, whereas the lessor of commercial residential premises would generally be (subject to the long-term accommodation exception), entitled to obtain input tax credits for such expenses.

If an investor acquires residential premises which are leased to another entity that leases similar premises from other owners and provides such premises to the general public for short-term accommodation, then the initial lease should be structured so as to impose an obligation upon the lessee entity to bear all costs associated with the maintenance and management of the premises and accept a lower rent. In essence, structure the lease in the same way as commercial leases operate – such leases impose an obligation upon the lessee to bear the costs of all expenses associated with the maintenance of the premises.

TAX SMART SELLING: PROPERTY

The message is clear and simple: get professional tax advice – this could save you thousands of dollars. After the event, it is usually too late for opportunities to generate tax savings. If at all possible, a desired outcome is to generate tax savings by increasing the taxable capital gain on the sale of a property and simultaneously create revenue deductions. The after-tax benefit of deductions for an individual (at 47%) more than offset the additional tax burden arising from an increased gain (at 23.5%). In other cases, the same strategy used by a company allows capital gains to be generated for use against capital losses with a corresponding decrease in taxable income.

Example - Standard sale

Toby has owned his factory and the surrounding property since 2003. He acquired the property (including the factory) for $3.2 million. By 2020, Toby's business has outgrown the factory, which he sells to a property developer who intends to knock down the factory and build town houses for resale. Since acquiring the factory Toby has claimed $200,000 in capital works deductions.

Toby sells the property to the property developer outright for $4 million, the $1,000,000 capital gain (on a $3.2 million cost base, reduced by the $200,000 Division 43 deductions clawed back) will give rise to a net tax liability of $235,000 (after applying the CGT 50% discount).

DIY Sale

Alternatively, assume Toby sells the property to the property developer under a contract stipulating that the vendor will demolish the factory. The sale price is adjusted by $100,000 to reflect the additional cost to Toby demolishing the factory. At this point the factory has residual 'undeducted construction expenditure' of $600,000.

In this scenario, the tax outcome is far more advantageous for Toby.

Under the capital works tax amortisation provisions, Toby is able to claim $600,000 revenue deduction in respect of the undeducted construction expenditure. This produces a tax saving of $282,000 (at the 47% tax rate).

From a capital gains tax perspective, the capital works deduction gives rises to a costs base adjustment for the property sold. Under the CGT rules, as the property was first acquired by Toby after 13 May 1997, the cost base is reduced by the $200,000 in capital works deductions claimed by Toby in the past and the $600,000 capital works deduction on demolition of the factory. As a result, the cost base is reduced to $2.4 million.

Toby's cost base for the property is increased to reflect the demolition costs he has incurred in demolishing the factory (say $100,000), bringing the cost base of the property to $2,500,000. With capital proceeds of $4,100,000 on the sale of the property, Toby's total taxable capital gain under this alternative is $1,600,000 resulting in tax on the capital gain of $376,000 (after applying the 50% capital gains discount). Taking into account the capital works deduction (giving rise to a tax saving of $282,000), Toby's net tax liability is $94,000. This represents a tax saving of $141,000 (being $235,000 - $94,000) compared to the scenario in which Toby sells the property without first demolishing the factory.

Pre 13 May 1997 property

Had the property been acquired before 13 May 1997, the benefit derived by Toby in this scenario would have been further increased. For properties acquired prior to this date, the cost base reduction to reflect Division 43 capital works deductions, are required above, would not have been necessary under the CGT rules. This would have resulted in a higher cost base and a smaller taxable capital gain.

Interest Deductions after a Rental Property Has Been Sold

In a property market under stress this issue is becoming more common.

Sale proceeds of a rental property will usually be applied against any outstanding loan. In the event a property is sold for less than the outstanding loan balance there will be a shortfall amount. The issue that then arises is whether a tax deduction can still be claimed for interest incurred on the loan shortfall amount.

The decisions in FCT – v – Brown (1999) FCA 721 (Brown) and FCT – v – Jones (2002) FCA 204 (Jones) clearly indicate that a taxpayer should be entitled to a tax deduction for interest on a loan shortfall amount arising from the sale of an income producing asset.

Taxation Ruling TR 2004/4 sets out the Commissioner's view following those decisions.

It should be noted that although Brown and Jones both dealt with taxpayer's carrying on a business, the courts and the ATO have indicated that the same principles can equally apply to non-business taxpayers (TD 95/27) including rental property owners.

Based on these decisions the below factors must be considered before making a claim for interest on a loan shortfall: -

- If the entire proceeds from the property's disposal are applied to the loan, then the interest will continue to be deductible.
- In the event there is a legal entitlement to pay the loan early and the taxpayer has sufficient assets to repay the loan, then this could affect the deductibility of interest subsequent to the sale of the rental property.
- Where a fixed term loan is refinanced at a lower rate after the rental property is sold this generally would not affect the deductibility of interest.
- The length of time elapsing since the sale of the rental property should not be an issue as long as the taxpayer does not have the capacity to repay the loan.

For example, in Guest – v – FCT FCA 193 interest deductions were allowed for 10 years after the business had ceased.

TAX TIP – INCREASING YOUR COST BASE ON FORMER PRINCIPAL PLACE OF RESIDENCE

Increasing your cost base

You can obtain uplift in the cost base of your house by having it deemed to have been acquired at market value on the day your home is first rented out. The following conditions must be satisfied: -

1. The home is rented out for more than 6 years (and no other property is treated as a 'main residence')
2. The home has been rented out after 20 August 1996; and
3. The full main residence exemption would have been available if the house was sold just before it was rented out.

To determine the market value of the house for CGT purposes, a person has the option of: -

1. Obtaining a valuation from a qualified valuer; or
2. Calculating their own valuation based on reasonably objective and supportable data.

Generally, if significant amounts are involved, it will be prudent to obtain a valuation from a qualified valuer, particularly if there is also any doubt about the market value of the property.

For further guidance see Law Administration Practice Statement PS LA 2005/8-Market Valuations.

Example 1 - Susan purchased a property in Melbourne in 2003 for $300,000 and occupied it as her main residence for 5 years. In 2008, she moved to Sydney for work and rented out her house. A qualified valuer values the market value of her house to be $650,000 at that time. In 2015 Susan decides to stay in Sydney and sells her house for $1,350,000 (i.e. 7 years after it is first rented out).

Capital Gains Tax Implications

Given that Susan meets all the above requirements, she can be deemed to have acquired her Melbourne home for its market value at $650,000 in 2008 (the date that the property was first used for income producing purposes).

When Susan sells the apartment, the capital gain (or loss) is calculated as follows:

Amount received:	$1,350,000
Less: Market value cost base of house in 2008	$ 650,000
Capital gain (loss)	$ 700,000

The **taxable capital gain** is then worked out as:

$$\text{Capital gain (or loss)} \times \frac{\text{Non-main residence days}}{\text{Days of ownership}}$$

$$= \$700{,}000 \times \frac{365}{2{,}555}$$

$$= \$100{,}000$$

Susan can then apply the 50% CGT discount (given that she has also held the property for more than 12 months). The capital gain on the sale of the Melbourne home will only be $50,000.

A great tax outcome

The reason Susan pays negligible tax of $23,500 on her profit of $700,000 is that she can BOTH revalue her house at 2008 (when she first rented it out) AND still partially claim the main residence exemption.

CO-OWNERSHIP OF RENTAL PROPERTY

The way that rental income and expenses are divided between co-owners varies depending on whether the co-owners are joint tenants or tenants in common or there is a partnership carrying on a rental property business.

Co-owners of an investment property – not in business

A person who simply co-owns an investment property or several investment properties is usually regarded as an investor who is not carrying on a rental property business, either alone or with the other co-owners. This is because of the limited scope of the rental property activities and the limited degree to which a co-owner actively participates in rental property activities.

Dividing income and expenses according to legal interest

Co-owners who are not carrying on a rental property business must divide the income and expenses for the rental property in line with their legal interest in the property. If they are: -

- Joint tenants, they each hold an equal interest in the property.
- Tenants in common, they may hold unequal interests in the property – for example, one may hold a 20% interest and the other an 80% interest.

Rental income and expenses must be attributed to each co-owner according to their legal interest in the property, despite any agreement between co-owners, either oral or in writing, stating otherwise.

Example: Joint Tenants

Mr and Mrs Hitchman are joint tenants in an investment rental property. Their activity is insufficient for them to be characterised as carrying on a rental property business. In the relevant year, Mrs Hitchman phones the Tax Office and asks if she can claim 80% of the rental loss. Mrs Hitchman says she is earning $67,000 a year, and Mr Hitchman is earning $31,000. Therefore, it would be better if she claimed most of the rental loss, as she would save more tax. Mrs Hitchman thought it was fair that she claimed a bigger loss because most of the expenses were paid out of her wages. Under a partnership agreement drawn up by the Hitchmans, Mrs Hitchman is supposed to claim 80% of any rental loss.

Mrs Hitchman was told that where two people are joint tenants in a rental property, the net rental loss must be shared in line with their legal interest in the property. Therefore, the Hitchmans must each include half of the total income and expenses in their tax returns.

Any agreement that the Hitchmans might draw up to divide the income and expenses in proportions other than equal shares has no effect for income tax purposes. Therefore, even is Mrs Hitchman paid most of the bills associated with the rental property; she would not be able to claim more of the rental property deductions than Mr Hitchman.

Example: Tenants in common

In the preceding example, if the Hitchmans held their property interest as tenants in common in equal shares, Mrs Hitchman would still be able to claim only 50% of the total property deductions.

However, if Mrs Hitchman's legal interest was 75% and Mr Hitchman's legal interest was 25%, Mrs Hitchman would have to include 75% of the income and expenses on her tax return and Mr Hitchman would have to include 25% of the income and expenses on his tax return.

Note: Interest on money borrowed by only one of the co-owners which is exclusively used to acquire that person's interest in the rental property does not need to be divided between all the co-owners.

If you do not know whether you hold your legal interest as a joint tenant or a tenant in common, read the Title Deed for the rental property.

Non-commercial rental

If you let a property or part of a property at less than normal commercial rates, this may limit the amount of deductions you can claim.

Renting to a family member

This issue arises frequently, and the following example provides guidance.

Mr and Mrs Hitchman were charging their previous Queensland tenants the normal commercial rate of rent - $180.00 per week. They allowed their son, Tim, to live in the property at a nominal rent of $40.00 per week. Tim lived in the property for four weeks. When he moved out, the Hitchman's advertised for tenants.

Although Tim was paying rent to the Hitchman's, the arrangement was not based on normal commercial rates. As a result, the Hitchman's could not claim a deduction for the total rental property expenses for the period Tim was living in the property. Generally, a deduction can be claimed for rental property expenses up to the amount of rental income received from this type of non-commercial arrangement.

Assuming that during the four weeks of Tim's residence, the Hitchman's incurred rental expenses of more than $160, these deductions would be limited to $160 in total, that is, $40 x 4 weeks.

If Tim had been living in the house rent free, the Hitchman's would not have been able to claim any deductions for the time he was living in the property.

Claiming Prepaid Expenses for 30 June 2021

If you prepay a rental property expense, such as insurance of interest on money borrowed, that covers a period of 12 months or less AND the period ends on or before 30 June 2022, you can claim an immediate deduction. A prepayment that does not meet their criteria AND is $1,000 or more may have to be spread over two or more years. This is also the case if you carry on your rental activity as a business and have not elected to be taxed under the simplified tax system for small businesses.

Common mistakes

Avoid these common mistakes when making claims or preparing schedules for your accountant: -

- Incorrectly claiming the cost of the land as a capital works deduction, that is, as part of the cost of constructing or renovating the rental property.
- Incorrectly claiming the cost of improvements such as remodelling bathrooms or kitchens or adding a deck or pergola as repairs. These are capital improvements and should be claimed as capital works deductions.
- Overstating claims for deductions on the interest on the loan taken out to purchase, renovate or maintain the property. A loan may be taken out for both income-producing and private purposes, such as to purchase motor vehicles or other goods or services. The interest on this private portion of the loan is not deductible and should not be claimed.
- Claiming deductions for properties which are not genuinely available for rent.
- Incorrectly claiming deductions when properties are only available for rent for part of the year. If a holiday home or unit is used by you, your friends, or your relatives free of charge for part of the year, you are not entitled to a deduction for costs incurred during those periods.
- Claiming deductions for items incorrectly classified as depreciating assets.
- If you financed the purchase of your rental property using a split loan facility, you cannot claim a deduction for the extra capitalised interest expense imposed under that facility.

CHECKLIST FOR EXPENSES FOR WHICH YOU MAY CLAIM AN IMMEDIATE DEDUCTION

Expenses for which you may be entitled to an immediate deduction in the income year you incur the expense include: -

- Advertising for tenants
- Bank charges
- Body corporate fees and charges
- Cleaning
- Council rates
- Electricity and gas
- Gardening and lawn mowing
- In-house audio / video service charges
- Insurance:
  - Building
  - Contents
  - Public liability
- Interest on loans

- Land tax
- Lease document expenses
  - Preparation
  - Registration
  - Stamp duty
- Legal expenses
- Mortgage discharge expenses
- Pest control
- Property agent's fees and commission
- Quantity surveyor's fees
- Accounting fees
- Repairs and maintenance
- Secretarial and bookkeeping fees
- Security patrol fees
- Servicing costs – for example, servicing a water heater
- Stationery and postage
- Telephone calls and rental
- Tax-related expenses
- Water charges

ATO INCREASES FOCUS ON RENTAL PROPERTY DEDUCTIONS

The ATO has an increased focus on rental property deductions this tax time and is encouraging rental owners to double-check their claims are correct before lodging their tax return.

In particular, the ATO is paying close attention to: -

- excessive deductions claimed for holiday homes
- husbands and wives splitting rental income and deductions for jointly owned properties that is not supported
- claims for repairs and maintenance shortly after the property was purchased; and
- interest deductions claimed for the private proportion of loans.

While the ATO will be paying close attention to these issues, it will also be actively educating rental property owners about what they can and cannot claim.

For example, the ATO will be writing to rental property owners in popular holiday locations, reminding them to only claim the deductions they are entitled to, for the periods the property is rented out or is genuinely available for rent.

Getting rental property deductions right

There are a few simple rules rental property owners should follow to avoid making mistakes on their tax return.

First, it is important for all property owners to keep accurate records. This helps to ensure they declare the right amount of rental income and they have evidence for claims made.

Secondly, rental property owners should only claim deductions for the periods the property is rented out or is genuinely available for rent. If a property is rented at below market rates, for example to family or friends, deduction claims must be limited to the income earned while rented.

Finally, costs to repair damage, defects or deterioration existing on purchase, or renovation costs cannot be claimed as an immediate deduction. These costs are deductible over a number of years.

Case studies

Holiday Homes

The ATO recently amended a taxpayer's return to disallow deductions claimed for a holiday home after discovering that: -

- The taxpayer rented the home to family and friends during the year at less than market rate.
- Besides a brochure which was only available at the taxpayers' business premises, there were no realistic efforts to let the property.
- The nightly rent advertised was much higher than that of surrounding properties.
- The pattern of income did not match the advertised rate, or the requirement for a five-night minimum stay.

The ATO ruled that the property was mainly used for the taxpayer's personal use, and deductions were limited to the amount earned from family and friends. The end result was that the taxpayer had to pay more tax and a penalty was imposed.

Husband and wives

The ATO has seen instances where a husband and wife jointly own a property but split the income and deductions unequally to get a tax advantage for the highest income earner. Some people have even included the income in the low-income earner's returns and the deductions in the high-income earner's returns. These types of arrangements attract higher penalties where they have been done deliberately.

Refinancing

The ATO recently addressed a situation where a property was refinanced by a taxpayer to pay for their daughters' wedding and an overseas holiday. The taxpayer claimed the whole interest amount but should have only claimed the portion of interest that relates to the rental property.

Repairs and Maintenance

A taxpayer recently claimed repairs and maintenance for a newly acquired rental property which was significantly improved upon purchase. The taxpayer provided an invoice from an interior developer for the "refurbishment" of the property. Further, documentation detailed the scope of the refurbishment which included completely stripping the property and replacing old fixtures and fittings with new. The large repairs and maintenance claim was disallowed because initial repairs and improvements to a property are not deductible.

Rebuilding

A husband and wife demolished their existing rental property and built a new dwelling. In their income tax return, they claimed an immediate deduction for their share of the entire cost of the building as repairs and maintenance. While the cost of constructing the new dwelling for rental purposes is permitted, the correct treatment is to spread the cost over 40 years, claiming 2.5 per cent of eligible construction costs as a capital works deduction. The repairs and maintenance claim was disallowed.

INTEREST ON LOANS

If you take out a loan to purchase a rental property, you can claim the interest charged on that loan, or a portion of the interest, as a deduction. However, the property must be rented, or available for rental, in the income year for which you claim a deduction. If you start to use the property for private purposes, you cannot claim any interest expenses you incur after you start using the property for private purposes.

Similarly, if you take out a loan to purchase land on which to build a rental property or to finance renovations to a property you intend to rent out, the interest on the loan will be deductible from the time you took the loan out. However, if your intention changes, for example, you decide to use the property for private purposes and you no longer intend to use it to produce rent or other income you cannot claim the interest after your intention changes.

While the property is rented, or available for rent, you may also claim interest charged on loans taken out: -

- to purchase depreciating assets
- for repairs; or
- for renovations.

Banks and other lending institutions offer a range of financial products which can be used to acquire a rental property. Many of these products permit flexible repayment and redraw facilities. As a consequence, a loan might be obtained to purchase both a rental property and a private car. In cases of this type, the interest on the loan must be apportioned into deductible and non-deductible parts according to the amounts borrowed for the rental property and for private purposes.

If you have a loan account that has a fluctuating balance due to a variety of deposits and withdrawals and it is used for both private purposes and for rental property purposes, you must keep accurate records to enable you to calculate the interest that applies to the rental property portion of the loan; that is, you must separate the interest that related to the rental property from any interest that relates to the private use of the funds.

If you have difficulty calculating your deduction for interest, contact your qualified tax adviser or the Tax Office.

Some rental property owners borrow money to buy a new home and then rent out their previous home. If there is an outstanding loan on the old home and the property is used to produce income, the interest outstanding on the loan, or part of the interest, will be deductible. However, an interest deduction cannot be claimed on the loan used to buy the new home because it is not used to produce income. This is so whether or not the loan for the new home is secured against the former home.

CAPITAL ALLOWANCE AND DECLINE IN VALUE

Capital expenditure incurred in constructing buildings and structural improvements may be tax deductible at either 2.5% or 4% of the eligible construction expenditure, depending on when construction commenced and how the building is used.

The deduction generally commences from the time the building is used to produce income. Ideally, upon purchasing a property you should be given a copy of the construction expenditure costing. In practice, this often is not available. In these circumstances, obtain a report prepared by a Quantity Surveyor, (Q.S.), which can then be used to determine the amount of your claim.

Note that the Q.S. will also separately identify fixture, fittings, and furnishings eligible for much higher decline in value depreciated claims. Any costs paid to the Q.S. in relation to the reports' preparation are tax deductible.

Often Q.S. reports cost between $400 and $500, but usually this proves to be money well spent as thousands of dollars of tax is saved.

NEGATIVE GEARING

Negative gearing may be explained as paying more interest and other outgoings than you receive in income from your investment. There are other (non-cash outgoings) such as depreciation that are also tax deductible.

At first negative gearing may seem unwise, but the following example may make the position clearer in the context of our current tax rules. Geared investments (shares, rental property or units' trusts financed by borrowings) provide a tax deduction if the interest and other costs of the investment exceed the income earned. This is called negative gearing.

If you purchase a house as an investment for $300,000 and borrow the entire amount at 7.5% pa interest, your annual interest repayments would total $22,500. You rent the house out for $350 per week, giving you an annual rental income of $18,200. The cost of rates, home maintenance, insurance, agent's fees and so on, total $6,000. The total tax deductions for this investment amount to $34,500 ($22,500 in interest, $6,000 in running costs and $6,000 in depreciation), but income is only $18,200.

The shortfall of $16,300 is wholly tax deductible – it is deducted from your gross income in assessing your taxable income. This is a considerable tax saving while you hold the investment. The investment, however, is making capital gains and you should eventually have a 50% CGT discount when the building is sold. If the investment property keeps pace with inflation, the running expenses are fully covered by the capital increase, but you have a tax deduction for the expenses.

CAPITALISATION OF INTEREST

In Hart v Federal Commissioner of Taxation (2002) it was held that compound interest, as with ordinary interest, derives its character from the use of the original borrowings.

In this case the compound interest was incurred on funds borrowed, under the split loan facility, to acquire property B which was used solely for income producing purposes.

As such, the compound interest was incurred in earning assessable income and is an allowable deduction under section 8-1 of the ITAA 1997.

However, we stress the Commissioner will apply his discretion under Part IVA of the ITAA 1936 to disallow the deduction. A full and detailed explanation of the reasons for the application of Part IVA may be found in Taxation Ruling TR 98/22. We consider that the ATO holds a similar view on split lines of credit where the circumstances are similar to the above scenario in ID 2006/297.

However, we would stress that no two cases are the same and some interesting rulings are contained in the Register of Binding Financial Rulings on the ATO's website www.ato.gov.au.

We would point out the ATO appears to be increasing its focus in this area.

On 7 March 2012 Taxation Determination TD 2012/1 was released in relation to split loans structures described as 'investment loan interest payment' arrangements.

SELLING THE MAIN RESIDENCE

In 2004, Tony and Alison purchased a luxury house in Surfers Paradise.

In 2019, their children left home, and the empty nesters are struggling with upkeep of the house and adjacent tennis court.

An option is to sell off the tennis court. If this occurs, they have been advised capital gains tax will be payable.

Let us consider the following: -

Tony and Alison decide to demolish the existing house, subdivide the land into 2 titles, construct a new smaller house on each title, and sell both houses.

Income Tax - Are Tony and Alison merely realising their family home in most advantageous way or do their activities amount to a business venture: McCurry (1998).

Although they are selling the property, they have held for over 15 years, it could be argued they are doing far more simply then selling the family home in most profitable manner.

At first sight, MT 2006/1, which deals with entitlements to an ABN, supports the argument that this is a business-type venture.

MT 2006/1 contains the example of Prakash and Indira, who have lived in the same house on a large block of land for a number of years. Prakash and Indira have decided to move out from the area and, to maximise sale proceeds, demolish their house, subdivide land into 2 blocks and a build new house on each block (which they sell).

MT 2006/1 tales the position that Prakash and Indira are entitled to an ABN in respect of the subdivision on the basis their activities go beyond minimal activities needed to sell subdivided land.

We should consider whether MT 2006/1 (in essence a GST ruling) is relevant for income tax purposes?

If income tax applies, Tony and Alison's assessable income would include: -

Sale proceeds – (value of blocks in 2006 + demolition costs + building costs + agent's fees).

CGT - If the transaction is on capital account, are Tony and Alison entitled to benefit of main residence exemption?

In respect of which dwelling? Tony and Alison do not appear to have used either dwelling as their main residence.

Does (should) the position change if Tony and Alison move back into 1 of the units before the sale? Is their use of the dwelling merely transitory?

GST - Per MT 2006/1, the ATO is likely to take position that Tony and Alison carrying on enterprise, and therefore required to register for GST.

Our second scenario is that alternatively, Tony and Alison do not wish to move out of the area but do want to scale down. They demolish the existing house, subdividing the land into 2 titles to build new houses one each title, then sell 1 house and retain and live in the other.

Income Tax - Could Tony and Alison argue that they did not purchase family residence for resale at profit and have lived in the dwelling for 16 years? Further that the main reason for redeveloping was to 'scale down', living in a smaller, 'low maintenance' dwelling and to achieve this they had to sell part of their existing property. As such any gain would be on capital account.

However, the ATO could take the view that Tony and Alison have obtained Council approval, created 2 separate titles, built new houses, with their activities resulting in any profit on sale being assessable and not arising from a mere realisation of assets.

CGT - Tony and Alison are not entitled to main residence exemption on the sale of the separate house.

Consider also TD 2000/14 ("If you buy land and dwelling A, live in dwelling A, subdivide into 2 blocks and build dwelling B, and then sell dwellings A and B, is main residence exemption available for both dwellings?").

GST - MT 2006/1 does not provide a clear answer as to whether Tony and Alison are carrying on an enterprise, and therefore required to register as none of the examples given in the ruling match their circumstances. They may consider seeking a Private Ruling from the ATO.

Our third scenario is that Tony and Alison construct a dwelling on the tennis court, move into that new house for 6 months and rent out the old house. They then sell the new house before moving back into the old house.

Income Tax - As per above, are Tony and Alison just realising their family home in the most advantageous way or do their activities amount to a business venture: McCurry (1998).

CGT - Can Tony and Alison claim main residence exemption for gain on sale of new house? That is, can Tony and Alison choose that the new house is their "main residence" if they only live there 6 months before selling?

The following provides guidance: -

- TD 51 ("What factors are taken into account in determining whether or not a dwelling is a taxpayer's main residence?"). Note, that TD 51 has been withdrawn due to alternative guidance available which confirms its content.
- TD 92/135 ("Is the main residence exemption relevant when the proceeds of sale of a dwelling are treated as income under ordinary concepts?).

TAX SMART FINANCING STRATEGIES

1. Maximise the percentage borrowing against your rental property (if you have equity in your residential home, the bank will often be flexible).
2. Repay your residential loan as quickly as you can (use all your excess cash to repay this loan).
3. Consider asking the bank if you can defer repayments on your rental property loan as long as possible. Note it is best to have some separate levels of minimum repayment in respect of both your residential loan and your rental property loan.
4. If permitted, increase your rental property borrowings to pay for all the costs related to your rental property. Maintain a separate (flexible) overdraft facility to cover all the costs of your rental property, such as repairs, agent's fees, capital improvements, advertising, council rates, land tax etc.
5. Use an interest offset deposit account as your everyday account (i.e. your wages can be paid into this account), with the interest otherwise payable on the deposit account reducing the interest payable on your residential loan.

6. Consider the possibility of intra-marriage transfers. For example, if you are looking to rent out your longstanding jointly owned residence and purchase a new home, consider transferring your old residence wholly into the name of one spouse (who would borrow to make the acquisition). The new residence could perhaps be acquired by the other spouse. Stamp duty costs will have to be considered.
7. You will put yourself in a difficult position if you mistakenly increase your rental property loan for a private purpose and then, on discovering your "mistake" try to refinance this cost. It is vital to get your borrowings and repayments right the first time.

Ineffective Strategies

1. Do not use two separate loans which are completely linked in terms of having just the one joint credit limit and one joint minimum monthly repayment. Ensure that there are separate limits and separate repayment levels for each loan.

Avoid a facility offered by a bank or other financial institution which promotes the "tax savings" in its marketing materials.

2. Avoid a split loan borrowing facility (i.e. one loan with two notional sub-accounts for separate borrowing purposes). This is unacceptable to the ATO.
3. Do not enter an arrangement which provides you with a tax saving, but which comes at a real commercial cost, such as payment of a higher interest rate or other charges.
4. Do not enter an arrangement with a bank which provides "unusual" terms – such as an indefinite deferral of repayment on one part of the borrowing.
5. Do not redraw amounts for private purposes from your rental property loan as this will mix the purposes and reduce the deductible element.

SMSFs – making loans

It is important for funds to keep in mind that high returns general equate with high risk and hence funds should obtain independent advice on investment decisions where possible. The fund's investment strategy should also be referenced and the reasons for making the loans clearly documented.

ATO GUIDANCE ON CAPITAL/REVENUE IN PROPERTY DEVELOPMENTS

In July 2019, the ATO released the Draft Property and Construction Website Guidance providing guidance in relation to the ATO position on property development and whether relevant property is held by the taxpayer on capital or revenue account.

The ATO says the Guidelines are to "facilitate consultation between the [ATO] …, tax professionals, industry associations and taxpayers engaged in property transactions. The guidance aims to provide insight and transparency into our decision making on a range of property development scenarios that we are seeing."

Some of the factors outlined by the ATO in the Guidelines include whether: -

- the landowner has held the land for a considerable period prior to the development and sale
- the landowner has conducted farming, or other non-development business activities, on the land prior to beginning the process of developing and selling the land
- the landowner originally bought the property as an investment, such as for long term capital appreciation or to derive rental income
- the property has recently been rezoned and whether the landowner actively sought rezoning
- a potential buyer of the property made an offer to the landowner before the landowner entered into a development arrangement
- the landowner applies for rezoning and planning approvals around the time or sometime after acquisition of the property, but before undertaking further steps that might lead to a profitable sale or entering into development arrangements
- the landowner has registered for GST on the basis that they are carrying on an enterprise in relation to developing the land
- whether the landowner and developer are related entities
- the level of financial risk borne by the landowner and the level of control of the landowner over the development; and
- the landowner has a history of buying and profitably selling developed land or land for development.

In the Guidelines the ATO indicates that where a taxpayer owns property on capital account and there is a change to revenue account then, depending on the facts and circumstances, that change could be a change of purpose to a profit-making undertaking or plan or the commencement of a business -this brings CGT event C4 into play.

The guidelines contain 12 worked examples that cover everything from large greenfield developments to smaller suburban land subdivisions.

We would urge anyone who wants to put gains on capital account (with the possible 50% CGT discount) to carefully review this guidance.

Isolated Transactions: Taxation Ruling TR 92/3

TR 92/3 is significant because the treatment of profits as assessable income can result from low scale developments.

In McCurry v FCT (1998), the Federal Court held that the profit made by 2 brothers on the purchase of land, the construction of 3 townhouses and the subsequent sale thereof, was a business operation or commercial transaction for the purpose of profit-making. The profit was therefore assessable as ordinary income, rather than as a capital gain.

In Taxation Ruling TR 92/3, the ATO sets out the following factors which may be relevant in determining whether an isolated transaction amounts to a business operation or commercial transaction: -

- the nature of the entity undertaking the operation or transaction
- the nature and scale of other activities undertaken by the taxpayer
- the amount of money involved in the operation or transaction and the magnitude of the profit sought or obtained
- the nature, scale and complexity of the operation or transaction
- the manner in which the operation or transaction was entered into or carried out
- the nature of any connection between the relevant taxpayer and any other party to the operation or transaction
- if the transaction involves the acquisition and disposal of property, the nature of that property; and
- the timing of the transaction or the various steps in the transaction.

Although the above factors provide guidance, the Commissioner and taxpayers will often disagree as to how they should be applied in any given situation. There may well be arguments about whether the taxpayer has taken more steps than are necessary to effect a “mere realisation”.

What is clear is the need for specialist advice before embarking on any course of action.

SHARING ECONOMY ACCOMODATION 2016-17 TO 2019-20 FINANCIAL YEARS DATA MATCHING PROGRAM PROTOCOL

The ATO has a particular focus on all aspects of the sharing economy. They believe that some people using sharing economy platforms are failing to report their income, either on purpose or because they assume their level of activity constitutes a hobby and does not require reporting. Their aim is to ensure that people renting a room, their home while they are away or an investment property through web or app-based platforms in the sharing economy understand their obligations.

In 2016 there were approximately 2 million individual taxpayers who reported rental income of $42 billion and/or claimed rental expenses totalling $45 billion.

There is an increase in people renting homes, apartments, units, or rooms via platform sharing sites to generate income. The increased use of these sites means there is an increased risk of people not understanding their tax obligations when it comes to renting out part or all of their property.

The ATO has a particular focus on how it can improve their information to assist individuals to understand the rules around short term rental income and will expand our use of third party data to identify omitted rental income and over claimed deductions.

The ATO also seek to identify taxpayers who use sharing economy rental platforms as a way to disguise their property as being genuinely available for rent by listing the property but not responding to enquiries.

The ATO will match the data provided by the rental platforms against ATO records to identify individuals who rent property on a short-term basis but may not be meeting their registration, reporting, lodgment and/or payment obligations.

RENTING OUT ALL OR PART OF YOUR HOME

When you rent out all or part of your residential house or unit through a digital platform like Airbnb, Home Away or Flipkey, you: -

- need to keep records of all income earned and declare it in your income tax return
- need to keep records of expenses you can claim as deductions
- do not need to pay GST on amounts of residential rent you earn.

If you are carrying on an enterprise renting out commercial residential premises, such as a commercial boarding house, you will have different income tax and GST obligations. However, just because you provide services in addition to providing a room (for example, provide breakfast or cleaning services) does not mean that you are providing 'board' – or anything else other than renting out your space. It is rare for someone to be carrying on a business because they are renting out a property.

CAPITAL GAINS TAX (CGT) ISSUES

In most cases, when you sell your private residence, the sale is free of capital gains. However, if you have used part of the property for income earning activities – like renting out through Airbnb – part of the gain will be taxable, resulting in an apportionment of main residence exemption.

Evidence suggests many Airbnb hosts are completely unaware of the CGT implications of renting out part of their home. Given the potentially long time lag between starting to rent out the property and the eventual sale, CGT can be a most unwelcome expense for those who haven't factored it into their cost/benefit analysis when they first decided to make part of the property available for rent.

The floor area calculation used in working out deductible expenses will also be used in calculating the taxable capital gain. Starting from the periods in which the property was first used to generate income, a proportion of the gain based on the floor area which was available for rent will be chargeable tax. This gain qualifies for the 50% Capital Gains Tax discount.

GST THE MARGIN SCHEME

When a taxable supply is made by a registered entity, it is liable for GST on the supply. The amount of GST is usually 1/11th of the sale price. However, when such an entity sells real property and is liable for GST on the sale of the property, it may elect to use the margin scheme to calculate its GST liability. Note however, it is not possible to use the margin scheme if the entity acquired the property through a taxable supply on which the GST was worked out without using the margin scheme.

Under the margin scheme the amount of the GST liability is 1/11th of the MARGIN (which is usually the sale price less cost of acquisition).

If the margin scheme is used, the purchaser will NOT be entitled to input tax credits on the acquisition – more on this later.

Example - Builder Pty Ltd purchases land from Wealthland for $1.1 million. When the transaction occurred, the margin scheme was used to calculate vendor Wealthland's GST and both entities are registered for GST.

Builder now sells the land to Smithers for $1.32 million. Builder is eligible to use the margin scheme to calculate its GST liability on the transaction. This is because the original purchase of the land from Wealthland constituted a taxable supply to Builder and the GST on that sale by the vendor was calculated using the margin scheme. If Builder uses the margin scheme, with the prior written consent of Smithers, its GST liability will be $20,000 (1/11th x ($1,320,000 - $1,100,000)).

Note however that Smithers will not be eligible to claim any input tax credit on the acquisition. If the margin scheme were not used, Builder's GST liability would be $120,000 (1/11th x $1,320,000). In that case Smithers would be able to claim input tax credits on the acquisition.

If the margin scheme had NOT been used in the original transaction (Wealthland to Builder) and GST had been calculated using the normal method, then Builder would not be allowed to use the margin scheme when it sold to Smithers.

In the event Wealthland was not a GST registered entity at the time it sold to Builder and not required to be registered, it would not be liable to pay any GST on the transaction. In that case Builder would still be entitled to use the margin scheme when it sells the land to Smithers. Note the only time an entity is disqualified from using the margin scheme is when it acquires a property through a taxable supply on which the GST was calculated without using the margin scheme.

Business Activity Statements

Recent updates have dealt with tax cases where taxpayers filling out B.A.S. have incorrectly claimed input tax credits where the margin scheme was applied on the purchase of real property. The ATO have shown little leniency when applying penalties and real care needs to be taken.

Cases

AAT Case (2009) AATA 805, YXFP and FCT – Supply of property not GST-free; no deduction for trading stock

The AAT has confirmed that the sale of a property by a property developer was not a GST-free supply by a going concern because the taxpayer had not satisfied that the supplier and recipient agreed in writing that the supply is of a going concern.

Also, the AAT considered whether an amount of $220,000 was considered legitimate trading stock and as such tax deductible.

However, the AAT determined that the $220,000 was in fact more in the nature of a capital contribution or loan to another property developing entity. Although the taxpayer may have been genuine in his belief that there had been an acquisition of trading stock, the AAT clearly thought otherwise, rejecting the tax deduction. So, developers beware, if the matter is not clear cut or there are unusual circumstances involved (particularly other entities), be very careful before making a claim for trading stock.

SMSF AND PROPERTY DEVELOPMENT

Property Development as opposed to passive investment means an entity is engaged in business

This issue comes up time and time again and a common misconception is that superannuation funds cannot carry on a business.

A review of SISA, the SISR and the Tax Acts finds no provision that prevents a SMSF from operating a business.

Further confirmation exists: -

- The national tax liaison group sub-committee minutes of 28.10.2005.
- Various ATO publications.

However, this does not give SMSF trustees carte blanch to engage in these activities.

There is too much at stake here and you must take specialist advice.

Broader Superannuation Industry (Supervision) Act 1993 (SISA) considerations include: -

- Prohibition against acquiring assets from related parties' section 66.
- The in-house asset rules Part 8 SISA.
- Prohibition against providing financial assistance to members section 65.
- The prohibition against borrowing section 67 but, note the exception for limited recourse borrowing arrangements (LRBA)...however these loans can only be taken out to purchase completed property.
- The sole purchase test – section 62.
- Investment strategy – section 52(B)...here any property development activities must be consistent with this.
- Trustees must not allow assets owned by SMSF to be encumbered by a mortgage view or other security – Reg 13.14 SISR.
- Trustee remuneration – section 17A – if a SMSF remuneration should not be paid.

These are only some of the considerations and we will expand on these and some trust structures in our forthcoming superannuation bonus issue.

HOLDING SHARES OR ACTIVELY TRADING: WHAT IS THE DIFFERENCE?

Until recently the Australian share market had enjoyed an extended period of growth, with prices at historically high levels and solid dividends being paid.

Taxpayers who have bought or sold shares as part of their investment strategy will need to determine their tax liability. An important part of that process involves deciding whether they are a share trader or shareholder.

While the Tax Office considers each case on its individual features, in summary, a share trader is someone who carries out business activities for the purpose of earning income from buying and selling shares. A shareholder, on the other hand, is someone who holds shares for the purpose of earning income from dividends and similar receipts.

Relevant matters include nature, regularity, volume and repetition of the share activity; the amount of capital employed; and the extent to which there is organisation in a business-like manner, through the keeping of books or records and the use of a system.

For a **share trader**: -

- receipts from the sale of shares are income
- purchased shares would be regarded as trading stock
- costs incurred in buying or selling shares are an allowable deduction in the year in which they are incurred; and
- dividends and other similar receipts are included in assessable income.

In the case of **shareholder:** -

- the cost of purchase of shares is not an allowable deduction – it is a capital cost
- receipts from the sale of shares are not assessable income – however, any net profit is subject to capital gains tax
- a net loss from sale of shares may not be offset against income from other sources, but may be carried forward to offset against future capital gains made from the sale of shares

- costs incurred in buying or selling shares are not an allowable deduction in the year in which they are incurred, but are taken into account in determining the amount of any capital gain
- dividends and other similar receipts are included in assessable income; and
- costs incurred in earning dividend income – such as interest on borrowed money – are an allowable deduction at the time they are incurred.

These practical examples supplied by the Tax Office could be helpful:

Carrying on a business of share trading

A 'business' for tax purposes includes 'any profession, trade, employment, vocation or calling, but does not include occupation as an employee.' This definition would include a business of share trading.

The question of whether a person is a share trader, or a shareholder is determined in each individual case. This is done by considering the following factors that have been used in court cases: -

1. the nature of the activities, particularly whether they have the purpose of profit making
2. the repetition, volume and regularity of the activities, and the similarity to other businesses in your industry
3. the keeping of books of accounts and records of trading stock, business premises, licences or qualifications, a registered business name and an Australian business number
4. the volume of the operations
5. the amount of capital employed.

Nature of activity and purpose of profit making

The intention to make a profit is not, on its own, sufficient to establish that a business is being carried on.

A share trader is someone who carries out business activities for the purpose of earning income and buying and selling shares.

Shares may be held for either investment or trading purposes, and profits on sale are earned in either case. A person who invests in shares as a shareholder (rather than a share trader) does so with the intention of earning income from dividends and receipts but is not carrying on business activities. It is necessary for you to consider not only your intention to make a profit, but also the facts of your situation. This would include details of how the activity has actually been carried out or a business plan of how the activities will be conducted.

A business plan might show, for example: -

- an analysis of each potential investment
- analysis of the current market and various segments of the market
- research to show when or where a profit may arise.

Share trader

Sally is an electrical engineer. After seeing a television program, Sally decides to start share trading. She sets up an office in one of the rooms in her house. She has a computer and access to the internet.

Sally has $100,000 of her own funds available to purchase shares and, in addition, she has access to a $50,000 borrowing facility through her bank.

She conducts daily analysis and assessment of developments in equity markets, using financial newspapers, investment magazines and stock market reports. Sally's objective is to identify stocks that will increase in value in the short term to enable her to sell at a profit after holding them for a brief period.

In the year ended 30 June 2020, Sally conducted 60 share transactions: 35 buying and 25 selling. The average buying transaction involved 500 shares and the average cost was $1000. The average selling transaction involved 750 shares and the average selling prices was $1800. All transactions were conducted through stock broking facilities on the internet. The average time that shares were held before selling was twelve weeks. Sally's activities resulted in a loss of $5000 after expenses.

Sally's activities show all the factors that would be expected from a person carrying on a business. Her share trading operation demonstrates a profit-making intention even though a loss has resulted. There is a repetition and regularity to her activities. Her activities are organised in a business-like manner. The volume of shares turned over is high and Sally has injected a large amount of capital into the operation.

Shareholder

Cecil is an accountant. He has bought 20,000 shares in twenty 'blue chip' companies over several years. His total portfolio costs $500,000. Cecil bought the shares because of consistently high dividends. He would not consider selling shares unless their price appreciated markedly before selling them. In the year ended 30 June 2020, he sold 2,000 shares over the year for a gain of $30,000.

Although Cecil has made a large gain on the shares, he would not be considered to be carrying on a business of share trading. He has purchased his shares for the purpose of gaining dividend income rather than making profit.

TAX-SMART, INVESTING IN SHARES

If you own shares you will have tax entitlements and obligations.

Do not pay more tax than you need to.

Acquisition	Ownership	Disposal
You can acquire shares: • by buying • by inheriting • as a gift • on the breakdown of your marriage • through employee share schemes • through a conversion of notes to shares • through demutualisation • through bonus share schemes • through dividend reinvestment plans • through mergers, takeovers, and demergers	The following activities can affect your tax: • receiving dividends • dividend reinvestment plans • bonus share schemes • call payments on bonus share schemes • receiving non-assessable payments • mergers, takeovers, and demergers	Disposing of your shares can affect your tax. You can dispose of your shares: • by selling • by giving them away • on the breakdown of your marriage • through company liquidation • through share buy-backs • through mergers, takeovers, and demergers
What you do during each stage of the life of your shares can affect your tax for years to come.		

BUYING Did you know?	OWING Did you know?	SELLING Did you know?
• Generally, the names you put on the purchase order determine who must declare the dividends and can claim the expenses.	• You need to declare all of your dividend income on your tax return, even if you use your dividend to purchase more shares (for example through a dividend reinvestment plan).	• When you dispose of your shares you may make a capital gain or capital loss.
• If you hold a policy in an insurance company that demutualises, you may be subject to capital gains tax either at the time of the demutualisation or when you sell your shares.	• Tax deductions on shares can include management fees, specialist journals and interest on monies borrowed to buy them.	• Your capital gain is the difference between your ‘cost base’ (costs of ownership) and your ‘capital proceeds’ (what you receive when you sell your shares).
• Even if you did not pay anything for your shares you should find out the market value at the time your acquired them.	• Receiving bonus shares can alter the capital gains tax cost base (costs of ownership) of both your original and bonus shares.	
• In some circumstances, you may be the owner of shares purchased in your child’s name.	• You may choose to roll over any capital gain or capital loss you make under an eligible demerger.	• The law has been changed so that an administrator as well as a liquidator can declare that a company’s shares are worthless.
• Costs associated with buying your shares such as brokerage fees and stamp duty are not deductible, however they form part of the cost base (costs of ownership) for capital gains tax purposes.	• The ATO produces an information fact sheet for each major takeover, merger, or demerger.	• If you have owned your shares for more than 12 months, you may be able to reduce your capital gains by the tax discount of 50%.
	• Payments or other benefits you obtain from a private company in which you are a shareholder may be treated as if they were a taxable dividend paid to you.	• Simply transferring your shares into someone else’s name may mean you have to pay capital gains tax.

Cases:

Greig V Commissioner of Taxation (2018) FCA 1084: Revenue Vs Capital and Lessons for Investors

This case highlights the uncertainty in respect of the revenue and capital implications of some share sales and was an appeal by the taxpayer against a decision by the Commissioner of Taxation's disallowance of deductions under section 8-1 **ITAA1997** of share losses and litigation costs totalling $12.35m.

The taxpayer argued he had an intention to make short-term profits from the purchase of shares on the ASX. However, the taxpayer's appeal was disallowed because the Court held that he was not in a business operation or commercial transaction of purchasing shares and was not carrying on a business of dealing in shares.

The taxpayer had a diverse portfolio of shares and made regular investments. With the help of his financial adviser, the Taxpayer bought $11.85m worth of shares in Nexus Energy Limited **(Nexus)** over a period of 25 months in 2013 and 2014. The taxpayer's investment approach - was to generate profits over a short-term period from investments in the mining, energy, and resource sectors. The taxpayer made gains and losses from his share portfolio and treated those losses as being on capital account (on this basis, the capital gains tax (CGT) rules applied.

Nexus went into voluntary administration in June 2014 and the taxpayer made a $11.85m share loss on his Nexus shares in December 2014 and incurred a further $0.5m in legal fees due to the legal action he took against Nexus and its voluntary administration.

The taxpayer's contention was that the share loss and legal fees should be deductible under section 8-1 (revenue account) relying on the principle in the Myer Emporium case because he had a profit-making intention at the time of purchasing the Nexus shares and he conducted a business of buying and selling Nexus shares.

The Myer Emporium principle is that an isolated transaction is ordinary income if the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain and the transaction was entered into, and the profit was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

Thawley J agreed that the taxpayer had a profit-making intention when buying the Nexus shares. However, the case turned on the whether the taxpayer bought the Nexus shares as part of a "business operation or commercial transaction" or whether the taxpayer was in the business in "dealing" in Nexus shares.

On this point, the taxpayer could not lead sufficient evidence that his actions were different to that of investors who purchase shares with the intention of deriving dividends or hoping the share price would increase or both. The taxpayer's arguments that he researched extensively into the Nexus shares and the continuous acquisition of the shares did not amount to actions constituting a "business operation or a commercial transaction".

Accordingly, Thawley J held that the taxpayer was not in the business of dealing in Nexus shares and the $12.35m of share losses and litigation costs were not deductible under section 8-1.

Note the taxpayer won on appeal to the Full Federal Court of Australia and this leads on to our next article.

GREIG V COMMISSIONER TAXATION

On 8.7.2020, the ATO released its Decision Impact Statement (DIS) on the Full Federal Court decision of Greig v Commissioner of Taxation [2020] FCAFC 25.

The Full Federal Court **(FFC)** found that Greig, an ex-mining executive investing for his retirement, held Nexus shares on revenue account and was entitled to deductions for their cost.

The key facts have been covered in the prior article.

Much of the FFC's decision involved a careful consideration the meaning of the words used in Myer as it related to the condition that property be acquired for the "purpose of profit making". The Court was satisfied that Grieg was possessed of that intention when acquiring Nexus shares, largely because there was no evidence to suggest any intention to derive gains otherwise than by sale at a profit, including no evidence to suggest that he anticipated any dividend income. This lack of potential dividends was also viewed as significant in the later decision of XPQZ & Ors v FCT in which the AAT, citing Greig v Commissioner of Taxation, found proceeds from the sale of shares by a closely-held trust to be ordinary income.

In considering the meaning of the terms "business operation or commercial transaction", the Court referenced Sydney University Emeritus Professor Ross Wait Parsons comment in 'Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting' published in 1985. In it, Parsons considered the expression "business deal" as used in a series of decisions which preceded Myer and referenced "profit making undertakings'. Parsons concluded that a transaction would qualify as a "business deal" if it is "the sort of thing a businessperson, or person in trade, might do".

The FFC equated the concept of a "business deal" with the concept of a "business operation or commercial transaction", as developed and referred to in Myer. Mr Gregory was clearly a sophisticated investor, with significant knowledge and experience of the mining industry also taking into account the frequency of his share purchases, the FFC found that Grieg's investment in Nexus was the sort of thing a businessperson might do. The FFC concluded that the conditions in Myer were satisfied and Grieg's investment was held on revenue account.

Given the above, Greig certainly does not match the description of the average private investor, to the extent he spent over $500,000 in legal fees seeking to prevent that compulsory transfer of his Nexus shares under the Deed of Company Arrangement. However, the Commissioner's decision not to appeal to the High Court could well be a tactical one exposing a greater number of private investors to revenue taxation as this has the potential to restrict the availability of the capital gains tax discount. This could mean more tax dollars collected from share trading and other investment activities.

The ATO's Decision Impact Statement notes that the FFC's decision is not "inconsistent with existing advice and guidance" but states it will be reviewing TR 92/3 Income tax: whether profits on isolated transactions are income and TR 92/4 Income tax: whether losses on isolated transactions are deductible. In the meantime, founders, sophisticated investors including significant individual shareholders and those applying industry skill and experience to undertake share trading on a periodic basis will need to carefully consider the availability of the capital gains tax discount and seek specialist advice to whether investment expenses are deductible.

Executor for the Late J.E. Osborne V FC of T (2014) AATA 128

This is an interesting case decided in favour of the taxpayer, i.e. that the trading in shares constituted a business. This has implications for persons managing a share portfolio under a power of attorney and is the management of a deceased estate.

Decision Impact Statement - Mehta and Commissioner of Taxation

The taxpayer was in full time employment at all times during the income years under review. On 26 June 2007, the taxpayer made an application for a margin lending facility and soon thereafter made his first purchase of shares.

During the income tax year ended 30 June 2008, the taxpayer made a total of 32 purchases and 3 sales. The taxpayer did not regard himself to be in a business of share trading for the year ended 30 June 2008.

During the income year ended 30 June 2009, the taxpayer carried out a total of 22 purchases and 27 sales of shares. He contributed $150,000 of his own capital to purchase shares and borrowed another $500,000 from BT Australia. The taxpayer also established a dedicated office for the share trading business in his home.

In his income tax return for the year ended 30 June 2009, the taxpayer claimed a loss of $125,293.

The Commissioner disallowed the claim on the basis that the taxpayer was not carrying on a business of share trading. The taxpayer objected and then applied to the Administrative Appeals Tribunal for review of the objection decision which affirmed the original decision.

The Tribunal found that the taxpayer was in the business of carrying on a business of share trading in the 2009 income year.

The ATO took the view that the case was decided on its facts and will not have any impact on any existing or future litigation proceedings.

Devi and Commissioner of Taxation (Taxation) (2016) AATA 67 (9 February 2016)

In this case the AAT found that a taxpayer was not carrying on a business of share trading. As such the taxpayer was not entitled to claim $20,000 loss resulting from share transactions in the 2011 income year. At the relevant time the taxpayer was paid around $40,000 per annum as a childcare worker.

In July 2010, the taxpayer commenced substantial share trading. In the 2010/11 year, the taxpayer engaged in 108 share transactions which included 71 purchases valued at approximately $380,000 and 37 sales valued at approximately $215,000. These transactions were in the main carried out in the first six months of the year with only 10 transactions, to a value of around $70,000, taking place in the second half of the year. Twenty different companies were involved, and the taxpayer claimed to have spent between 15 and 25 hours per week on these activities.

Key extracts from judgement

"In this case, the factors which favour Ms Devi carrying on business as a share trader are as followers: -

- The turnover was substantial, particularly having regard to Ms Devi's wages; and
- Ms Devi maintained a home office for the purpose of undertaking the share transactions.

The factors which do not favour Ms Devi carrying on business are as follows: -

- The share transactions were not regularly and systematically carried out throughout the 2011 income year – there were only 10 share transactions in the second half of the income year.
- The activities were very basic and lacked sophistication to constitute a share trading business.
- There was no demonstrated pattern of trading although it was accepted there was a business plan even before the written document was later produced.
- She had no skills or experience or interest in shares; and
- Specific share trading factors weigh heavily against Ms Devi carrying on a share trading business.

Having regard to the evidence and to all the factors set out above, Ms Devi was not carrying on business as a share trader. Her activities were very basic and lacked sophistication to constitute a share trading business particularly as there was no demonstrated pattern of trading."

This case serves as a warning to advisers and taxpayers alike. Do not assume that because you start off with a flurry of activity that you are automatically a share trader.

In giving her evidence, it was clear the taxpayer lacked detailed knowledge of the ASX and the shares she had invested in. Also, expect ATO scrutiny, where "share trading" losses cause losses resulting in large refunds on PAYG employment income.

UNSOPHISTICATED SHARE TRADING ACTIVITIES NOT A "BUSINESS"

Hill V FC of T [2019] AATA 1723, P Britten – Jones (Deputy President) and S Griffiths (Member), Adelaide, 8 July 2019.

In similar fashion to Devi, it was held that a taxpayer's share trading activities were not a "business" as they were unsophisticated and not carried out in a business-like manner. As a result, the taxpayer was not entitled to claim or carry forward existing losses in the income years in question.

The taxpayer worked in the aviation industry and also traded shares on the ASX. Orders were usually placed on his days off with most transactions placed using a computer in a home office set up for trading. For research, the taxpayer used the internet generally. He did not consult a stockbroker or financial advisor. His share trading plan was to obtain retirement income. The "business plan" was a half-page document with few records of trading kept. Following an audit, the Commissioner determined that the taxpayer's share trading activities were not a "business", resulting in revenue and carried forward loses being denied in the 2015, 2016- and 2017-income years. After the Commissioner disallowed his objection, the taxpayer applied to the AAT for a review of the objection decision.

The AAT said the taxpayer's share trading was infrequent and characterised by numerous periods of no trading. There was also no established system and the trading was irregular. This pointed to the taxpayer being involved in a series of individual transactions on a speculative basis rather than as a share trader conducting a business. As the taxpayer was working full-time in the aviation industry for the majority of the relevant period, the overall impression was that the share trading activities were very much a side issue which did not occupy a significant amount of the taxpayer's time except for a limited period when trading became more frequent and extensive.

In addition, the AAT found the taxpayer did not arrange his share trading activities in a business-like manner; he did not incorporate a trading vehicle or register a business name and there were few records kept of the trading or other associated activities. Further, the taxpayer did not engage professional assistance from a stockbroker or financial planner despite having no qualifications in these areas. His written business plan was unsophisticated and contained very little detail.

Key points in ruling

- The share trades were infrequent and there were many periods of no trading with no established system and irregular trading.
- This indicated a series of individual transactions on an irregular basis – not a genuine share trader carrying on a business.
- Given the taxpayer's full-time occupation in the aviation industry for most of the period in question, this pointed to the share trading being a side issue except for a limited time of frequent trades.
- Further the taxpayer did not incorporate a trading vehicle or register a business name and few records were kept. There were no budgets of intended expenditure or expected revenue.
- As stated, he did not engage any professionals, undertake extensive research, or seek specialist advice. Given he had no qualifications in the area, the applicant would have sought professional assistance from a broker, bookkeeper, or accountant if his intention was to operate a business of share trading.
- His written business plan was unsophisticated and contained very little detail. Stating an intention to invest in shares to receive dividends and capital growth in the medium to long term is not indicative of an intention to carry out a share trading business.

TAX IMPLICATIONS FOR VARIOUS SECURITIES

Tax time is a confusing time of year for most investors. The ASX assembled the following table to help identify the tax implications of the various products traded on ASX.

Instalment Warrants	Holders will need to consider dividends and associated franking credits (subject to 45 day holding period rule). Some Holders may be entitled to deductions for interest paid. Remember, some instalment transactions involving shares and warrants may not trigger a capital gains tax event.
Exchange Traded Options	Tax assessment is dependent on individual's classification as a trader, a speculator, or as a hedger. Selling options for premiums is treated as income subject to the individual's classification (as above). Buying an option and then exercising into the underlying share adds to the cost base for CGT purposes. The length of time shares are held for will determine the CGT rate, and remember the holding period rule in relation to dividends.
Listed Investment Companies (LICs)	Dividend payments are typically fully franked and capital gains are managed by the fund manager to minimise cost to investors.
Equities (shares)	Shareholders need to keep a record of the date and value of share parcels they acquire. When shares are sold, they are generally subject to capital gains tax (CGT). The length of time shares are held for will affect the CGT rate applicable. Shareholders can receive franked dividends. These carry imputation credits that may potentially reduce tax payable on dividend income. Shareholders should consult their taxation adviser regarding the deductibility of interest on margin loans.
Bonds and Hybrids	The sale or redemption of bonds is generally not subject to CGT but is assessable for income tax. However, there are CGT considerations following disposal of shares that are received from convertible notes. It is important to note that there are distinctions in the taxation treatment for convertible notes issued after 14 May 2002.
International Shares via ASX World Link®	ASX World Link® service provides dividend and transaction information in Australian dollars to help in preparation of tax returns. Investors may be able to claim a foreign tax credit in respect of all or part of the dividend withholding tax amount.
Infrastructure funds	A portion of the income (distributions) is typically tax deferred until the holder sells their units. Property trusts a portion of the income (distributions) is typically tax deferred until the holder sells their units.
Pooled development funds (PDFs)	These funds display some unique taxation characteristics and investors are advised to seek professional advice. Generally, capital gains and dividends are tax-free. The PDF only pays 15% corporate tax rate. Dividends carry franking credits at the 30% rate.
Exchange Traded Funds (EFTs)	Dividends from EFTs typically have franking credits attached to them. Capital gains are managed by the fund manager in order to minimise costs to investors. Low portfolio turnover means Indexed EFTs have low capital gains tax consequences.
Absolute Return funds	Capital gains are managed by the fund's manager to minimise cost to investor. Dividends may be fully franked.
Investors' Disposal of Shares	If you have sold or given away shares you may have a capital gain or capital loss to take into account when completing your tax return for the income year in which you sold or gave them away.

Acquisitions and Disposals

You acquire shares when you become their owner. The most common way of acquiring your shares is by buying them.

However, there are other ways such as receiving them: -

- as bonus shares
- on the breakdown of your marriage
- through a conversion of notes to shares
- through employee share schemes
- through demutualisation
- through a merger, takeover or demerger
- through dividend reinvestment plans; and
- as an inheritance or as a gift.

Simply, you dispose of your shares when you stop being their owner. The most common way of disposing of your shares is by selling them. Other ways include disposal through a merger, takeover or demerger, or through a share buy-back. You may also dispose of the shares by giving them away or through your will upon death.

What happens when you sell or give away shares?

Disposing of shares is a capital gains tax event (CGT event). When a CGT event happens, you need to know whether you have made a capital gain or a capital loss to determine whether you need to pay tax on your capital gain or claim a capital loss on your tax return. Sometimes a rollover may apply which enables the capital gain to be deferred or disregarded until a later CGT event happens.

You can only offset your capital losses against capital gains you make on other assets, reducing the overall amount of tax you must pay. You can use these losses in the financial year you made them, with unused capital losses carried forward for use in a future year.

To work out your capital gain or capital loss – and therefore ensure you do not pay more tax than you need to – you need to know how much you spent on your shares when you first acquired them and while you owned them. This means making sure you keep records.

If you give away shares or your shares were given to you as a gift, you use the stock exchange closing price on the date of the gift in your calculation. If the company is not quoted on the exchange – for example, it is a private company, you will need an independent accounts valuation to demonstrate the share value.

Why should you keep records?

You will generally either pay tax on any capital gain or claim a capital loss on what you make on your shares when you sell them or give them away. You will need to have records to work out whether you can claim a capital loss or record a capital gain when you complete your yearly tax return.

Although CGT on shares transferred under a Will is usually disregarded, your beneficiaries may need your records to work out the cost base of your shares.

You need to keep evidence of all you have spent, from the beginning, to ensure you (and your beneficiaries) do not pay more tax than needed.

What records should you have?

Most of the records you will need would have been given to you by the company that issued the shares, your stockbroker or online share trading provider and your financial institution (if you took out a loan). It is important for you to have kept everything they gave you in relation to your shares.

You should have records of:-

- the date of purchase
- the date of sale
- the amount paid to purchase the shares
- any commissions paid to brokers when you acquired or disposed of them
- any stamp duty paid; and
- the amount received upon sale.

You may (if applicable) also need records of:-

- details of any non-assessable payments made to you during the time you owned the shares
- the date and amount of any calls if the shares were partly paid
- the date and number of shares purchased through a dividend reinvestment plan
- the treatment of your shares during a merger, takeover or demerger; and
- the amount of any loans taken out to purchase your shares.

What do you do if you do not have records?

If you do not have the relevant records, you may be able to reconstruct them by obtaining copies, or details from:-

- the company
- your stockbroker or investment adviser
- your bank statements
- The Australian Stock Exchange (ASX)
- the share registry administering the shares
- your online share trading provider; or
- your financial institution.

The main thing is to get as many relevant details as possible. In particular, each record should show:-

- the date of the transaction / event
- the parties involved; and
- how it is relevant to working out your capital gain or capital loss (i.e. what the receipt or record is for).

How long should you keep records?

You must keep records of everything that affects your capital gains and capital losses for at least five years after the relevant CGT event (such as the sale of the shares).

Is there an easier way for you to keep records?

Yes. An easier way to keep your records is to set up a capital gains tax (CGT) asset register. It is comparatively easy and once you have entered your information into the register you may be able to discard records much sooner than would otherwise be the case.

If you have a taxable capital gain on the disposal of an asset such as shares, carefully consider whether you have purchased an eligible asset that has gone down in value. Prior to 30 June each year, consideration should be given to crystallising capital losses. This means in effect, creating a capital gains tax event disposal by selling an underperforming asset to offset taxable capital gains with taxable capital losses.

SHARE INVESTORS

"Wash Sales" and Part IVA

Taxable ruling (TR2008/03) deals with the "Application of Part IVA to 'wash sale' arrangements."

Generally speaking, the term 'wash sale' refers to an arrangement under which a taxpayer sells an asset to realise a capital loss on the sale, and then offsets this against a capital gain that they have made elsewhere.

The ATO will examine transactions where there is effectively no change in beneficial ownership of the asset because the taxpayer either buys the asset back at the lower cost base or sells it to a related party.

The message here is, do not make it obvious that the disposal is a wash sale.

SHARE TRADERS

At year end, when reviewing share trading profitability and other assessable income, carefully consider closing stock valuations for ASX listed shares. Effectively you have a choice to value each individual parcel of shares at purchase cost or listed market value. This could enable you to defer tax or better utilise lower marginal tax rates over a number of years.

TAXATION DETERMINATION TD 2011/22

TD 2011/22 released in August 2011 determines that Part IVA of the Income Tax Assessment Act 1936 can apply to a scheme designed to convert otherwise assessable interest income into non-assessable non-exempt dividends.

Be very cautious about entering into such arrangements.

Your Notes

DISCLAIMER

The information statement and opinions expressed in this publication are only intended as a guide to some of the important considerations to be taken into account relating to taxation matters. Although we believe that the statements are correct, and every effort has been made to ensure that they are correct, they should not be taken to represent taxation advice and you must obtain your own independent taxation advice. Neither the authors, nor the publisher or any people involved in the preparation of this publication give any guarantees about its contents or accept any liability for any loss, damage or other consequences which may arise as a result of any person acting on or using the information and opinions contained in this publication.

Readers seeking taxation advice should obtain their own independent advice and make their own enquiries about the correctness of the information set out in this publication and its accuracy in relation to their own particular circumstances.

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