bO2 Corporate Essentials

Tax Smart Australia

Issue
#0113

Tax Essentials
Tax Effective Shares & Property Investment

OCTOBER	2021

THE NEWSLETTER
Recent Tax Developments

MICHAEL'S CORNER
Covid-19 Vaccines and The Workplace
Article No. 013

SPECIAL BONUS ISSUE
Tax Effective Shares & Property Investment

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The Newsletter

RECENT TAX DEVELOPMENTS

CHANGES TO THE R&D TAX INCENTIVE FROM 1.7.2021

The Research and Development Tax Incentive **(R&DTI)** has been in operation for ten years. This initiative aims to encourage innovation entities to grow and elevate their creative projects in Australia.

The Department of Industry, Science, Energy and Resources **(AusIndustry)** and ATO regulate the R&DTI. AusIndustry administers the R&DTI, and the ATO reviews the R&DTI expenditure claims when lodged by the entity.

Reforms to the R&DTI were announced as part of the Federal Budget in 2020/21. They formed part of the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery)* Act 2020. The following changes apply from 1.7.2021.

Changes to the R&D scheme:

- The tax offset for eligible R&D activities is based on a premium on top of the corporate tax rate for your entity.
- Entities with **less than** an aggregated turnover of $20 million – may claim a refundable R&D tax offset; this is your corporate tax rate **plus an 18.5% premium**. Previously entities making less than $20 million could claim a tax offset rate of 43.5%.
- Entities with **more than** an aggregated turnover of $20 million may claim a non-refundable R&D tax offset, which is your corporate tax **plus an incremental premium**. These incremental premiums are based on an entity's R&D intensity for its R&D expenditure. Previously entities making more than $20 million could claim a non-refundable R&D tax offset at a rate of 38.5%.
- The expenditure threshold has increased from $100 million to $150 million and is now a permanent feature of the law.
- A tax benefit can be denied by the Tax Commissioner in the form of an amount of a refundable or non-refundable R&D tax offset that an R&D entity seeks to obtain from a tax avoidance scheme.
- There is a 'uniform clawback' rule.
- Changes to assessable income for R&D entities.
- Changes to R&D entity's deductions.
- Changes to balancing adjustments for R&D assets held by R&D partnerships.
- Changes to transitional rules are amended to align with the primary amendments. Still, they continue to apply to R&D assets acquired before the R&DTI in 2011.
- The Commissioner must publish information about R&D entities where the entities have claimed notional deductions for R&D activities, including the amounts claimed.

Once eligibility has been determined, the R&D entity must register its entity with AusIndustry to be eligible for the R&DTI. Once the application is reviewed and if approved, your entity will be given a registration number to lodge a request for the RD&TI.

The R&D entity must summarise its eligible expenses by lodging them with the ATO's R&D incentive schedule. Your registration number must be included.

Part of the application process requires a description of your projects and activities. The registration must be lodged within ten months of the income year end and lodged with the entity's company tax return.

FBT RETRAINING AND RESKILLING EXEMPTION NOW LAW

Employers who provide training or education to redundant, or soon to be redundant, employees may now be exempt from fringe benefits tax (FBT).

Eligible employers can apply the exemption to retraining and reskilling benefits provided on or after 2 October 2020.

There are no limits on the number of training or education courses your employees may undertake or the cost of the education or training.

You don't need to include these exempt retraining and reskilling benefits in your FBT return or your employee's reportable fringe benefits amount.

Suppose you've already lodged and paid your 2021 FBT return. In that case, you'll need to amend your return to reduce the FBT paid for any exempt retraining and reskilling benefits.

If you intend to claim the exemption, you must keep a record of all training and education provided to redundant, or soon to be redundant, employees.

AN INCREASE IN SMSF MEMBERSHIP RECEIVES ROYAL ASSENT

Treasury Laws Amendment (Self-Managed Superannuation Funds) Bill 2020 received royal assent on 22 June 2021. From 1 July 2021, self-managed super funds (SMSF) and small APRA funds (SAFs) will be able to have up to six members instead of the previous cap of four.

If you are considering expanding your fund, you will need to consider things such as:

- what your fund's trust deed allows
- the structure of your fund, and
- its reporting requirements.

Some State and Territory laws restrict the number of trustees a trust can have. Because an SMSF is a type of trust, your fund may be impacted by these restrictions. To avoid this issue, you can set up your SMSF with a corporate trustee and each member as a director of the corporate trustee.

It is important to seek professional advice and check State or Territory law restrictions before registering or expanding your fund.

The ATO has implemented the necessary system changes to enable SMSFs to add members five and six to their fund through the Australian Business Register (ABR).

ATO DATA-MATCHING PROGRAM – LIFESTYLE ASSETS

In July 2021, the ATO announced its intention to acquire lifestyle assets data from insurance policies for 2020-21 through to 2022-23 for the following assets where the value is equal to or exceeds nominated thresholds.

Asset class	Minimum asset value threshold
Marine vessels	$100,000
Motor vehicles	$65,000
Thoroughbred horses	$65,000
Fine art	$100,000 per item
Aircraft	$150,000

The data items include:

- client identification details (names, addresses, phone numbers, dates of birth, Australian business number, email addresses), and
- policy details (policy number, policy inspection date, start date of current policy, end date of current policy, total value insured, purchase price of the property insured, registration or identification number of the property, insurance category, policy cost, description of the property insured, primary use type)

The objectives of the lifestyle assets program are to: data-matching

- promote voluntary compliance and increase community confidence in the integrity of the tax and superannuation systems
- assist with profiling to provide compliance staff with a holistic view of a taxpayer's wealth
- identify possible compliance issues with income tax, CGT, FBT, GST and superannuation obligations
- determine avenues available to assist in debt management activities
- gain insights from the data to help to develop and implement treatment strategies to improve voluntary compliance, which may include educational or compliance activities as appropriate
- identify and educate those individuals and businesses who may be failing to meet their registration and/or lodgement obligations and assist them to comply
- help ensure that individuals and businesses are fulfilling their tax and superannuation reporting obligations.

LABOR AIMS TO DELIVER INCOME TAX CUTS AND CERTAINTY ON NEGATIVE GEARING

Earlier this year, the ALP dumped its dividend franking credits policy, which would have abolished franking credits refunds for people who paid no tax. This cost them clearly at the 2019 Federal Election. The coalition dubbed it the 'retiree tax' in their election-winning campaign.

On 26.7.2021, the ALP also announced an Albanese Labor government would deliver the same legislated tax relief to more than 9 million Australians as the Morrison Government, with the Shadow Cabinet and Caucus confirming that Labor in government would uphold the legislated changes to personal income taxes and maintain the existing regimes for negative gearing and capital gains tax (CGT)

You may recall it was ALP policy to reduce the CGT discount on assets held longer than 12 months from 50% to 25%.

Clearly, Labor intends to take its unpopular tax policies off the table and turn the forthcoming Federal election into a battleground over the Federal Government's handling of the Covid-19 pandemic.

We remain apolitical, and it's up to the voters to decide.

WHAT TO EXCLUDE FROM YOUR BUSINESS'S ASSESSABLE INCOME?

Not all payments you receive are assessable income for income tax purposes. Therefore, some may not need to be included as assessable income.

List of non-assessable amounts

The following amounts are not assessable: betting and gambling wins (unless you operate a betting or gambling business)

- earnings from a hobby
- gifts or inheritance
- GST you have collected
- non-assessable non-exempt government grants for grant recipients
- prizes and awards not related to your business
- money you have borrowed
- money you contribute as the business owner.

Non-assessable non-exempt government grants for grant recipients

The Federal Government can declare eligible business support grants as non-assessable, non-exempt (NANE) income. This means you do not include NANE income in your income tax return, and you do not pay tax on it.

COVID-19 recovery payments

Some COVID-19 recovery payments from the government to support small businesses will be NANE income for tax purposes.

Eligibility

To meet the eligibility requirements to treat support grants as NANE income on your income tax return, you will need to self-assess.

A payment will be NANE if it was received:

- under an eligible grant program
- in the 2020–21 or 2021-22 financial years
- by a small business with an aggregated turnover of less than $50 million in the income year, the payment was received.

Example - ***Receiving a grant eligible for NANE income***

Fresh Brew is a small business operating a café in Victoria.

Fresh Brew received an eligible grant payment under the Outdoor Eating and Entertainment Package for the 2020-21 financial year.

This package is part of the Victorian Government's response to the economic impacts of Coronavirus.

The Minister has declared that the Outdoor Eating and Entertainment Package is a grant program eligible for NANE income.

In the 2020-21 financial year, Fresh Brew self-assessed and identified that they are a small business. Their turnover was less than $50 million in the income year the payment was received.

As Fresh Brew received an eligible grant payment in the 2020-21 financial year and is a small business, they do not need to include the grant in their business income.

Natural disasters

Some recovery grants from natural disasters are also NANE. The key takeout is to check out whether any government grant or non-business receipt qualifies as non-assessable non-exempt income (NANE).

To ensure it does not get lumped with your normal business, always include it as a separate income item in your accounting software. This will ensure all NANE gets properly identified.

TIME TO CLAIM THE JOBMAKER HIRING CREDIT

The ATO has advised the JobMaker Hiring Credit scheme's third claim period is now open. Suppose you've taken on additional eligible employees since 7 October 2020. In that case, you may be able to claim JobMaker Hiring Credit payments for your business.

To claim, you need to:

- Register at any time before 6 October 2021 through ATO online services, Online Services for Business, or through your registered tax or BAS agent.
- Nominate your additional eligible employees by running payroll events through your Single Touch Payroll (STP)-enabled software.
- Claim your payments – enter your headcount and payroll information for the Jobmaker period. The ATO will calculate your claim amount based on the information you provide.

Eligible businesses can receive up to:

- $10,400 over a year for each additional eligible employee hired aged 16 to 29 years
- $5,200 over a year for each additional eligible employee hired aged 30 to 35 years.

The JobMaker Hiring Credit is available to businesses for each additional eligible employee hired before 6 October 2021.

If you're thinking about taking on extra staff, check if you're eligible to participate in the scheme. The ATO has the resources available to help you, including a guide, key dates, and a tool for estimating payments.

Remember, registered tax agents and BAS agents can help you with your tax.

MUNKAYILAR v C OF T – WORK-RELATED DEDUCTIONS DISALLOWED BUT SHORTFALL PENALTY REDUCED

The taxpayer, a social worker, worked as support staff for an organisation providing services for adults and children with disabilities. In his 2018 tax return, prepared by his tax agent, the taxpayer claimed work-related deductions (laundry, non-slip shoes, mobile phone charges and hand cream) totalling $670. He also claimed self-education expenses consisting of fees for a child protection course ($9,435), a HELP debt ($4,000), travel expenses from work to Geelong for training ($1,500) and depreciation of a computer ($137). When the return was lodged, the taxpayer was yet to pay the course fees and was unsure whether he was obliged to do so. It turned out the employer paid this in disallowing the work-related deductions and the self-education expenses. The ATO also imposed a 50% shortfall penalty.

The Administrative Appeals Tribunal (AAT) held that:

- the course fees were not deductible as the taxpayer had not paid them
- the HELP debt was not deductible by virtue of s 26-20 of the ITAA 1997
- there was no evidence to support the travel expenses; and
- the taxpayer could not substantiate the various work-related deductions (for example, there were no receipts).

In dealing with the shortfall penalty, although the AAT held that reasonable care had not been taken in preparing the 2018 tax return and the "safe harbour" exception did not apply, they were willing to remit the shortfall penalty by 85%. This was largely because the tax agent had made a mistake in claiming the course fees and provided incorrect advice to the taxpayer in relation to the deductibility of HELP loan repayments and the travel expenses.

EXTENDING RELIEF FOR VIRTUAL MEETINGS AND ELECTRONIC COMMUNICATIONS

On 10.8.2021, Parliament passed legislation renewing temporary relief that allows companies to use technology to meet regulatory requirements under the Corporations Act 2001.

These temporary relief measures will allow companies to hold virtual meetings and use electronic communications to send meeting materials and execute documents until 31 March 2022.

This relief ensures that companies can meet their obligations as they continue to deal with the uncertainty of the COVID-19 pandemic. The renewed relief will give much-needed certainty to listed and unlisted companies expected to hold an annual general meeting later this year and early next year.

The legislation also gives ASIC permanent powers to provide individual or class order relief in relation to meetings and sending documents to provide additional flexibility. ASIC will provide this relief in circumstances beyond companies' control, such as those caused by the COVID-19 pandemic.

With the extension of this temporary relief, the government will seek to introduce permanent reforms later this year. The reforms will allow companies to use technology to hold meetings, such as hybrid meetings, and sign and send documents.

SUPPORTING BUSINESSES AND INDIVIDUALS IMPACTED BY COVID-19

The passage of the *Treasury Laws Amendment (COVID-19 Economic Response No. 2) Bill 2021* on 10.8.2021 will provide additional support to individuals and businesses that continue to be affected by the COVID-19 pandemic.

The Bill provides additional relief for individuals who are doing it tough by ensuring that COVID-19 disaster payments received by individuals from the 2020 21 income year are tax-free.

The Bill also gives effect to the Morrison Government's commitment to assist any state and territory that is unable to administer its business support payments in the event of a significant lockdown imposed by a state or territory.

The Treasurer will also be able to determine the tax treatment of eligible COVID-19 business support payments administered by the Commonwealth.

Under the Bill, the ATO will share data with Australian government agencies to administer a COVID-19 business support program that the Treasurer has declared is eligible for data sharing.

Importantly, the Bill will also provide flexibility to enable necessary temporary adjustments for complying with information and documentary requirements under Commonwealth legislation.

TAXATION RULING TR 2021/4 INCOME TAX AND FRINGE BENEFITS TAX: EMPLOYEES: ACCOMMODATION, FOOD AND DRINK EXPENSES, TRAVEL ALLOWANCES AND LIVING-AWAY-FROM-HOME ALLOWANCES

This Ruling which was released on 11.8.2021, explains:

- When an employee can deduct accommodation and food and drink expenses under section 8-1 of the ITAA 1997 when travelling on work, including where it is necessary to apportion.
- The fringe benefits tax (FBT) implications, including the application of the otherwise deductible rule, where an employee is reimbursed for accommodation and food and drink expenses or where the employer provides or pays for these expenses.
- The criteria for determining whether an allowance is a travel allowance (as defined in subsection 900-30(3)) or a living-away-from-home allowance (LAFHA) benefit (see section 30 of the Fringe Benefits Tax Assessment Act 1986 (FBTAA)) and the differences between them.

Whether accommodation and food and drink expenses are deductible depends on the facts and circumstances of each case. This Ruling uses examples to show how to determine the deductibility of these expenses in a range of situations.

TR 2021/4 Contains 14 worked examples that are relevant to everyday situations.

CORRECTLY CLAIM TEMPORARY FULL EXPENSING

Some sole traders have experienced errors when completing the temporary full expensing (TFE) and backing business investment (BBI) sections in their tax returns.

The error occurs when you incorrectly select an item from the TFE opt-out drop-down list in your return.

If you are not opting out of TFE or BBI or claiming a TFE deduction, you can skip all the labels about TFE or BBI in your tax return. No errors will occur, and you can proceed to lodge your tax return.

To claim TFE:

- add your TFE claim to your 'Depreciation expenses'
- complete the 'Temporary full expensing deductions' labels to include the value of the TFE deduction claimed, and
- complete the number of assets you are claiming for.

Only complete the 'Temporary full expensing deductions' labels if you are claiming TFE.

To opt-out of TFE or BBI:

- select the appropriate option at the relevant opt-out question
- state the number and value of assets you are opting out of TFE or BBI.

You only need to complete the opt-out question and details if you choose not to apply TFE or BBI to your eligible assets.

Remember, registered tax agents and BAS agents can help with your tax return.

LEGISLATION UPDATES

PAID PARENTAL LEAVE SCHEME BILL INTRODUCED

Legislation introduced into Parliament on 25.8.2021 will allow parents to count the period they have received the COVID-19 Disaster Payment towards the work test for Parental Leave Pay (PLP) and Dad and Partner Pay(DaPP).

This Bill will come as welcome relief for families living in extended lockdown conditions. The change will help parents who have had their hours of work reduced or stood down during the recent outbreaks retain their eligibility for the payments under the Paid Parental Leave Scheme.

The change will also support families who have received the COVID-19 Disaster Payment to meet the work test and will apply to anyone who receives the payment in the future.

The amendments, included in the **Paid Parental Leave Amendment (COVID-19 Work Test) Bill 2021**, follow a similar approach in 2020 where time spent receiving the JobKeeper payment counted towards the Paid Parental Leave work test.

Primary carers of a newborn can receive Parental Leave Pay for up to 18 weeks which can be transferred to the other parent at any time should they take over primary caring responsibilities. Flexibility measures introduced last year also allow the final six weeks to be shared or taken by either parent at any time until their child turns 2. In addition, Dad and Partner Pay is available for two weeks. Both payments are paid at the national minimum wage of $772.55 per week.

Families may also be eligible for Family Tax Benefit Part A up to $191.24 per child a fortnight for children up to 12 and Part B up to $162.54 per family a fortnight for children under 5.

BILL INTRODUCES REPORTING REGIME FOR THE SHARING ECONOMY

Legislation to implement a reporting regime for the sharing economy was introduced into Parliament on 25 .8. 2021.. The Bill requires operators of online marketplaces or electronic distribution platforms (EDPs)to report seller identification and payment details relating to transactions facilitated through their platform to the Australian Taxation Office (ATO).

The sharing economy has grown significantly over recent years. There is a risk that some sellers who use these platforms are not reporting their full income or paying the right amount of tax. The reporting regime helps ensure that the sharing economy meets their tax obligations and do not have an unfair advantage compared to similar activity elsewhere in the economy due to poor tax compliance. Key players in the sharing economy include Airbnb, Uber, and Lyft.

The **Treasury Laws Amendment (2021 Measures No.7) Bill 2021** will:

- require electronic platform operators to provide information on transactions made through the platform to the ATO
- facilitate the closure and any transitional arrangements associated with Australian Financial Complaints Authority replacing the Superannuation Complaints Tribunal; and
- removes the $250 non-deductible threshold for work-related self-education expenses.

EXPORT FINANCE AUSTRALIA EQUITY INVESTMENT BILL PASSES HOUSE

This Bill also passed the House of Representatives on 26.8.2021 and moved to the Senate.

The purpose of the Export Finance and Insurance Corporation Amendment (Equity Investments and Other Measures) Bill 2021 (the Bill) is to give legislative effect to the Federal Government's decision to broaden the range of transactions that Export Finance Australia (EFA) can finance. The Bill will enable the EFA to make equity investments, including supporting important infrastructure investments in the Indo-Pacific export-linked projects in Australia.

SUPPORTING MORE SMALL AND MEDIUM-SIZED BUSINESSES TO ACCESS FUNDING

The Federal Government is expanding eligibility for the SME Recovery Loan Scheme. The expansion will provide additional support to small and medium-sized businesses (SMEs) who continue to deal with the economic impacts of the COVID-19 crisis.

In recognition of the continued economic impacts of COVID-19, the government will remove requirements for SMEs to have received JobKeeper during the March quarter of 2021 or to have been a flood-affected business to be eligible under the SME Recovery Loan Scheme.

As with the existing Scheme, SMEs dealing with the economic impacts of Coronavirus with a turnover of less than $250 million will be able to access loans up to $5 million over a term of up to 10 years.

Other key features of the SME Recovery Loan Scheme include:

- The Government guarantee will be 80 per cent of the loan amount.
- Lenders are allowed to offer borrowers a repayment holiday of up to 24 months.
- Loans can be used for a broad range of business purposes, including to support investment.
- Loans may be used to refinance any pre-existing debt of an eligible borrower, including those from the SME Guarantee Scheme.
- Loans can be either unsecured or secured (excluding residential property).

The expanded scheme will enable lenders to continue supporting Australian small businesses when they need it most.

The SME Recovery Loan Scheme builds on earlier loan schemes introduced during COVID-19, under which around 74,000 loans totalling around $6.2 billion were written.

The loans will be available through participating lenders until 31 December 2021. The expansion complements the Commonwealth's other financial support to businesses impacted by the current COVID-19 health restrictions.

The Morrison Government will continue to support small businesses as they seek to rebuild, adapt, and create jobs on the other side of this crisis.

Further information can be found on the Treasury website.

AUSTRALIANS LOSE $70 MILLION ON SCAMS, ACCORDING TO SCAMWATCH

- There was a 119.6 per cent increase in the losses associated with investment scams between the first six months of 2020 compared with the first six months of 2021.
- Cryptocurrencies were the most common payment method used in investment scams and caused the biggest losses. Of the 1,931 reports involving a loss, 955 (49.5%) were due to cryptocurrencies with losses of $29,277,896. Bitcoin accounted for over $25 million of these losses.
- People aged 65 years and over have lost the most money to investment scams so far in 2021, experiencing losses of $18.8 million from 548 reports.
- There has been an increase of 66 per cent in the number of reports about investment scams made by people aged 18-24 years. The losses of more than $1.7 million so far is an increase of 259 per cent compared to all last year.
- Indigenous consumers made 84 reports of investment scams and lost $945,270, a three-fold increase on the $336,796 lost for all last year.
- The phone was the most common contact mode used with investment scams, accounting for 1,429 reports (30%) of all investment scam reports with losses of $27.7 million (39% of all losses to investment scams).
- Mobile apps and social networking sites accounted for 40% of all investment scams, which involved a financial loss.

GRANTS TO BOOST AUSTRALIAN EXPORTERS' GLOBAL GROWTH

In August, Minister for Trade, Tourism, and Investment Dan Tehan outlined recent reforms to export grants. The grants will better support

Australian exporters to succeed on the world stage, supporting local jobs and businesses.

Applications are now open for the reformed Export Market Development Grants (EMDG). The program, which will ensure exporters know how much funding they will receive before they spend, has been improved by simplified legislation, a streamlined application process and a shift to a forward-looking grant program.

“The EMDG program has helped support Australian success stories like the Wiggles, Atlassian and Penfolds to become international sensations,” Mr Tehan said.

“Our government provided $214.5 million to more than 4,700 Australian businesses to support their exporting activities through the EMDG program in 2020-21.

“These businesses employed more than 70,000 people and generated around $4.7 billion in export income.

“EMDG is a valuable form of assistance for Australian exporters, and these changes will help many new and emerging exporters reach new heights in the years to come.

Since 1974 EMDG has supported close to 50,000 Australian exporters and distributed around $5.7 billion in grant payments.

The top five markets for EMDG grant recipients in 2020–21 were the US (56.9%), followed by the UK (25.3%), China (17.5%), Singapore (8.9%) and Canada (8.6%).

Reforms to EMDG are supported by a new application form which allows for better integration across Austrade services to deliver an improved client experience and export outcomes.

Applying for Export Market Development Grants from 1 July 2021

For export promotional activities from 1 July 2021, EMDG will no longer operate as a reimbursement scheme. Applications open on 16 August and close on 30 November 2021.

You can still claim reimbursement of eligible expenses incurred up to 30 June 2021 by applying under the final year of the reimbursement scheme. Applications for the reimbursement scheme close 30 November 2021 or 28 February 2022 if you are using a participating EMDG consultant.

The new forward-looking grant program will enable you to plan your marketing and promotional activities with confidence because you will know how much you will receive over the life of your grant agreement.

Grants are designed to support you during different stages of your export journey, and if you are an exporter or will be soon, you need to explore this.

STRENGTHENING UNFAIR CONTRACT TERM PROTECTIONS FOR CONSUMERS AND SMALL BUSINESSES

On 23.8.2021, the government released a draft Bill to strengthen unfair contract term (UCT) protections for consumers and small businesses.

The exposure draft Bill proposes reforms to the Australian Consumer Law and the Australian Securities and Investments Commission Act 2001 to help reduce the prevalence of unfair terms in standard form contracts and improve consumer and small business confidence when entering into standard form contracts.

Key reforms include:

- Prohibiting the use, application, and reliance on an unfair term.
- Providing courts with the power to impose a financial penalty for a contravention.
- Expanding the protections to capture a larger number of small businesses; and
- Creating a rebuttable presumption that a term is unfair if a court has already found a similar term used in similar circumstances is unfair.

The consultation on the draft Bill follows an earlier consultation process on options to enhance the UCT protections.

CASH FLOW BOOST FOR EMPLOYERS – SCHEMES TO ARTIFICIALLY CREATE OR INFLATE ENTITLEMENTS

This is now an area of ATO focus as they are aware of schemes that may be used to artificially create or inflate an entitlement to the cash flow boost. These include artificial:

- business restructures that attempt to create eligibility for the cash flow boost
- arrangements to split a business that exceeds the $50 million aggregate turnover threshold in order to create eligibility for both parts of the business
- re-characterisation of payments to salary and wages to maximise the cash flow boost.

Strong integrity measures have been designed to protect against these types of schemes.

Businesses involved in these schemes may:

- have their entitlement to the credit cancelled
- be required to repay the amount received, along with interest or penalties.

An advisor who helped a client to make arrangements to create an entitlement for the cash flow boost artificially:

- may have promoted a tax exploitation scheme
- could become subject to a civil penalty under the Promoter Penalty Laws.

The ATO will be actively reviewing entitlements to the cash flow boost. Their digital reporting systems, including Single Touch Payroll, informs how many employees each business has.

If they identify that you have entered into a scheme to create or inflate entitlements to the cash flow boost artificially, you will either:

- not receive any cash flow boost
- be required to repay any overpaid amounts.

Taxpayers and advisors who have entered into these types of arrangements will be subject to increased scrutiny. Compliance action may also be undertaken.

Registered tax agents who advise taxpayers to claim the cash flow boost inappropriately may be referred to the Tax Practitioners Board. The board will consider whether there has been a breach of the Tax Agent Services Act 2009.

Under Division 290 of Schedule 1 to the Taxation Administration Act 1953, Promoter penalty laws may also apply to promoters of these schemes. Penalties may include:

- civil penalties of up to 5,000 penalty units for individuals
- 25,000 penalty units for body corporates
- impositions of up to twice the amount of consideration received or receivable.

If you have entered into an arrangement of this type, you should seek independent professional advice.

REFUND OF LARGE-SCALE GENERATION SHORTFALL BILL PASSES HOUSE

On 26.8.2021, the Treasury Laws Amendment (2021 Measures No. 6) Bill passed the House of Representatives and will now be considered by the Senate.

The Bill proposes to:

- Make refunds of large-scale generation shortfall charges non-assessable non-exempt income for income tax purposes.
- Increase the maximum amount of penalty units included in regulations that prescribe an industry code, with specific amendments for industry codes relating to franchising.
- Remove the requirement for superannuation trustees to provide an actuarial certificate when calculating exempt current pension income using the proportionate method, where all members of the fund are fully in retirement phase for all of the income year.
- Provide regulatory certainty for industry participants that are governed by industry codes prescribed by regulations; and
- Create a new mechanism for sharing superannuation information for family law proceedings.

ATO ISSUES GUIDANCE ON TAX DEDUCTIONS FOR NON-ASSESSABLE NON-EXEMPT (NANE) COVID-19 GRANTS

Recently the Federal Government declared a number of New South Wales and Victorian COVID-19 business support programs to be eligible for non-assessable non-exempt (NANE) income treatment.

Broadly, payments will be treated as NANE income if made under an eligible program, received in the current financial year, and received by a business with an aggregated turnover of less than $50 million.

The ATO has issued guidance making it clear you can only claim a tax deduction for the part of these expenses related to gaining your assessable income. You cannot claim a tax deduction for the part that relates to getting the non-taxable government grant.

There is no set way to work out the part of the expense that relates to each purpose, but the way you work it out should be fair and reasonable. You should keep a record of how you work it out.

Example – ***Expenses incurred to gain assessable income and to get a non-taxable government grant***

Flame Pty Ltd is eligible to receive a non-taxable government grant.

Flame Pty Ltd asks their accountant to apply for this grant on their behalf. Their accountant does not separately bill Flame Pty Ltd for this service but itemises the fee charged for applying for the grant in a quarterly bill that they give to Flame Pty Ltd for professional services provided over the quarter.

Flame Pty Ltd cannot claim a deduction for this part of the Bill.

Expenses that you would usually incur in the ordinary course of carrying on your business but are incidentally related to getting a non-taxable government grant.

You can claim a tax deduction for the whole of these expenses.

Getting a government grant is considered incidental where the expense relates to the whole of your business and is a type of expense you would usually incur. It will be considered that a government grant is not incidental where the expense is not one that you normally incur and is a pre-condition of being eligible for the grant.

Example – ***Expenses incidentally related to getting a non-taxable government grant***

Flame Pty Ltd is eligible for a non-taxable government grant if they keep their staff on the payroll.

Flame Pty Ltd uses the grant to pay for wages, rent and utilities that they would ordinarily incur in carrying on his business.

Flame Pty Ltd can claim a deduction for the wages, rent and utilities paid.

ANTI-AVOIDANCE TASK FORCE FOCUS IN 2021–22

The ATO has outlined the Tax Avoidance Taskforce targets for 2021-22. During 2021–22, the focus will continue to be specialist large market advisors who promote and run tax avoidance schemes and engage in uncooperative, misleading, and obstructive behaviour. This includes the misuse of legal professional privilege (LPP) during their reviews and audits. The ATO is developing best practice guidance to establish best practice when making LPP claims in a tax dispute.

Under their engagement and streamlined assurance programs through their various compliance products, the ATO has indicated that they will continue engagement with the Top 500 and Next 5000 taxpayers and their associated entities.

The Taskforce uses its "growing data holdings" to identify and treat tax avoidance behaviours. This data is also used to improve systems designed to ensure leveraged approaches are applied across this population, reducing risk.

The Medium and Emerging program focuses on the performance and compliance of the medium and emerging private groups. The ATO reports risks most associated with this group, including tax or economic performance not comparable to similar businesses, low transparency of tax affairs, aggressive tax planning, accessing business assets for tax-free private use, and poor governance and risk-management systems.

By updating the Taskforce's programs since inception, they have engaged with 1,978 taxpayers and their associated entities that fall within this category. It has raised $229.2 million in liabilities, with collections reported at $142.43 million in cash.

Another specific initiative of the Taskforce, The International Risk Program to date, has conducted 325 compliance activities with privately-owned wealthy groups and non-resident taxpayers on international tax-related matters, raising $266.4 million in liabilities and collecting $232.8 million in cash.

The ATO has pointed out that it continues to identify and address taxpayers deliberately entering abusive trust arrangements.

The Top 1000 Combined Assurance Review program commenced in late September 2020 and builds on the Top 1000 tax performance program. Work will commence with the reviews and associated engagements regarding those taxpayers that obtained overall low assurance.

Complex trust structures and distribution flows designed to exploit the use of trusts will again be firmly in ATO sights.

The ATO is working with their partner agencies to remove and disrupt harmful practices. Sharpening their focus on the small number of wealthy individuals (and their private groups) who continue to engage in deliberate tax avoidance behaviours,

The ATO will continue to advance their D&A capabilities and use cutting-edge technology to improve how they analyse and use data to support the Taskforce. Further improvements to data accessibility and risk detection services will enhance their ability to target engagement and assurance work. This program of work will continue over the next two years, with technology and analytics enhancements that continue to manage, interrogate, and provide insights from their extensive data resources.

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

Question 1
Subject: Dual Company Structure

Would you please help with the following questions?

There is a Holding company and Trading company under a dual company structure.

The Holding company owns 100% shares of the Trading company and has no other business activity.

Only the income for the Holding company will be the dividend income if the Trading company pays the franked dividend in the future.

Here are the questions.

a) Does the Holding company need to apply for the ABN and TFN in the above circumstance?

b) Do we need to lodge the company tax return every year for the Holding company although no dividend income is received?

c) Suppose the Holding company receives dividends from the Trading company. Should the Holding company pay the corporate tax on this dividend income?

d) There may be small expenses related to the Holding company. Can this be included in the company tax return of the Holding company, e.g., accounting fee, or postage and so on?

Answer

a) Having been registered with ASIC, the company is entitled to an ABN – effectively, the client has a choice. There is no requirement for it to have an ABN. As there is the possibility of receiving dividends, inter-entity transactions and additional subsidiaries, a TFN should be applied for. In the event of future tax consolidation and/or GST grouping, the holding company should have both a TFN and ABN.

b) A return is not strictly necessary but could be lodged in the event of no income and care taken to ensure records are retained to prepare financial statements (Corp Law requirement). However, this is not best practice, and normally financial statements at the very least are prepared annually.

c) This will depend on whether the dividends are franked. Normally only franked dividends are paid, which means the franking credits cover the holding company tax liability.

d) Yes, as the holding company expects to receive dividends, these minor expenses will be deemed to be incurred in earning assessable income.

Question 2
Subject: Home Schooling

Can an employee take carers leave for home-schooling during a Covid-19 lockdown?

Answer

The answer is no. Careers leave only applies and is taken when the person they are caring for is sick, ill or injured.

A business can pay it if they wish, but they are not obligated.

Question 3
Subject: Loan for Investment Rental Property

If a family member lends funds for another family member to purchase an investment property and charges interest on the loan, is the interest deductible for the member/owner of the property?

I assume if one claims a deduction, the other member declares the interest in their tax return.

What rate of interest should be charged against the loan?

Answer

The interest is deductible to the owner of the property as the principal was used to invest in an income-earning asset.

You are correct – the lender must include the interest they receive in their assessable income.

A commercial interest rate should be charged, making reference to the big 4 bank's standard variable home loan rate.

This interest rate will fluctuate over time.

Question 4
Subject: FBT - Change of Position

An employee leaves working for a large chain as an area manager, takes a new position at an associated subsidiary being an area manager.

The employer's ABN changes, but he rolls his AL, LSL, and SL to the new employer, as it's the same parent company.

As part of the package at the large chain, he gets a salary packaged car under a Novated Lease.

He leaves the large chain and starts with the subsidiary the next day.

Upon leaving, he ceases the novated lease, trades in the old car, and gets a new one with the subsidiary.

In August, the salary packaging company advised him he had a $10,460 adjustment on his salary package to pay. The shortfall relates to the actual v estimated usage of the car. The running costs were $10,460 over his budgeted running costs.

Can he claim a deduction for the amount he has to pay for running costs for the motor car, i.e., the $10,460 subject to the logbook percentage?

Or is the documentation pointing to an employee contribution of $10,460 and not deductible?

Answer

If this amount represents a shortfall on a trade-in, it is before-tax dollars costed to the employee's package.

As all expenses are borne by the employer, the taxpayer has not incurred an expense in earning assessable income.

We note that the statutory formula is being used in calculating the FBT liability.

As the cost is to his pre-tax salary package, he would be double-dipping if he claimed a tax deduction which, as we have stated, is not available in any case.

While we don't have the documentation, we don't see how a tax deduction can be claimed in these circumstances.

Question 5
Subject: Setting Up a Company

For example (his wife and brother-in-law) are planning of purchasing the late sisters' property as an investment property. They intend to keep their sisters legacy at the same time as an investment for him and his wife for future generations. They will be using their own personal funds (husband and wife) for the purchase. The sale proceeds can be included in the liquid assets for distribution among the beneficiaries by the executor.

Husband and the sister of the deceased Maria are thinking of setting up a company and purchase the property through this Company name. It would be much appreciated to hear your view and insight.

Concerning this new company,

1. It is a "Shelf" company from an organisation that specialises in this practice providing us with necessary documents. Much better than setting it up myself through ASIC for registration.
2. Other than limited liability and maximum tax on future income of 30%, if an asset is purchased under a company, what other benefits are there from a taxation perspective?
3. From a tax perspective, what are the pros and cons of purchasing the property as an investment under a company name versus buying it under husband and wife's name?

Answer

A shelf company is the best option for set-up purposes should you decide to go this way. If you have an Accountant, they can arrange this for you.

As this proposed company will earn passive income, you are correct in stating the company tax rate is 30%.

The downside is that companies do not get the 50% capital gains tax discount for assets held longer than 12 months.

A possibility for the couple is to use the company as a trustee and set up a discretionary trust.

As income flows through a trust with tax to be paid by the beneficiaries, it retains its character.

This means the 50% capital gains tax discount can be accessed.

The trustees also decide who in the family group is allocated the income, and there are potential tax minimisation opportunities

The investment vehicle selected must fit current requirements while considering asset protection and estate planning issues.

For instance, holding the property in a discretionary trust means it will not form part of the couple's individual deceased estates.

This may determine whether they wish to hold the property in their own names.

Question 6
Subject: Redundancy Payment

I need to make a redundancy payment but need some advice on how to calculate the payment correctly.

Answer

We take it the payment has been negotiated and that it is only a matter of determining the tax treatment.

If it is a genuine bona fide redundancy, then the following tax treatment applies.

No tax will be payable on $11,341 plus $5,672 for each year of completed service.

The balance of the payment will be an Eligible Termination Payment.

The tax treatment will depend on the recipient's age – refer to page 10 of our 2022 annual publication.

Question 7
Subject: Lessee and GST

We are a not-for-profit registered charity, registered for GST and endorsed for income tax exemption, operating as a church.

Another legal entity (also a registered not-for-profit charity) owns the church property. It leases it to our legal entity, which is the local church.

The lessee pays property costs (e.g., rates, insurance) as part of the lease agreement.

Because the invoices are related to the property ownership, it is not an option to request that all invoices be issued in the lessee's name.

Can the lessee pay those tax invoices on the lessor's behalf and claim the GST for the invoices issued in the lessor's name?

Would you please direct me to any relevant ATO advice or legislation to support your response?

Answer

The owner of the church should send you a separate invoice to recover their costs on the outgoings.

This is what normally happens, and it is possible that GST will be charged on the tax invoice.

You will then be able to claim the GST back when you lodge your Business Activity Statement.

Question 8
Subject: HR Health Check docs

I am being asked to do a HR health check at our workplace. What things would they be covering, or what information do I need to provide them?

Answer

This is a question that we are asked frequently.

Log in to your secure portal and look at the current and up to date Covid resources available as a member. You will see the latest workplace Covid-19 safety plan template.

This is the information required to update your workplace Safety Policy Manual and your requested HR health check. All you have to do is customise it to suit your workplace.

Alternatively, you can click on the link below, and it will take you to it.

https://www.bo2.com.au/news-articles/mp-files/03-08-21-work-place-covid-19-safety-plan-template.doc/

I trust this has helped with your enquiry. Don't hesitate to contact us if we can be of further assistance.

Question 9
Subject: Carry-Back Losses

There are two separate questions:

1. Would you please provide a brief explanation as to the mechanics behind carry-back losses? And
2. details as to who is entitled to fuel tax credit and how it is calculated.

Answer

The loss carry back is covered in the Form C instructions guide section S item 13.

We trust you find the following link useful:

www.ato.gov.au/Forms/Company-tax-return-instructions-2021/?page=2#losscarryback

As you have requested the mechanics for fuel tax credits, we consider the following link most useful:

www.ato.gov.au/Calculators-and-tools/Fuel-tax-credit-tools

Question 10
Subject: Superannuation-Performance Bonus

Is the superannuation to be paid when I pay an employee a performance bonus?

Answer

Correct, you do pay super because a bonus falls within the definition of Ordinary Times Earnings (OTE).

Question 11
Subject: Snap Lockdown Payment

Our preschool is currently in the LGA with a snap lockdown. I am just curious if we have no children turn up to preschool - and no jobs to be done at preschool, can I send my staff home with no pay? Do I use their sick pay?

If they don't want to come to work due to mental health, what kind of payment do I pay them?

They will not be working from home, as they cannot work from home due to being a preschool.

Answer

They need to look for suitable alternative work as preschools are essential and are not mandated to close.

Suitable alternative work may be that they clean the preschool or do some forward planning.

The employees cannot be simply stood down.

It would be an annual leave day for people who do not wish to come to work unless they were ill or injured or caring for someone in that category; then, it would be personal leave.

Question 12
Subject: Changing Company Registration

I have composed a resolution concerning changing the company registration from Queensland to NSW. Can you suggest the fastest thing to do to address the resolution? The company was just incorporated yesterday. This shelf company noted that these changes would cost $1,000, which should have been confirmed before the registration.

We are looking forward to your kind advice.

Answer

Our perspective is that the state of registration is of little consequence.

This is a remainder from the days when prior to 1990, each state had a Corporate Affairs department that dealt with company registrations.

The Federal Government, through the formation of ASIC, took over this responsibility in 1990.

A registered company is free at any time to conduct business in more than one state and have or change its registered office to any state of its choosing.

It is the address of the registered office, which is important.

It is fine to have a minute or resolution, noting the registration state should have been NSW.

As for changing the state of registration and incurring a $1,000 expense... in our view, this is unnecessary.

Question 13
Subject: What Pay Rate?

Our Educator is Certificate 3 in children's service qualified and is working towards a Diploma of Early Childhood Education and Care in NSW Pre-school.

We are a small Pre-school and already have a diploma trained Educator.

Do we have to pay them at the diploma level because they have completed 50% of their course?

Answer

The employee is not entitled to be paid at diploma level until they achieve the diploma. Partial completion is not eligible.

Question 14
Subject: Voluntary Bankruptcy and SMSFs

In the event of voluntary bankruptcy and SMSF, I presume the director of the corporate trustee must remove themself, and therefore fund must close.

What happens to the assets in the fund?

Are the funds exposed to the bankruptcy trustee if already bankrupt, and the fund must then close?

If the funds remain in the SMSF (cash), can I close the fund and remove the cash without it being taken by the trustee, or must the money stay in a super fund? I am 62 years old and can retire and take the money out.

Answer

You are right that a disqualified person cannot act as a trustee of a self-managed superannuation fund (SMSF) when they become bankrupt.

This applies whether they are the director of a trustee company or act as an individual trustee.

The ATO must be informed immediately, and alternative arrangements must be made within the six-month period of grace.

Where the funds held in the SMSF are liquid, such as shares or cash at the bank, this usually does not cause a problem as the funds can be rolled over into a superannuation fund that is not a SMSF.

However, there may be problems when the assets are not liquid. Such as real property where there may be delays in selling or when the Trustees simply do not wish to sell as they believe the property is a good investment.

In such cases, they can appoint a small APRA fund to act as the fund trustee.

A small APRA fund allows the members to run the investment along similar lines to a SMSF, but a specialist company regulated by APRA performs the trustee role. There are costs associated with this which need to be considered when deciding what course of action to take.

If your client is an undischarged bankrupt, it maybe better that the funds stay in superannuation.

If the funds pass to the individual, the trustee may in some limited circumstances access them in bankruptcy, resulting in further financial loss.

Exercise extreme caution taking professional advice.

Question 15
Subject: What Level Is Paid?

I have an employee who will soon complete her Diploma in Early childhood Education and Care services.

She is also room leader when the ECT is absent or off the floor doing programming duties.

This employee is paid at a higher rate when required to do these duties.

Here are the answers to the questions.

1. At what level is she paid when she gets her diploma?
2. On the date we receive her new qualifications, is this the date she moves to the next level each year, NOT the date she started work with us.
3. Are we required to pay her a higher rate when she is left in charge of the room or is this in her Job description for a Diploma trained Educator? Yes, she gets higher duties.
4. What paperwork am I required to give her to sign off on once she agrees to the role? e.g., new job description, variation to wages etc., I'm not sure?

Answer

1. Level 3.4 when not supervising
2. That date of her qualifications, there are no higher pay levels in level 3
3. If she carries out the duties for more than 2 hours, clause 18 of the award gives a better breakdown of higher duties.
4. A new position description and an updated letter of offer if no other terms and conditions are changing. If there are changes to terms and conditions, a new employment contract would be a good idea.

Question 16
Subject: Policy on Bereavement Leave

We are updating our policy on bereavement leave, and we want to support our staff as much as we can.

Is it best practice to offer the employees additional financial support for bereavement leave?

e.g., Organisation covers employees cost for travel or additional days. Could you explain why this should or should not be done?

Answer

Yes, it is good practice to offer additional support. Still, it would be best to be wary of how much support you give and whether it is evenly distributed amongst the bereaved staff members.

Organisations generally do not cover costs of travel for employees but may loan them funds for travel. Then get an authorised payroll deduction for the cost to be paid back.

Many businesses grant additional days due to cultural or religious needs, and some may extend the meaning of family.

An example of this is in indigenous culture. Many people are close to Aunties and Uncles, and the legislation does not provide bereavement leave for these family members.

You may wish to grant leave in these circumstances. Please bear in mind we only used one cultural group as an example.

Question 17
Subject: Trust Return – Deceased

I am in the process of preparing the 2021 trust return for a deceased person who passed away in September 2019.

The 2020 estate return has been lodged and assessed to the trustee.

In Dec 2020, the estate disposed of the deceased's rental property originally acquired in Dec 1997, resulting in a capital gain of around $650,000.

The estate is still under administration and is to be finalised towards the end of September this year.

It is intended that the return will be lodged with income assessed to the trustee under the 3-year provisions.

Is the trustee entitled to the 50% discount ($325,000) on capital gain?

Answer

The trustee is definitely entitled to the 50% discount.

The cost base is the original acquisition cost with the usual adjustments for capital expenditure and renovations etc.

Question 18
Subject: Second Job Travel

My question is about the second job travel km that an employee, not a contractor, can claim.

From home to the first workplace (Private), I understand that the first workplace to workplace 2 is (Allowable to Claim).

Are the following allowed or not?

1. 2nd Workplace to Home
2. From home to 2nd workplace
3. 2nd workplace to home

If not an employee but a contractor with an ABN, can he claim travel expenses from home to the various workplaces?

Answer

For Employee

You are correct in your understanding that from home to the first workplace (Private) and the first workplace to workplace 2 is allowable to claim.

1. No, this is commuting from a workplace to home

2. Again, commuting and is non-deductible

3. Not deductible – again, this is commuting

For Contractor

They can claim travel expenses from home to the workplaces, only if he is an independent contractor with his home as a genuine place of business.

For instance, if he works almost exclusively for another Contractor, it is unlikely he will be an independent contractor.

Question 19
Subject: Medicare Levy Surcharge

Our client aged 57 withdrew $633,572 (8Q) from his super in 2021.

Tax withheld was $139,386 (8)

Tax-free Component was $213,949

It was not a death benefit. He does not have a Private Fund.

Is the above payment subject to MLS?

Answer

A taxable superannuation benefit is included in assessable income. The Medicare Levy Surcharge (MLS) will be payable on the portion of the amount withdrawn subject to tax.

The Medicare Levy Surcharge is based on taxable income with adjustments for taxable fringe benefits and amounts of trust distributions subject to family trust distribution tax.

Question 20
Subject: Payment of Tax

Please could you confirm the latest date that you can pay company income tax to the ATO for the tax year ending 30.6.2021?

Answer

This is largely determined by the due date for lodgement, and your Accountant/Tax Agent will advise.

The company will self-assess and pay the tax at the time of lodgement.

A company with a turnover of less than $2 million for the year ended 30 June 2000 will be expected to lodge their 2021 tax return by 31.3.2021, making payment on that date.

If the company did not have a tax liability for the year ended 30 June 2020, their lodgement date for the year ended 30 June 2021 is 15.5.2022.

They have an extension until 5.6.2022 to pay their tax.

Question 21
Subject: Capital Gains Tax payable?

A young couple purchased a unit in February 2016 for $1,100,000. The couple could not afford to live there, so they lived with their parents until May 2019. The unit was rented for the period March 2016 to May 2019.

In May 2019, the couple returned to their unit and used it as their main residence. At that point, the estimated value of the unit was $1,200,000. Subsequently, the unit was sold while it was their prime residence in April 2021 for $1,475,000.

(i) Is there any Capital Gains Tax payable?

(ii) Can we use the capital increase of $100,000 as the capital gain during the renting period, i.e. March 2016-May 2019, as Capital Gain?

Answer

It would appear the couple did not live in the dwelling.

The settlement being February 2016, with the unit being rented out in March 2016.

Therefore the 6-year temporary absence cannot be applied.

There appears to be some suggestion the couple did live in the unit… "in May 2019, the couple returned to the unit."

We would caution against using the 6-year temporary absence.

There is no facility to use the $100,000 capital gain suggested.

Capital gains tax will be applied using the days the dwelling was not the principal place of ownership divided by the days of total ownership.

Effectively the taxable capital will be determined on this basis using the 5 elements of the cost base then applying the individual 50% CGT discount.

Michael's Corner

COVID-19 VACCINES AND THE WORKPLACE

For the guidance of issuing mandated vaccines in the workplace, the Fair Work Ombudsmen has provided a guide on workplaces as a structure.

- **Tier 1 work** - where employees are required as part of their duties to interact with people with an increased risk of being infected with coronavirus (for example, employees working in hotel quarantine or border control).
- **Tier 2 work** - where employees are required to have close contact with people who are particularly vulnerable to the health impacts of coronavirus (for example, employees working in health care or aged care).
- **Tier 3 work** - where there is interaction or likely interaction between employees and other people such as customers, other employees, or the public in the normal course of employment (for example, stores providing essential goods and services).
- **Tier 4 work** - where employees have minimal face-to-face interaction as part of their normal employment duties (for example, working from home).

Where the employee sits in the tiers is depends upon it being a lawful directive for the employee to be vaccinated.

Employers can direct their employees to be vaccinated if the direction is lawful and reasonable. Whether a direction is lawful and reasonable will be fact dependent and needs to be assessed on a case-by-case basis.

For a direction to be lawful, it needs to comply with any employment contract, award or agreement, and any Commonwealth, state or territory law that applies (for example, an anti-discrimination law).

A range of factors may be relevant when determining whether a direction to an employee is reasonable. Things to take into consideration include:

- the nature of each workplace (for example, the extent to which employees need to work in public-facing roles, whether social distancing is possible and whether the business is providing an essential service)
- the extent of community transmission of COVID-19 in the location where the direction is to be given, including the risk of transmission of the Delta variant among employees, customers, or other members of the community
- the effectiveness of vaccines in reducing the risk of transmission or serious illness, including the Delta variant.
- work health and safety obligations
- each employee's circumstances, including their duties and the risks associated with their work
- whether employees have a legitimate reason for not being vaccinated (for example, a medical reason)
- vaccine availability.

There needs to be consultation with employees when implementing a COVID-19 vaccination policy.

For example, staff that cross the border from NSW into QLD would be reasonable to expect those employees to be vaccinated. Now Victoria is implementing the same for border crossings from NSW into Victoria.

The reasons would be covered under tier 1, as they have an increased risk by going into a Federally declared COVID-19 hotspot. Also, the state government of Queensland has mandated vaccinations as of 21 August 2021. South Australia from 12 September 2021 Victoria from 23 September 2021.

Two clauses from above and again shown below set out the lawful reasons for requiring an employee to be vaccinated.

Employers can direct their employees to be vaccinated if the direction is lawful and reasonable. Whether a direction is lawful and reasonable will be fact dependent and needs to be assessed on a case-by-case basis.

For a direction to be lawful, it needs to comply with any employment contract, award or agreement, and any Commonwealth, state or territory law that applies (for example, an anti-discrimination law).

As this is a major change, consultation with the employees must be canvassed, and reasonable employee views must be considered. What is considered reasonable is that "I have a medical condition to prevent me from having AZ" (see the GP to provide a medical certificate). What is unreasonable is, "I just don't want it because I don't know what is in it".

What happens if an employee refuses to be vaccinated?

If an employee refuses to be vaccinated (contrary to a specific law, agreement or contract that requires vaccination, or after receiving a lawful and reasonable direction), an employer should, as a first step, ask the employee to explain their reasons for refusing the vaccination.

Suppose the employee gives a legitimate reason for not being vaccinated (for example, the employee has an existing medical condition that means vaccination is not recommended for the employee). In that case, the employee and their employer should consider any other options available instead of vaccination. This could include alternative work arrangements.

Whether disciplinary action is reasonable will depend on the circumstances. Employers are encouraged to discuss options with their employees based on their individual workplaces.

Can an employer take disciplinary action if an employee refuses to get vaccinated?

An employer may be able to take disciplinary action, including termination of employment, against an employee for refusing to be vaccinated if the employee's refusal is in breach of:

- a specific law, or
- a lawful and reasonable direction requiring vaccination.

Before taking any action, an employer should talk to the employee and discuss the employee's reasons for not wanting to get vaccinated. For example, the employee may have a medical condition that means vaccination is not recommended.

Whether an employer can take disciplinary action will depend on the individual facts and circumstances. To work out if and how an employer can take disciplinary action, employers should consider the terms, obligations, and rights under any applicable:

- enterprise agreement or other registered agreement
- award
- employment contract
- workplace policy
- state or territory public health order.

Employers don't otherwise have the power to suspend employees without pay unless an enterprise or other registered agreement, award or employment contract allows them to. Employees have various protections against being dismissed or treated adversely in their employment. Employers should make sure that they follow a fair process and have a valid reason for termination, or they may breach unfair dismissal or adverse action laws under the Fair Work Act.

Employers should also consider getting legal advice in these situations.

Can an employer require an employee to provide evidence that they have been vaccinated?

Suppose an employer has provided a lawful and reasonable direction to be vaccinated for coronavirus, and an employee complies. In that case, the employer can also ask the employee to provide evidence of their vaccination.

An employer should also make sure that a requirement to provide evidence is lawful and reasonable. As stated above, whether a direction would be lawful and reasonable depends on all the circumstances. If it is unclear whether a direction or the employee's refusal is reasonable, employers should not take disciplinary action lightly and seek legal advice.

An employer may ask to view evidence of an employee's vaccination status without raising privacy obligations provided they do not collect (i.e., make a record or keep a copy of) this information. An employer should not collect vaccination status information from an employee unless the employee consents and the collection is reasonably necessary for the employer's functions and activities. However, consent to the collection is not required if the collection is required or authorised by law (for example, a public health order applies or where the employer must meet their obligations under WHS laws.

CHANGES TO CASUAL EMPLOYEES

Casual Employment Information Statement

Employers must give this document to new casual employees when they start work. Transitional rules apply to existing employees.

Before 27 September, all casual employees of big businesses need to ensure they all receive the Casual Employment Information Statement.

This statement explains the meaning of casual employment and the rights for casual employee's to convert to full and part-time employment.

There are two areas in which an employer does not have to offer conversion from casual to part/full-time employment, and they are:

- There are reasonable grounds for them not to.
- The employee is not eligible.

Link to the information statement.

https://www.fairwork.gov.au/employee-entitlements/national-employment-standards/casual-employment-information-statement

Another Landmark Decision for Employers

On 4 August 2021, the High Court handed down its decision in the landmark case of *WorkPac v Rossato & Ors [2021]* HCA 23 **(WorkPac v Rossato)**. In its decision, the High Court found that Mr Rossato was a casual employee for the purpose of the Fair Work Act 2009 (FW Act) and Workpac's Enterprise Agreement, and, as such, Mr Rossato was not entitled to paid annual leave, personal leave, and compassionate leave under the FW Act nor entitlements for permanent employees under the applicable Enterprise Agreement.

Please note that this is general advice for information only. Any application of legislation and/or Industrial Relations or contractual requirements may require professional advice to suit your circumstances. If you have a question for Michael's team, email us at info@bO2.com.au or sign-up for a Buzz Session...

Your Notes

Special Bonus Issue

Tax Effective Shares & Property Investment

WHAT'S NEW IN 2021

- Commercial Property – Taxation Considerations – an update
- New Home Guarantee
- Common mistakes with Rental Properties – an update
- Reduced Rental income in times of Covid-19
- Draft Taxation Ruling TR 2021/D5 Income Tax: Expenses associated with holding vacant land
- The taxation implications of dealings in cryptocurrency.

DENIAL OF TAX DEDUCTION FOR VACANT LAND LEGISLATION RELEASED

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

Property developers, investors, and primary producers should review 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 land use 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. Deductions denied for expenses, which ordinarily would be a cost base element, such as borrowing expenses and council rates, may be included in the asset's cost base 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 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:

- Property has been constructed on the land, received approval to be occupied, and is available for rent; or
- The owner uses the land 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-SMSFs, 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 expenses (finance interest) are incurred or 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.
- The land is vacant until the structure is lawfully able to be occupied and used or available for use (e.g., no deduction during construction).
- If the structure is not actively leased/hired/licenced or available for lease/hire/licence, the land is vacant.

Deductions may be denied for property developers where the land is recorded as capital or is not subject to a future development program. 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.

DRAFT TAXATION RULING TR 2021/D5

INCOME TAX: EXPENSES ASSOCIATED WITH HOLDING VACANT LAND

This draft ruling provides examples addressing common situations which demonstrate how section 26-102 of the ITAA 1997 applies in practice from 1.7.2019 to deny a tax deduction for these expenses.

Below are eight examples.

Example 1 - ***Manager's Residence***

Jamilla owns a 100-hectare block of farmland on a single title that includes an established house previously used as a manager's residence. The house is currently vacant but is capable of being occupied.

The house is a substantial and permanent structure with an independent purpose that is not incidental to the purpose of any other structure. It enables someone to live on the land and oversee farming activities.

Subsection 26-102(1) does not apply to deny a deduction for the holding costs in relation to the land as the land is not vacant. This is the case, even though the home area is minimal compared with the farming land.

Example 2 - ***Residential Vacant Land***

Lien owns a vacant block in a residential area on which she intends to build a rental property. The block is fenced on three sides and has a small shed. Lien stores tools and equipment in the shed to maintain the block. The fence and shed are not substantial and permanent structures with a purpose independent of any other proposed structure on the residential block. They exist to support the use and function of the proposed rental property. For the purposes of subsection 26-102(1), the land is considered vacant, and deductions for the costs of holding the land are denied.

Example 3 - ***Demolishing an Established House***

Arun purchased an established house which he has used as a rental property for several years. On 1 July 2019, he decided to demolish the existing house to build a townhouse. The tenants vacated the property in October 2019, and the house was demolished in December 2019. The property was in use or available for use until the date of demolition. Any holding costs that Arun may otherwise be entitled to deduct until the property was demolished would not be limited by section 26-102.

Example 4 - ***Existing Residential Premises That Are Not in Use or Available for Use Are Demolished***

Continuing from Example 3 of this Ruling, the tenants vacated the property in October 2019 because the local council declared the residential premises as structurally unsafe to occupy. Arun demolished the property in December 2019. Any holding costs that Arun would otherwise be entitled to deduct from October 2019 when the residential premises were not legally able to be occupied would be limited by section 26-102 as the house is not 'in use or available for use'.

Example 5 - ***New Construction***

Harry purchased vacant land on 1 July 2019 and built a house on the land. He obtains the occupancy certificate on 9 February 2020 and lists the property with a real estate agent for lease on 1 March 2020. From this date, the house is lawfully able to be occupied and available for lease. Any holding costs that Harry would otherwise be entitled to deduct from 1 March 2020 will not be denied by section 26-102.

Example 6 - ***Interest Expense for Multiple Purposes***

Giovanna took out a mortgage to purchase a vacant block of land in September 2019. Giovanna intends to build a house on the land (which she will rent out). Giovanna does not carry on a business. Giovanna takes out a separate loan for the construction of the house. In relation to acquiring the land, Giovanna will not be able to claim a deduction for her interest expense until the house is lawfully able to be occupied and leased or available for lease. Suppose a deduction is otherwise available for the construction loan interest expense. In that case, Giovanna will not be prevented from deducting the expense by section 26-102.

Example 7 - ***Carrying on A Business***

The John and James Smith Partnership operates a property development business and, as part of its business, acquires land in preparation for the development of a new apartment complex. As the land is being used in carrying on a business, subsection 26-102(1) does not limit the holding costs that the partnership can deduct.

Example 8 - ***Land Used in Family Business***

Amanda owns 1,000 hectares of bare cropping land over multiple titles. Amanda leases her land to a trading entity that her parents control. The trading entity runs a business selling the produce from the land. Amanda is employed by the trading entity but is not an affiliate of, or connected with, the trading entity. The rent on the land is at market value. The exception in subsection 26-102(9) applies to Amanda as the lease resulted from an arm's length dealing, and the lessee is using the land in carrying on a primary production business. Accordingly, subsection 26-102(1) will not prevent Amanda from claiming deductions in relation to her land.

There are three further examples in the draft ruling.

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 TR 2018/3. In the past 31 years, a number of related tax determinations have been issued, and the 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 accounting standard AASB 15. The key difference for business now appears to be with the fundamental dissimilarities 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 continue to be two methods that 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 the 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 the accounting recognition of revenue into line 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 throughout 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.

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

RENOVATING PROPERTIES

Personal Property Investor

Suppose you're considered a personal property investor. Your net gain or loss from the renovation, being 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 suppose you are registered in some other business capacity. In that case, 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:

- When he bought the property, he intended to gain rental income rather than 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, following his success with this renovation (either in his own right or with another or others), Doug undertook another renovation similar to the first, intending to achieve the same profit levels. He will be regarded as being in the business of property renovation.

Profit-Making Activity of Property Renovations

Suppose you're carrying out a profit-making activity of property renovations, also known as 'property flipping'. In that case, you report in your income tax return your net profit or loss from the renovation being - 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 must 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 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. 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

Suppose you're carrying on a business of renovating properties or 'flipping' properties. In that case, the purchased properties are regarded as trading stock (even if you live in one for a short period). 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, flipping, or undertaking a profit-making activity regarding 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 are 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 other property renovating businesses?

No single factor is necessarily decisive in reaching a conclusion, 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 intending to renovate and sell 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 first property sale, 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.

With the ATO having real difficulty in proving subjective intention, this situation can be a line ball. When renovations are complete, it is not wise to immediately place a home on the market, with an aggressive marketing campaign, 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. 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. We advise developers not to expect the ATO refund to be available in the normal cycle – it may well be held up. It would be best if you had 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.

These changes no longer allow subsequent property owners to claim deductions on items purchased by the property's previous owners.

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. This is until the investor no longer owns the asset or 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 property owners cannot 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. These changes include no longer allowing foreign or temporary tax residents to claim the main residence CGT exemption and expanding the scope of the CGT withholding system for foreign residents.

TOP TEN TIPS FOR INVESTMENT PROPERTIES

Start thinking about these issues now, not just prior to tax year end on 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 five 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.

If 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 more than one person owns the properties.

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 merging 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

Suppose you have purchased a negatively geared investment. In that case, you may have your PAYG deductions reduced to allow for the losses being incurred.

You can request the ATO provide a PAYG variation certificate 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 the sale of property or other assets during the year, consider disposing assets that 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. 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 them in the current year.

However, capital losses may not be offset against normal income such as salary or business trading income. If 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 #109 February 2021, page 18, tax tip #20, which outlines the importance of a CGT Asset Register.

9. Trusts

The use of a trust improves asset protection, estate planning. It allows increased flexibility for property investors – see Issue #112 August 2021 pages 25-30.

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.

10. Be aware of the changed legislation on the deductibility of interest on vacant land previously discussed in this edition on page 22.

COMMERCIAL PROPERTY – TAXATION CONSIDERATIONS

Given the adverse effect of the COVID-19 pandemic on the commercial real estate market, owners of commercial properties are currently offering generous lease incentives to attract prospective tenants.

We will examine the tax issues surrounding lease incentives. The tax and cash flow impact will differ according to the type of incentive being affected. Below are some of the most commonly missed deductions you should consider.

LEASE INCENTIVES

- **Rent-free period or a reduced rent period:** The landlord is not allowed any deduction in respect of the rent forgone because it is not a loss or outgoing incurred. However, the landlord will pay tax on the reduced rent amount.
- **Holiday package or other entertainment:** These incentives are not an allowable deduction. This is expenditure relating to providing entertainment and non-deductible.
- **Fit-out contributions:** With free fit-outs, treatment depends on whether ownership of the fit-out passes to the tenant or remains with the landlord. Suppose the landlord retains ownership of the fit-out. In that case, they will be eligible to claim either a capital allowance or capital works deduction, depending on the nature of the cost. In the event, the ownership of the fit-out is transferred to the tenant. An immediate deduction is available to the landlord.

Depending on the lease incentive provided, the difference in tax deduction available could be quite significant. For example, if a landlord provides a rent reduction of $200,000 on a 6-year lease, the rent forgone by the landlord is $33,333 per year. This means paying tax on $33,333 per year.

On the other hand, if the landlord charges full rent and contributes for office fit-outs of $200,000 and ownership of the fit-out remains with the landlord. The landlord may be able to claim these at 2.5% - assuming the capital works provision is applicable (i.e. the deduction claimable every year will be $3,000).

Comparing this with a scenario where the landlord contributes for office fit-outs of $200,000 and ownership of the fit-out passes to the tenant. The landlord will be able to claim an immediate deduction of $200,000 in the year the incentives were provided.

In the above scenarios, the cash outlay by the landlord is the same ($200,000), but the outcome for tax varies significantly. Therefore, when structuring lease incentives, careful decisions are called for.

Note the transactions need to be commercially realistic and be between arm's length parties. If not, the ATO may apply the anti-avoidance provisions rendering the transactions ineffective for tax purposes.

CAPITAL WORKS

Capital works are income tax deductions that may be claimed for buildings and structural improvements. This can be claimed at usually 2.5% (over forty years) or 4% (over twenty-five years), depending on the type of property and the construction commencement date.

A quantity surveyor's report will generally provide a schedule of the capital works deductions claimable each year. We recommend commercial property owners obtain this report. This deduction will result in substantial tax savings. The cost of the quantity surveyor's report is tax-deductible. If the actual construction cost is unavailable, quantity surveyors can provide an estimated construction cost with the capital works claims based on this estimate. The report will also outline any deductions that are claimable on depreciation of plant and equipment. Plant and equipment usually have a higher depreciation rate than buildings and structural improvements.

Some costs are not claimable – these include landscaping and land acquisition (together with on-site preparation costs, such as clearing and demolishing buildings). Note that existing buildings upon purchase may have unexpired capital works claims.

The tax deduction for capital works impacts the calculation of the cost base for the commercial property. Any deductions that arise under capital works will be excluded from the CGT cost base or reduced cost base to avoid double-dipping. This adjustment is applicable for assets acquired after 13 May 1997, or where the asset was acquired before that date, but the expenditure that gave rise to the capital works deduction was incurred after 30 June 1999. However, given the 50% capital gain discount, obtaining revenue deductions for capital works generally provides a better outcome (providing you are eligible for the discount). Tax will only be paid on 50% of the capital gains.

LEASING EXPENSES

Any leasing expenses paid to secure a new lease is a tax deduction.

Taxpayers can also claim an immediate deduction for lease documentation expenses. This includes costs relating to preparing, registering or stamping a lease of property to the extent the property is used for the purpose of producing assessable income.

MAKE GOOD COSTS

A commercial lease usually includes a 'make good' provision requiring the tenant to leave the leased premises in the same condition as at the commencement of the lease.

The nature of the work undertaken by the landlord will determine the tax treatment. Repairs and restoration may be tax-deductible, while capital items purchased may be deductible or be eligible for the capital works deduction.

Make good expenses can be treated as deductible repairs:

- Where it restores the function of an asset without improving it
- Where it replaces the parts of an asset rather than the entire asset

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 also uses 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 continue throughout 2021-22, with an 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

This applies to Residential property only. 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.'

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 find hard to sell.

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

Where The Taxpayer makes division 129 adjustments, 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.

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, where dual-use premises are involved. 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 that provides for an adjustment to ensure a proper accounting for GST that is in proportion to the private or input taxed use of the acquired property.

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.

When claiming input tax credits and making adjustments for changes, the message here is that big dollars equal big risk, particularly where the accountant or the business owner enters unchartered waters – seek professional advice.

NEW RESIDENTIAL PREMISES AND GST

The ATO has 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, 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 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.

Suppose you have a change in creditable purpose. In that case, 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. In contrast, a decreasing adjustment will reduce your GST liability.

Adjustments for the change in creditable purpose are often made over a number of years. They 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.

Suppose you review your activity statements and report any mistakes voluntarily. In that case, 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 purchasing real estate assets from a foreign resident seller increased from 10 per cent to 12.5 per cent. The threshold values at which the laws apply have also been reduced from $2 million to $750,000.

This regime impacts purchasers of real property and shares in non-listed property-rich companies and units in unlisted property trusts.

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

Property Acquisitions

Suppose you are a purchaser of property for more than $750,000. In that case, **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). Still, 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. 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 is 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 that 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 both Australian and foreign vendors can use.

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 three 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 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 who buy land then either build a new home or repair or renovate an existing house on the land before moving in.
- Those 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 who demolish their existing main residence to build a new home.

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 that 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 two or more persons jointly own a rental property. Where two people own the property, an asset costing up to $600 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 than rental properties with only 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 one person owns must be depreciated over the asset's effective life (subject to the low-value pool method of depreciation – see below).

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

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

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

1. **Depreciation for a low-cost asset in the 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, suppose the same asset was being depreciated over its effective life and not as part of a low-value pool. In that case, it could only be effectively depreciated for one day in the income year, resulting in a negligible tax deduction.

Clearly, for low-cost assets 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 the first year** – Generally, depreciation claims for an asset (in its earlier years) will be greater in a low-value pool than depreciating the same asset over its effective life, where the asset has an effective life of more than four 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. The low-value pool rules are applied to each joint owner's interest in the asset and not to the asset as a whole. Suppose the cost of a joint owner's interest in an asset is less than $1,000. In that case, the joint owner's interest will qualify as a low-cost asset. It can be allocated to a low-value pool even if the overall cost of the asset is more than $1,000.

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

Therefore, joint owners of a rental property will 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 than a rental property owned only by one person.

Be mindful that depreciation is only one expense. 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 if 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. In contrast, 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.

Suppose an investor acquires residential premises leased to another entity. And that entity also 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 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 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 possible, the desired outcome is to generate tax savings by increasing the taxable capital gain on property sales 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.

<u>Example</u> ***- 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 had outgrown the factory. He sells to a property developer who intends to knock down the factory and build townhouses 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 that Toby sells the property to the 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 a 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 can claim a $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 Toby first acquired the property 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 the 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 property's cost base 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 ($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. The cost base reduction to reflect Division 43 capital works deductions required above would not have been necessary under the CGT rules for properties acquired prior to this date. This would have resulted in a higher cost base and a smaller taxable capital gain.

Interest Deductions after a Rental Property Has Been Sold

When a property market is under stress, this issue is worth considering.

Sale proceeds of a rental property will usually be applied against any outstanding loan. If a property is sold for less than the outstanding loan balance, there will be a shortfall. 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) 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 claiming interest on a loan shortfall:

- Suppose the entire proceeds from the property's disposal are applied to the loan. In that case, the interest will continue to be deductible.
- If there is a legal entitlement to pay the loan early and the taxpayer has sufficient assets to repay the loan. In that case, this could affect the deductibility of interest after the sale of the rental property.
- A fixed-term loan is refinanced at a lower rate after the rental property is sold. Generally, this 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 six years (and no other property is treated as a 'main residence')
2. The home was rented out after **20 August 1996**; and
3. The full main residence exemption would have been available if the house had been 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.

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

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

Example - Susan purchased a property in Melbourne in 2003 for $300,000 and occupied it as her main residence for five 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 decided to stay in Sydney and sold her house for $1,350,000 (i.e., seven years after it was 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:

$$\frac{\text{Capital gain (or loss) x non-main residence days}}{\text{Days of ownership}} = \$700{,}000 \times \frac{365}{2{,}555}$$

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

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

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

CO-OWNERSHIP OF RENTAL PROPERTY

The way rental income and expenses are divided between co-owners varies depending on whether the co-owners are joint tenants or tenants in common or 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, either alone or with other co-owners, is usually regarded as an investor who is not carrying on a rental property business. 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 each hold an equal interest in the property.
- Tenants in common 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. This is 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 to claim most of the rental loss, saving more tax. Mrs Hitchman thought it was fair to claim a bigger loss because most expenses were paid out of her wages. Under a partnership agreement drawn up by the Hitchmans, Mrs Hitchman should claim 80% of any rental loss.

Mrs Hitchman was told 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 Hitchman's must each include half of the total income and expenses in their tax returns.

Any agreement that the Hitchman's might draw up to divide the income and expenses in proportions other than equal shares has no effect for income tax purposes. Therefore, even if 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*

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

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

Suppose you let property or part of a property at less than normal commercial rates. In that case, 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 rent rate - $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.

DON'T BET AGAINST THE HOUSE THIS TAX TIME

The Australian Taxation Office (ATO) reminds property investors to beware of common tax traps that can delay refunds or lead to an audit costing taxpayers time and money.

In 2019–20, over 1.8 million Australians owned rental properties and claimed $38 billion in deductions.

According to Assistant Commissioner Tim Loh:

- The most common mistake rental property and holiday homeowners make is neglecting to declare all their income. This includes failing to declare any capital gains from selling an investment property.
- To put it simply, you should expect tax consequences for any property that you earn income from that isn't your main residence.
- The ATO is expanding the rental income data they receive directly from third-party sources such as sharing economy platforms, rental bond authorities, and property managers.
- Taxpayers will be contacted about the income they've received but haven't included in their tax returns. This will mean they need to repay some of their refunds.
- The ATO often allows taxpayers who have made genuine errors to amend their returns without penalty. But deliberate attempts to avoid tax on rental income will see the ATO take action.
- People should remember that there's no such thing as free real estate when it comes to their tax returns. Data analytics scrutinise returns for rental deductions that seem unusually high, and the ATO will ask questions, leading to a delay in processing your return.
- So far, the ATO has adjusted more than 70% of the 2019–20 returns selected for a review of rental information.
- Most people contacted about their rental deductions can justify their claims. However, there are instances

where claims were rejected as taxpayers didn't keep receipts, claimed for personal use, or claimed for ineligible deductions.

- The ATO often reject claims for interest charges on personal loan amounts and immediate claims for the full amount for capital works (for example, a kitchen renovation), so it is vital that you have good records.
- If you take out a loan to buy a rental property and rent it out at market rates, the interest on that loan is deductible. However, suppose you redraw money from that mortgage for personal use, such as buying a boat or going on a holiday. In that case, you can't claim the interest on that part of the loan.
- The ATO also sees taxpayers claiming capital works as a lump sum rather than spreading the cost over a number of years. Capital works include a new building or an extension, renovations, or structural improvements.

The cost of repairs for wear and tear to the property are deductible immediately if they are to replace or fix existing items, such as curtains, without upgrading them. However, improvements or capital expenses, such as a kitchen renovation, are not deductible immediately. The ATO has advice, guidance, and an online tool on our website to help taxpayers make these calculations. Taxpayers can also speak to a registered tax agent.

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 begin.

Similarly, if you take out a loan 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, suppose you change your intentions and decide to use the property for private purposes and no longer produce rent or other income. In that case, 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. Consequently, 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 private purposes.

If you have a loan account with a fluctuating balance due to various deposits and withdrawals and used for private and rental property purposes, you must keep accurate records. This will enable you to calculate the interest that applies to the rental property portion of the loan. It is essential to separate the interest related to the rental property from any interest related 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. Suppose there is an outstanding loan on the old home, and the property is used to produce income. Then, 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.

REDUCED RENTAL INCOME IN TIMES OF COVID-19

The COVID-19 pandemic has placed property owners and tenants in unforeseen circumstances. Many tenants are paying reduced rent or have ceased paying because their income has been adversely affected by COVID-19.

You should include rent as income at the time it is paid, so you only need to declare the rent you have received as income. If payments by your tenants are deferred until the next financial year, you do not need to include these payments until you receive them.

While rental income may be reduced, owners will continue to incur normal expenses on their rental property. The owners will still be able to claim these expenses in their tax return, provided the reduced rent charged is determined at arms' length and considers current market conditions.

This applies whether the tenants or the owner initiated the reduction in rent.

Some owners may have rental insurance that covers a loss of income. It is important to remember that any payouts from these policies are assessable income and must be included in tax returns.

Many banks have moved to defer loan repayments for stressed mortgagees. In these circumstances, rental property owners can still claim interest being charged on the loan as a deduction- even if the bank defers the repayments.

Short-term rentals

The ATO recognises that circumstances have seen many short-term rentals see cancellations or sit vacant due to COVID-19 or bushfires.

Where COVID-19 or natural disasters have adversely affected income, demand, or cancellations of existing bookings for a short-term rental property, deductions are still available provided the property was still genuinely available for rent in these situations.

If owners decided to use the property for private purposes, offered the property to family or friends for free, offered the property to others in need or stopped renting the property out. They cannot claim deductions in respect of those periods.

As a rule, if your plans to rent a property in 2021 were the same as those prior to Covid-19 but were disrupted by the pandemic or bushfires, you will still be able to claim the same proportion of expenses you would have been entitled to claim previously.

When determining the proportion of expenses that can be claimed for short-term rental properties impacted by COVID-19 or bushfires. The reasonable approach is to apportion expenses based on the previous year's usage pattern unless you can show it was genuinely available for rent for a longer period in 2021.

If you, family, or friends move into the property to live in it because of COVID-19 or bushfires, you need to count this as private use when working out your claims in 2021.

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.

The Q.S. will also separately identify fixtures, fittings, and furnishings eligible for a 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. Suppose the investment property keeps pace with inflation. In that case, the running expenses are fully covered by the capital increase. Still, 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. 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. 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.

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 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 want 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 other spouse could perhaps acquire the new residence. 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 try to refinance this cost on discovering your "mistake". 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 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 bank or other financial institution offering a facility that 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 that provides you with a tax-saving but comes at a real commercial cost, such as paying a higher interest rate or other charges.
4. Do not enter an arrangement with a bank that provides "unusual" terms – such as an indefinite deferral of repayment on one part of the borrowing.
5. Do not redraw amounts from your rental property loan for private purposes. Doing so will mix the purposes and reduce the deductible element.

ATO GUIDANCE ON CAPITAL/REVENUE IN PROPERTY DEVELOPMENTS

In July 2019, the ATO released the Draft Property and Construction Website Guidance, providing direction on 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 the 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, the level of control the landowner has 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 urge anyone who wants to put gains on capital account (with the possible 50% CGT discount) to review this guidance carefully.

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.

Suppose you carry on an enterprise renting out commercial, residential premises, such as a commercial boarding house. You will have different income tax and GST obligations. However, offering services in addition to providing a room (e.g., breakfast or cleaning services) does not mean you are providing ‘board ‘or anything 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 it out through Airbnb, part of the gain will be taxable, resulting in the apportionment of the main residence exemption.

Evidence suggests many Airbnb hosts are completely unaware of the CGT implications of renting out part of their home. CGT can be an unwelcomed expense, given the potentially long time-lag between starting to rent out the property and the eventual sale. This is particularly true 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 when the property was first used to generate income, a proportion of the gain based on the floor area available for rent will be chargeable tax. This gain qualifies for the 50% Capital Gains Tax discount.

GST THE MARGIN SCHEME

When a registered entity makes a taxable supply, it is liable for GST on the supply. The amount of GST is usually 1/11th of the sale price. When such an entity sells real property and is liable for GST on the sale, 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. Builder would not be allowed to use the margin scheme when it sold to Smithers.

Suppose Wealthland was not a GST registered entity when 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 that an entity is only disqualified from using the margin scheme 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 has shown little leniency when applying penalties, and real care needs to be taken.

HOLDING SHARES OR ACTIVELY TRADING - WHAT IS THE DIFFERENCE?

Australia continues to be a nation of investors, with close to 9 million adult Australians holding investments outside their super and primary dwelling.

More than half have investments in direct shares, and there has been an increase of new investors. Close to a quarter of all investors started investing in the past two years. Women now make up 45% of all new investors.

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 carries out business activities to earn income from buying and selling shares. On the other hand, a shareholder holds shares to earn income from dividends and similar receipts.

Relevant matters include the nature, regularity, volume and repetition of the share activity, the amount of capital employed and to what extent there is organisation in a business-like manner through the keeping of books, 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 **Shareholders**:

- 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 the 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

For tax purposes, a 'business' 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.

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 to earn income by buying and selling shares.

Shares may be held for either investment or trading purposes, and profits on the sale are earned in either case. A person who invests in shares as a shareholder (rather than a share trader) does so intending to earn income from dividends and receipts but is not carrying on business activities. It would be best to consider your intention to make a profit and the facts of your situation. This would include details of how the activity has 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. 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 with an average cost of $1000. The average selling transaction involved 750 shares, and the average selling price was $1800. All transactions were conducted through stockbroking 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 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, and he 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 as carrying on a business of share trading. He has purchased his shares to gain dividend income rather than make a 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 • through employee share schemes • through company liquidation • through 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 share buy-backs • through mergers, takeovers, and demerger
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 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.
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 and 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 v Capital and Lessons for Investors

This case highlighted the uncertainty in respect of the revenue and capital implications of some share sales. It 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. 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. The taxpayer made an $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 contended that the share loss and legal fees should be deductible under section 8-1 (revenue account), relying on the Myer Emporium case principle because he had a profit-making intention at the time of purchasing the Nexus shares. 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. 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.

Although unsuccessful in the Federal Court, the taxpayer won on appeal to the Full Federal Court of Australia, leading to our next article.

Greig v Commissioner of Taxation (Cont....)

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 careful consideration of the meaning of the words used in Myer as it related to the condition that property is acquired for the "purpose of profit-making". The Court was satisfied that Grieg possessed that intention when acquiring Nexus shares. Largely, there was no evidence to suggest any intention to derive gains other than by sale at a profit or suggest that he anticipated any dividend income. The lack of potential dividends was also viewed as significant in the later decision of XPQZ & Ors v FCT. 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 the publication, Parsons considered the expression "business deal" as used in a series of decisions preceding 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 in the mining industry. Also, considering 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 be a tactical one. Exposing a greater number of private investors to revenue taxation can potentially 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" and will review 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 periodically 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 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 in the management of a deceased estate.

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. Therefore, the taxpayer was not entitled to claim a $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, including 71 purchases valued at approximately $380,000 and 37 sales valued at approximately $215,000. These transactions were carried out in the first six months of the year with only ten 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 the 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 ten share transactions in the second half of the income year.
- The activities were very basic and lacked the sophistication to constitute a share trading business.
- There was no demonstrated trading pattern, 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.

Regarding the evidence and all the factors set out above, Ms Devi was not carrying on business as a share trader. Her activities were very basic and lacked the 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 you are automatically a share trader because you start with a flurry of activity.

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 WERE 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 a 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 losses denied in 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 a share trader conducting a business. 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 a side issue that 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. There were few records 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 the ruling

- The share trades were infrequent, and there were many periods of no trading with no established system and irregular trading.
- A series of individual transactions was indicated 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, keeping few records. 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 that he had no qualifications in the area, the applicant would have sought professional assistance from a broker, bookkeeper, or accountant if he intended to operate a share trading business.
- 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 the 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 depends on an individual’s classification as a trader, a speculator, or a hedger. Selling options for premiums are 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 the fund manager manages capital gains to minimise the 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 tax 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 the 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 the 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 a 15% corporate tax rate. Dividends carry franking credits at the 30% rate.
Exchange-Traded Funds (ETFs)	Dividends from ETFs typically have franking credits attached to them. The fund manager manages capital gains in order to minimise costs to investors. Low portfolio turnover means Indexed ETFs have low capital gains tax consequences
Absolute Return funds	The fund's manager manages capital gains to minimise the cost to the investor. Dividends may be fully franked.

Investors Disposal of Shares

Suppose you have sold or given away shares. In that case, you may have a capital gain or capital loss to consider 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 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, enabling the capital gain to be deferred or disregarded until a later CGT event.

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. Suppose the company is not quoted on the exchange – for example. In that case, it is a private company, and 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 determine 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 would be best if you had 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 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. 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

When reviewing share trading profitability and other assessable income at year end, 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.

CRYPTOCURRENCY

It is important to note that dealing in cryptocurrency has tax implications. This is an area of ATO attention.

Cryptocurrencies' innovative and complex nature can lead to a genuine lack of awareness of the tax obligations associated with these activities. Also, the pseudonymous nature of cryptocurrencies may make it attractive to those seeking to avoid their taxation obligations.

As interest in cryptocurrency has increased, the ATO has worked with partners to:

- understand the tax implications
- plan an appropriate regulatory response.

This ensures the ATO approach is consistent with government policy and aligned to that of partner agencies.

The tax consequences for taxpayers acquiring or disposing of cryptocurrency vary depending on the nature and circumstances of the transaction.

The cryptocurrency data-matching program allows the ATO to identify and address multiple taxation risks:

- Capital gains tax (CGT) – If you acquire cryptocurrency as an investment, you may have to pay tax on any capital gain you make on disposal of the cryptocurrency. Disposal occurs when:
  - selling cryptocurrency for fiat currency
  - exchanging one cryptocurrency for another
  - gifting cryptocurrency
  - trading cryptocurrency
  - using cryptocurrency to pay for goods or services
- Omitted or incorrect income reporting – In some situations, cryptocurrency transactions can also give rise to ordinary income. Taxpayers who trade cryptocurrency or businesses that accept cryptocurrency as payment have an obligation to report the income generated in their tax returns.
- Fringe benefits tax (FBT) – The cryptocurrency payment is a fringe benefit when employees receive cryptocurrency as remuneration under a salary sacrifice arrangement.

TRANSACTING WITH CRYPTOCURRENCY

A capital gains tax (CGT) event occurs when you dispose of your cryptocurrency. Disposal can occur when you:

- sell or gift cryptocurrency
- trade or exchange cryptocurrency (including the disposal of one cryptocurrency for another cryptocurrency)
- convert cryptocurrency to fiat currency (a currency established by government regulation or law), such as Australian dollars, or
- use cryptocurrency to obtain goods or services.

If you make a capital gain on disposal of cryptocurrency, some or all the gain may be taxed. Certain capital gains or losses from disposing of a cryptocurrency that is a personal use asset are disregarded.

Suppose the disposal is part of a business you carry on. In that case, the profits you make on disposal will be assessable as ordinary income and not as a capital gain.

A digital wallet can contain different types of cryptocurrencies. Each cryptocurrency is a separate CGT asset.

Exchanging cryptocurrency for another cryptocurrency

If you dispose of one cryptocurrency to acquire another cryptocurrency, you dispose of one CGT asset and acquire another CGT asset. Because you receive property instead of money in return for your cryptocurrency, the market value of the cryptocurrency you receive needs to be accounted for in Australian dollars.

Suppose the cryptocurrency you received can't be valued. In that case, the capital proceeds from the disposal are worked out using the market value of the cryptocurrency you disposed of at the time of the transaction.

Example 1 - On 5 July 2017, Katrina acquired 100 Coin A for $15,000. On 15 November 2017, Katrina exchanged 20 Coin A for 100 Coin B through a reputable digital currency exchange.

Using the exchange rates on the reputable digital currency exchange at the time of the transaction, the market value of 100 Coin B was $6,000. For the purpose of working out Katrina's capital gain for her disposal of Coin A, her capital proceeds are $6,000.

Cryptocurrency as an investment

If you acquire cryptocurrency as an investment, you may have to pay tax on any capital gain you make on the disposal of the cryptocurrency.

You will make a capital gain if the capital proceeds from the disposal of the cryptocurrency are more than its cost base. Even if the market value of your cryptocurrency changes, you do not make a capital gain or loss until you dispose of it.

If you hold the cryptocurrency as an investment, you will not be entitled to the personal use asset exemption. However, suppose you hold your cryptocurrency as an investment for 12 months or more. In that case, you may be entitled to the CGT discount to reduce a capital gain you make when you dispose of it.

If you have a net capital loss, you can use it to reduce a capital gain you make in a later year. You can't deduct a net capital loss from your other income.

You must keep records of each cryptocurrency transaction to determine whether you have made a capital gain or loss from each CGT event.

Example 2 - Terry has been a long-term investor in shares and has a range of holdings in various public companies in a balanced portfolio of high and low-risk investments. Some of his holdings are income-producing, and some are not. He adjusts his portfolio frequently at the advice of his adviser.

Recently, Terry's adviser told him that he should invest in cryptocurrency. On that advice, Terry purchased a number of different cryptocurrencies, which he has added to his portfolio. Terry doesn't know much about cryptocurrency but, as with all his investments, he adjusts his portfolio from time to time following appropriate investment weightings.

If Terry sells some of his cryptocurrency, the proceeds would be subject to CGT. This is because he has acquired and held his cryptocurrency as an investment.

Staking rewards and airdrops

Proof of Stake is a form of 'consensus mechanism' that requires forgers (similar to miners) to hold units of a cryptocurrency so they can validate transactions and create new blocks. Forgers participate in consensus by staking their existing tokens.

A forger selected to forge a new block is rewarded with additional tokens when the new block has been created. The additional tokens are received from holding the original tokens. The money value of those additional tokens is classed as ordinary income of the forger at the time they are derived.

Other consensus mechanisms that reward existing token holders for their role in maintaining the network will have the same tax outcomes. This would include rewards derived through Proof of Authority and Proof of Credit mechanisms by Validators, Agent Nodes, Guardian Nodes, Premium Stakers and other entities performing comparable roles.

Token holders who participate in 'proxy staking' or vote their tokens in delegated consensus mechanisms, and receive a reward by doing so, also derive ordinary income equal to the money value of the tokens they receive.

Some projects 'airdrop' new tokens to existing token holders (for example, Pundi X and Tron) to increase the supply. The money value of an established token received through an airdrop is ordinary income of the recipient at the time it is derived.

Example 1 - Anastasia holds 50,000 NULS tokens, which she stakes to a NULS pool as a premium staker. Anastasia receives additional NULS tokens when her pool participates in consensus, including a small payment of tokens from the node leader for supporting their node.

The money value of the additional NULS tokens Anastasia receives is assessable income of Anastasia at the time the tokens are derived.

The cost base of Anastasia's additional NULS tokens will be their market value at the time they were derived.

Example 2 - Merindah has held TRX tokens since December 2018, entitling her to receive monthly BTT airdrops from February 2019.

The money value of the BTT tokens Merindah receives as a result of holding her TRX tokens is assessable income of Merindah at the time the tokens are derived.

The cost base of Merindah's airdropped BTT tokens will be their market value at the time they were derived.

Personal use asset

Some capital gains or losses that arise from the disposal of a cryptocurrency that is a personal use asset may be disregarded.

Cryptocurrency is a personal use asset if kept or used mainly to purchase items for personal use or consumption.

Cryptocurrency is not a personal use asset if it is kept or used mainly:

- as an investment
- in a profit-making scheme, or
- in the course of carrying on a business.

Where cryptocurrency is acquired and used within a short period to acquire items for personal use or consumption, the cryptocurrency is more likely to be a personal use asset.

If the cryptocurrency is acquired and held for some time before any such transactions are made, or only a small proportion of the cryptocurrency acquired is used to make such transactions. It is less likely that the cryptocurrency is a personal use asset. In those situations, the cryptocurrency is more likely to be held for some other purpose.

Except in rare situations, the cryptocurrency will not be a personal use asset:

- when you have to exchange your cryptocurrency for Australian dollars (or to a different cryptocurrency) to purchase items for personal use or consumption, or
- If you have to use a payment gateway or other bill payment intermediary to purchase or acquire the items on your behalf (rather than directly with your cryptocurrency).

The relevant time for working out if an asset is a personal use asset is at the time of its disposal.

During a period of ownership, the way that cryptocurrency is kept or used may change. For example, cryptocurrency may originally be acquired for personal use and enjoyment but ultimately kept or used as an investment to profit on ultimate disposal or as part of carrying on a business. The longer a cryptocurrency is held, the less likely it will be a personal use asset. Even if you ultimately use it to purchase items for personal use or consumption.

Only capital gains you make from personal use assets acquired for less than $10,000 are disregarded for CGT purposes. However, all capital losses you make on personal use assets are disregarded.

Example 1 - Michael wants to attend a concert. The concert provider offers discounted ticket prices for payments made in cryptocurrency. Michael pays $270 to acquire cryptocurrency and uses it to pay for the tickets on the same day. Under the circumstances, Michael acquired and used the cryptocurrency. It is a personal use asset.

Example 2 - Peter has regularly kept cryptocurrency for over six months, intending to sell at a favourable exchange rate. He has decided to buy some goods and services directly with some of his cryptocurrencies. Because Peter used the cryptocurrency as an investment. The cryptocurrency is not a personal use asset.

Example 3 - Josh pays $50 to acquire cryptocurrency each fortnight. During each of the same fortnights, he uses the cryptocurrency to enter directly into transactions to acquire computer games. Josh does not hold any other cryptocurrency.

Josh identifies a computer game that he wishes to acquire from an online retailer that doesn't accept cryptocurrency in one fortnight. Josh uses an online payment gateway to acquire the game. Under the circumstances in which Josh acquired and used the cryptocurrency, the cryptocurrency (including the amount used through the online payment gateway) is a personal use asset.

Loss or theft of cryptocurrency

You may be able to claim a capital loss if you lose your cryptocurrency private key or your cryptocurrency is stolen.

We need to consider this in context. The issue is likely to be whether the cryptocurrency is lost, the evidence of your ownership is lost, or you have lost access to the cryptocurrency.

Generally, where an item can be replaced, it is not lost. A lost private key can't be replaced. Therefore, to claim a capital loss, you must be able to provide the following kinds of evidence:

- when you acquired and lost the private key
- the wallet address that the private key relates to
- the cost you incurred to acquire the lost or stolen cryptocurrency
- the amount of cryptocurrency in the wallet at the time of loss of private key

- that the wallet was controlled by you (for example, transactions linked to your identity)
- that you are in possession of the hardware that stores the wallet
- transactions to the wallet from a digital currency exchange for which you hold a verified account or is linked to your identity.

Chain splits

A chain split refers to the situation where there are two or more competing versions of a blockchain. These competing versions share the same history up to the point where their core rules diverged.

Cryptocurrency held as an investment

Suppose you hold cryptocurrency as an investment and receive a new cryptocurrency as a result of a chain split. Such as Bitcoin Cash being received by Bitcoin holders. In that case, you do not derive ordinary income or make a capital gain at that time due to receiving the new cryptocurrency.

If you hold the new cryptocurrency as an investment, you will make a capital gain when you dispose of it. When working out your capital gain, the cost base of a new cryptocurrency received as a result of a chain split is zero. If you hold the new cryptocurrency as an investment for 12 months or more, you may be entitled to the CGT discount.

Example 1 - Alex held 10 Bitcoin on 1 August 2017 as an investment, when Bitcoin Cash split from Bitcoin. Immediately after the chain split, Alex held 10 Bitcoin and 10 Bitcoin Cash. Alex does not derive ordinary income or make a capital gain as a result of the receipt.

On 25 May 2018, Alex sold the 10 Bitcoin Cash for $4,000. Because the cost base of the Bitcoin Cash was zero, Alex made a total capital gain of $4,000 in the 2017–18 income year from the sale of the Bitcoin Cash.

Determining which cryptocurrency is the new asset received due to a chain split requires examining the rights and relationships existing in each cryptocurrency you hold following the chain split. If one of the cryptocurrencies you hold as a result of the chain split has the same rights and relationships as the original cryptocurrency you held, then it will be a continuation of the original asset. The other cryptocurrency you hold as a result of the chain split will be a new asset.

Example 2 - Bree held 60 Ether as an investment just before the chain split on 20 July 2016. Following the chain split, Bree held 60 Ether and 60 Ether Classic. The chain split resulted from a protocol change that invalidated the holding rights attached to approximately 12 million pre-split Ether.

Ether Classic exists on the original blockchain, which rejected the protocol change and continued to recognise all holding rights that existed before the chain split. Ether Classic is the continuation of the original asset. The Ether that Bree received as a result of the chain split is her new asset. The acquisition date of Bree’s post-split Ether is 20 July 2016.

Where none of the cryptocurrencies you hold following the chain split has the same rights and relationships as the original cryptocurrency, you held. Then the original asset may no longer exist. CGT event C2 will happen for the original asset. In that case, each of the cryptocurrencies you hold as a result of the chain split will be acquired at the time of the chain split with a cost base of zero.

Example 3 - Ming held 10 Bitcoin Cash as an investment just before the chain split on 15 November 2018. Ming had acquired Bitcoin Cash on 6 April 2018 with a cost base of $8,300. Following the chain split, Ming held 10 Bitcoin Cash ABC and 10 Bitcoin Cash SV. Both projects involved changes to the core consensus rules of the original Bitcoin Cash protocol.

Neither project exists on the original blockchain. Miners using the pre-fork software would not find blocks on either the ABC or SV chains. Neither of the post-split assets is the continuation of the original asset. The community abandoned the original asset at the time of the chain split. CGT event C2 happened to Ming’s original Bitcoin Cash on 15 November 2018. Ming calculates a capital loss of $8,300, which is equal to the cost base of his original asset.

Ming’s Bitcoin Cash ABC and Bitcoin Cash SV both have an acquisition date of 15 November 2018 and a cost base of zero.

Cryptocurrency held in a business you carry on

A new cryptocurrency you receive as a result of a chain split in relation to cryptocurrency held in a business you carry on will be treated as trading stock held for sale or exchange in the ordinary course of the business. The new cryptocurrency must be brought to account at the end of the income year.

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.

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