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Work-related and rental property claims on ATO's watch list

Tax time is in full swing and the ATO has highlighted areas of concern for individuals ahead of tax return lodgment time. High on the ATO's watch list is work-related expense claims that are significantly higher than expected. In particular, the ATO will be paying particular attention to claims that have already been reimbursed by employers and expenses that are, in fact, private. These items are not deductible.

TIP: You are entitled to claim deductions for some expenses that are directly related to earning your income. The expenses must not be private, domestic or capital in nature. If the expense is both private and work-related, you can claim a deduction for the work-related portion.

The ATO will also keep a keen eye on rental property deductions. The ATO will be playing close attention to:

- excessive deductions claimed for holiday homes;
- husbands and wives splitting rental income and deductions inappropriately for jointly owned properties;
- claims for repairs and maintenance shortly after the property was purchased; and
- interest deductions claimed for the private proportion of loans.

TIP: You can claim expenses relating to your rental property but only for the period your property was rented or available for rent (eg advertised for rent). If part of your property is used to earn rent, you can claim expenses relating to that part of the property. You will need to work out a reasonable basis to apportion the claim. Please contact our office for assistance.

Share-economy service providers need to assess tax implications

New internet and mobile technologies have allowed people to consider enterprises such as letting a spare room, letting a car space, doing odd jobs or other activities for payment, or driving passengers in a car for a fare. However, the ATO has warned that

individuals providing such share-economy services may have tax obligations, which may include declaring income and registering for GST.

TIP: It may be prudent for all share-economy service providers to assess whether they are meeting their tax obligations. Please contact our office for assistance.

The ATO has also confirmed that people who provide ride-sharing services are providing "taxi travel" under the GST law. It said the existing tax law applies and therefore drivers are required to register for GST regardless of their turnover. Affected drivers must also charge GST on the full fare, lodge BASs and report the income in their tax returns.

TIP: Recognising that some taxpayers may need to take corrective actions, the ATO is allowing drivers until 1 August 2015 to obtain an ABN and register for GST. The ATO said it does not intend to apply compliance resources regarding GST obligations for drivers prior to 1 August 2015 – except if there is evidence of fraud, or other significant matters.

Franked distributions funded by capital-raising under scrutiny

The ATO has cautioned companies about raising capital to fund franked distributions. The ATO is reviewing arrangements where companies raise new capital to fund franked distributions and release accumulated franking credits to shareholders.

In a typical case, the ATO is seeing companies issue rights to shareholders and use funds raised to make franked distributions via special dividends or an off-market share buy-back. The ATO said these arrangements are distinct from ordinary dividend reinvestment plans involving regular dividends.

ATO Deputy Commissioner Tim Dyce said the distributions are unusually large compared to ordinary dividends and occur at a similar time, and in a similar amount, to the capital raised. "So, a potentially large amount of franking credits is released with minimal net changes to the company's economic position. There is also minimal impact on the shareholders, except in some cases they may receive refunds of franking credits and in the case of buy-backs they may also get improved capital gains tax outcomes," he added.

The ATO considers that the arrangements may not be compliant with the tax law. In particular, the ATO has warned of the potential application of the general anti-avoidance rules. It has also warned that penalties may apply to participants.

“Contrived” dividend arrangements used by SMSFs flagged by ATO

The ATO is investigating arrangements where a private company with accumulated profits channels franked dividends to a self-managed super fund (SMSF) instead of to the company’s original shareholders. As a result, the original shareholders escape tax on the dividends and the original shareholders (or individuals associated with the original shareholders) benefit as members of the SMSF from franking credit refunds to the SMSF.

The ATO was concerned that contrived arrangements are being entered into by individuals (typically SMSF members approaching retirement) so that dividends subsequently flow to, and are purportedly treated as exempt from income tax, in the SMSF because the relevant shares are supporting pensions. The ATO also warned the arrangement has features of dividend stripping which could lead the ATO to cancel any tax benefit for the transferring shareholder and/or deny the SMSF the franking credit tax offset.

Lump sum finalisation payment taxable

An individual has been unsuccessful before the Administrative Appeals Tribunal (AAT) in a matter concerning the tax treatment of a lump sum finalisation payment. The Tax Commissioner considered the payment was assessable as ordinary income. The taxpayer disagreed.

In 1995, the individual was diagnosed with a number of illnesses and was deemed unfit for work. She was paid monthly benefits under her employer’s salary continuance policy, which she declared as assessable income. When that scheme discontinued, she commenced participation in a government scheme which continued the monthly payments. In 2008, she was informed that the Commonwealth intended to finalise its obligations and pay a final lump sum in July 2008. Under a deed of release, the scheme made a final payment of just over \$2 million to the taxpayer, less an amount of \$931,119.40 (being tax withheld and remitted to the ATO).

The AAT concluded the final payment was “income according to ordinary concepts” under the tax law. It was therefore assessable income to be taken into account in assessing the taxpayer’s taxation liabilities for the year ended 30 June 2009.

“Nomad” had continuity of association with Australia

An individual has been unsuccessful before the AAT in arguing that he had “let go” of Australia in 1999 to pursue his “nomadic” working life abroad and that his base of operations was in the United Kingdom.

The taxpayer was born in the United Kingdom, and worked as a diver and diving supervisor for overseas companies at many places around the world.

However, the AAT held he was a resident of Australia for the 2006 to 2011 income years for tax purposes. The AAT noted that the taxpayer’s physical, emotional and financial ties to Australia in those years were very strong. In particular, he jointly owned a home in Australia with his wife of over 23 years and his emotional ties to her were “clearly the most significant in his life”.

The AAT also held the taxpayer did not satisfy the rules to have his foreign sourced income treated as exempt income, nor was he entitled to any foreign tax offset as he had not produce evidence of any foreign tax paid on his overseas earnings.

The AAT therefore affirmed amended tax assessments which increased the taxpayer’s tax liability by around \$300,000 for the relevant income years.

The taxpayer has appealed to the Federal Court against the decision.

Important: Clients should not act solely on the basis of the material contained in Client Alert. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. Client Alert is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.