

client alert | explanatory memorandum

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CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 24 July 2017.

Work-related expense claims under scrutiny

The ATO has warned taxpayers to avoid making incorrect claims for work-related expenses at tax time this year. This year, the ATO is using real-time data to compare taxpayers with others in similar occupations and income brackets, to identify higher-than-expected claims related to expenses for work vehicles, travel, internet and mobile phones, and self-education.

Many taxpayers do not have a good understanding of what deductions they can claim, and believe they can claim for items which they in fact cannot. For example, some taxpayers think they can make a standard claim of \$300 without having spent the money. This isn't true! While receipts are not needed for claims up to \$300, taxpayers must have actually spent the money claimed, and be able to show the ATO how they worked out their deductions if asked. Deductions for work uniforms are a common area of confusion for employees at tax time.

Commissioner flags work-related expense claims as a problem area

In a wide-ranging address to the National Press Club in Canberra, ATO Commissioner Chris Jordan recently stated that the next big challenges for the ATO are influencing community attitudes about paying tax and minimising "tax gaps".

No tax system has, or ever will have, zero gaps, but the challenge is to minimise them, he said. For large corporates, the ATO believes that the tax gap is around \$2.5 billion – equivalent to about 6% of collections. Mr Jordan said the gap suggests that the ATO is collecting around 94% of the corporate tax that it should be getting from this market, with 91% coming in voluntarily and 3% through compliance interventions. This \$2.5 billion gap is well below the figure of \$50 billion thrown around by various commentators, he said. However, the ATO considers that the tax gaps for small business and individuals are likely to be bigger than those for the large market.

For individuals, Mr Jordan said the risks of non-compliance are mainly around work-related expenses, with over \$22 billion in claims for 2014–2015. Random and risk-based audits are showing many errors and over-claims for work-related expenses, stemming from legitimate mistakes and carelessness through to recklessness and fraud, Mr Jordan said.

The ATO is also concerned about the large number of incorrect claims made for work-related clothing and laundry expenses and the cents-per-kilometre method for car expenses. In 2014–2015, around 6.3 million people made claims against clothing expenses, totalling almost \$1.8 billion. On that basis, the Commissioner said that almost half of the individual taxpayer population was required to wear a uniform, protective clothing or had special requirements for items like sunglasses and hats. While many of these claims would be legitimate, Mr Jordan wondered how many people have assumed that they can just claim \$150 regardless of whether they have spent that amount on the required items. Similarly, he said some individuals are claiming for car expenses but their employers have told the ATO there is no requirement for the employees to use their car for work, or individuals are making claims that are excessive, with the assumption that no explanation is required.

Appeal case: work-related expenses partly allowed

In a recent appeal case, the Administrative Appeals Tribunal (AAT) has partly allowed a taxpayer's claims for work-related motor vehicle expenses, work-related travel expenses, self-education expenses and other work-related expenses for the year ended 30 June 2012: *Amin and FCT* [2017] AATA 1042.

During the relevant year, the taxpayer was a vendor relationship manager at a company that provided infrastructure management services. He claimed various amounts for work-related motor vehicle expenses, work-related travel expenses, self-education expenses and other work-related expenses which the Commissioner disallowed.

The AAT said the only substantive tax issues for it to decide were whether the taxpayer was entitled to the deductions for the following:

- *Work-related motor vehicle expenses*: the AAT found that the taxpayer failed to prove the legitimacy of his \$36,079 claim. Based on the limited evidence before the AAT, it was not convinced that the taxpayer was required to travel as part of his employment in the relevant year and did not any claim for work-related car expenses. Among other things, the AAT noted that the taxpayer apparently “claimed to be using his Maserati vehicle 100% of the time for work purposes. This was contrary to the log book, to the extent that was reliable, that referenced some private usage”.
- *Work-related travel expenses*: the taxpayer had claimed \$7,185. The AAT allowed the full cost of air fares for the taxpayer’s US trip for a work-related conference and meetings (the Tribunal held that the costs could not be apportioned), but held that accommodation expenses should be apportioned (as they were charged separately).
- *Work-related self-education expenses*: the Tribunal allowed some, but not all, of the \$21,944 in self-education expenses that the taxpayer had claimed.
- *Other work-related expenses*: The taxpayer had claimed an additional \$8,371 of expenses. The AAT allowed depreciation on a computer, which it was satisfied it was used in gaining or producing the taxpayer’s assessable income, but disallowed the other claimed work-related expenses.

Employee travel expense deductions and allowances

The ATO has released Draft Taxation Ruling TR 2017/D6 on the deductibility of employee travel expenses. This lengthy draft ruling covers transport expenses as well as expenditure incurred when travelling away from home (accommodation, meal and incidental expenses). The draft ruling sets out general principles for determining if a travel expense satisfies the requirements in s 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997): that is, whether the expense is incurred in gaining or producing assessable income and whether it is non-private, non-domestic expenditure.

These general principles are that:

- a transport expense is not deductible where the travel is to start work or depart after work is completed (ie ordinary home-to-work travel);
- a transport expense is deductible if the travel is undertaken in performing the employee’s work activities; factors to consider include:
 - whether the work activities require the employee to undertake the travel;
 - whether there is payment to undertake the travel;
 - whether the employee is subject to the employer’s direction and control for the period of the travel; and
 - whether these factors have been contrived to give a private journey the appearance of work travel;
- employee expenditure for accommodation, meal and incidentals is not deductible unless the work requires the employee to be away from home – this will be the case where it is reasonably necessary to incur the expense because of “special demands” or “co-existing work locations” travel undertaken in performing the employee’s work, but such expenditure is only deductible to the extent that the work requires the employee to sleep away from home; and
- relocation expenses (both travel and accommodation) are not deductible.

The draft ruling defines “special demands” travel as travel between home and a regular work location where the journey, or part of it, is included in the activities for which the employee is paid under the terms of employment, and this is reasonable because of the special demands of the work (eg due to the remoteness of the work location). “Co-existing work locations” travel involves travel that can be attributed to the employee needing to work in more than one location, and the travel is directly between work locations, or between home and an alternative work location. Further, it must be reasonable to conclude that the travel is undertaken in performing the employee’s work activities because of the requirement to work in multiple locations.

Reasonable travel and overtime meal allowance amounts for 2017–2018

Taxation Determination TD 2017/19 sets out the amounts the ATO will treat as reasonable for the 2017–2018 income year in relation to employee claims for:

- overtime meal expenses – the reasonable amount is \$30.05;
- domestic travel expenses – reasonable amounts are provided at three salary levels for:
 - accommodation at daily rates;
 - meals (breakfast, lunch and dinner); and
 - deductible expenses incidental to travel;

- domestic travel expenses for employee truck drivers who have received a travel allowance and are required to sleep (take their major rest break) away from home – the reasonable amount is \$55.30 per day; and
- overseas travel expenses – reasonable amounts are shown for cost groups to which a country has been allocated. Where travel is to a country that is not listed, the employee can use the reasonable amount for Cost Group 1 in the table for the relevant salary range. Reasonable amounts are provided at three salary levels for:
 - meals (breakfast, lunch and dinner); and
 - deductible expenses incidental to travel.

Working holidaymakers and tax returns for 2017

New arrangements, commonly known as the “backpacker tax changes” came into place from 1 January 2017 for employers of working holidaymakers. For the 2017 year, employers will need to issue two payment summaries to a working holidaymaker who is employed both up until 31 December 2016 and after 1 January 2017. This is to ensure that the working holidaymaker pays the right amounts of tax on their working holidaymaker income.

The ATO says that where an employer issues a payment summary for income earned from 1 January 2017, they need to include a code H on that payment summary. Code H indicates that it is working holidaymaker income. All employers are required to use the new code if they have employed working holidaymakers from 1 January, irrespective of whether they have registered with the ATO. If tax practitioners know that the income was derived on or after 1 January 2017 and there is no code H on the payment summary, they should ensure that a code H is placed at the appropriate place at Income 1 on the income tax return.

If employers have only provided one payment summary for income derived from both pre- and post-1 January 2017 periods, practitioners should work with them to determine the amounts to be apportioned to each period, and show the two amounts on the income tax return. The post-1 January income needs to display the code H.

Small business asset write-offs: be careful not to under-claim

Small businesses with a turnover of less than \$10 million can write off assets costing less than \$20,000 each in their 2016–2017 return. All simplified depreciation rules will apply to assets when choosing this method.

The ATO has observed that some tax agents have under-claimed by not applying all of the simplified depreciation rules. To use simplified depreciation rules correctly, the business must:

- write off eligible assets costing less than \$20,000 each;
- pool most other depreciating assets that cost \$20,000 or more;
- write off the small business pool balance if it is less than \$20,000 at the end of an income year; and
- only claim a deduction for the portion of the asset used for business or other taxable uses.

The \$20,000 write-off threshold now applies until 30 June 2018.

Small businesses with tax debts: setting up a payment plan

The ATO reminds small businesses that if they have a tax debt of \$100,000 or less, they can take advantage of the ATO’s self-help service to set up a payment plan in two easy steps:

- Use the payment plan estimator to work the options.
- With their Tax File Number (TFN) or Australian Business Number (ABN) on hand, set up a payment plan by either phoning the ATO’s automated service on 13 72 26 or using the online services for sole traders and individuals on their myGov account.

In some circumstances, the ATO says, a business may be eligible for interest-free payment plans for activity statement debts. To find out about eligibility, phone the ATO on 13 11 42.

If a business pays its tax debt late or by instalments, interest accrues on the unpaid debt. And even where a business has a payment plan, the ATO says it still needs to lodge all of its ongoing activity statements and tax returns on time, even if the business cannot pay by the due date.

To deal with tax debts of more than \$100,000, businesses can phone the ATO on 13 11 42.

Federal Court rules on arrangement to avoid PAYG deductions

The Federal Court has dismissed the taxpayers’ appeals against an Administrative Appeals Tribunal (AAT) decision. The AAT had ruled against one of the taxpayers (a company as trustee of a trust) concerning an

alleged sham arrangement, input tax credits denied, GST shortfall penalties, a penalty for not withholding and remitting pay as you go (PAYG) tax amounts, and certain income tax deductions. Two additional taxpayers (a couple) were also unsuccessful before the AAT in a consequential matter – amended assessments had increasing their taxable incomes due to an increase in trust income and shortfall penalties.

Mr E operated a business providing casual labour for orchardists and vigneron through a company (Alper Harvesting Contractors Pty Ltd) which had engaged employees and accounted for PAYG deductions and payroll tax. In June 2011, the operation changed: Sunraysia Harvesting Contractors Pty Ltd was incorporated. It acted as trustee of a discretionary trust – Sunraysia Harvesting Contractors Trust – for which Mr and Mrs E were the beneficiaries. It was argued that Sunraysia no longer engaged employees, but instead subcontracted three companies (Danood, Jameron and Kigra) that engaged the employees, and those companies (not Sunraysia) were required to account for PAYG deductions and payroll tax, if necessary.

After a tax audit, the Commissioner concluded that the arrangements between Sunraysia and Danood, Jameron and Kigra were “a sham”. The Commissioner disallowed input tax credits Sunraysia had claimed on supplies it said those companies had made to it between 1 July 2011 and 31 December 2013. The Commissioner also imposed GST shortfall penalties.

The taxpayers appealed to the AAT, which said the circumstances pointed to the conclusion that the three companies concerned “were part of a façade created by [a third party] to permit Sunraysia to avoid remitting PAYG deductions”. It said the arrangements between Sunraysia and the three companies “were never intended to create any legally enforceable obligation”. The taxpayers then appealed to the Federal Court.

The Federal Court said that, “[i]n design, the structure ... looks to be but a crude, interposed company of no worth, run by a straw man (a feature reminiscent of the ‘bottom of the harbour’ behaviours of a generation ago) with ‘phoenix’ successors. Whatever fiscal efficacy that had depended on [Mr E adopting it]. As it happened, he failed to show that he ever intended the key legal elements of the structure to take effect ... The appeal must be dismissed, with costs.” (*Sunraysia Harvesting Contractors Pty Ltd (Trustee) v FCT* [2017] FCA 694, Federal Court.)

Default assessments confirmed for undisclosed income of property business

A taxpayer has been unsuccessful in proving that default assessments were excessive or otherwise incorrect: *Peter Sleiman Investments Pty Ltd as Trustee for The Sleiman Family Trust v FCT* [2017] AATA 999.

PSI Pty Ltd (PSI) was the trustee of a discretionary family trust. PSI lodged income tax returns in its capacity as trustee for the years ended 30 June 2000 to 30 June 2004. For the years ended 30 June 2005 to 30 June 2007, it lodged forms indicating that “returns were not necessary”. For the years ended 30 June 2008, 30 June 2009 and 30 June 2010, it did not lodge income tax returns nor “returns not necessary” forms.

In June 2013, the Commissioner issued income tax assessments to PSI for the 2008, 2009 and 2010 income years totalling just over \$3.7 million in tax and \$3.3 million in penalties.

PSI contended that it did not do more than own and derive rental income from properties it owned in Sydney. It contended that its total income was significantly less than the ATO had assessed. To use one year as an example, it said its income for 2008 was \$225,547, while the ATO had assessed it at over \$983,000. PSI further argued that the office for its rental business consisted of no more than a desk and a computer. On this basis, it challenged the default assessments.

The Administrative Appeals Tribunal (AAT) agreed with the Commissioner’s assessments. The AAT said PSI had not shown that the assessments were excessive or otherwise incorrect, and had not proven what its actual taxable income should have been. These requirements would not be satisfied by identifying errors that the ATO might have made in its approach to particular items.

The taxpayer comprehensively failed in its quest. It was unable to produce any evidence to support its contentions. Indeed, the evidence it tendered worked very much against the taxpayer. The depreciation schedules showed significant outgoings on capital assets, indicating business activities well beyond the passive holding and rental of commercial and residential property. The outgoings included purchases of over 30 motor vehicles, plus firearms and fitness equipment. There was also expenditure on a “bomb dog”, which the taxpayer somewhat reluctantly agreed had nothing to do with a business of owning property and deriving rent.

Other evidence included bank statements with repeated references to “consultation fees”, “gun licences” and a “security industry register”. There was a loan application form which pointed to PSI having earnings more than 20 times the rental income it asserted. There was also evidence the taxpayer had provided significant loans to related parties, but no indication of any income or returns derived from those activities.

The AAT concluded that the contemporaneous material did not, at any level, support the taxpayer’s contention that it solely derived income from rent. Rather, it strongly suggested that income was derived from providing financial services to other related companies and “very likely” from involvement in other industries, such as security and hospitality. The AAT concluded, somewhat bluntly, that the taxpayer had not even “come close”

to demonstrating that the assessments were excessive. There was a “myriad of discrepancies” between what PSI contended and what the evidence showed. The AAT also held that the 75% penalty tax was appropriate given the taxpayer’s deliberate and inexplicable behaviour in not lodging the relevant returns. The ATO sought to increase the penalty by a further 20% for the 2009 and 2010 income years, against which the taxpayer argued unsuccessfully. The ATO was allowed the capacity to impose the additional penalty.

ASIC takes action on super fund websites failing to make disclosures

The Australian Securities and Investments Commission (ASIC) has recently intervened in relation to 21 superannuation trustees that failed to adequately disclose transparency information on their super fund websites.

Under s 29QB of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), each super fund must disclose transparency information (TI) on a website and keep it up to date at all times. TI comprises remuneration, governance and other fund information such as fund trust deeds and product disclosure statements, a summary of significant event notices and a summary of how the trustee voted in the last financial year in relation to its listed shares.

ASIC expects super fund websites to be easily found by searching the fund’s name using an internet search engine, and to have a homepage that prominently points to the TI. An ASIC review, however, revealed transparency deficiencies by 21 super funds, two of which were large funds with assets exceeding \$10 billion, including:

- not having a super fund website (10 funds);
- displaying no TI on the fund website (four funds);
- providing no remuneration information (five funds); and
- disclosing remuneration in bands, rather than for each individual executive officer (two funds).

ASIC wrote to the trustees of the 21 super funds, representing 15% of the trustee population, asking them to address these transparency failures. As a result, seven trustees disclosed the required information, five made it easier to find the information and trustees of two small funds that did not have websites sought relief from TI obligations. ASIC also said that seven trustees transferred fund members to another fund before winding up the fund, while two trustees improved their procedures for ensuring TI is up to date.

AASB says more companies should consider reporting tax liabilities ahead of new guidance

The Australian Accounting Standards Board (AASB) says that more Australian companies could be recognising amounts in dispute with the ATO in financial reports, under new guidance from the IFRS Interpretations Committee (IFRIC). The IFRIC guidance will be issued by the AASB shortly.

On 7 June 2017, the International Accounting Standards Board (IASB) issued IFRIC 23 *Uncertainty over Income Tax Treatments* to specify how to reflect uncertainty in accounting for income taxes. It is effective from 1 January 2019. The IFRS said it may be unclear how tax law applies to a particular transaction or circumstance, or whether a taxation authority will accept a company’s tax treatment. IAS 12 *Income Taxes* specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. IFRIC 23 provides requirements that add to the requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes.

The AASB says company directors are now required to continually assess the aggressiveness of tax positions taken. They must assume the tax authority has full knowledge of all the relevant facts, regardless of whether their companies have had or are likely to have a tax audit, or are likely to be issued an amended assessment.

If it is probable that the tax authority will not accept the company’s treatment, the AASB says a tax liability for the expected settlement amount must be recognised in the Statement of Financial Position, with an associated tax expense. Even if it is probable that the tax authority will accept the treatment, directors still need to assess whether disclosure of a contingent liability is necessary.

While the new guidance is not effective until 1 January 2019, the AASB recommends that all companies reassess whether to record a tax liability in their 2017 reporting.

Revenue Minister Kelly O’Dwyer has said that tax is a key Government focus, “so it is good to see an increased emphasis on encouraging clearer disclosures by corporates of areas of tax uncertainty in their financial statements”.

AASB Chair Kris Peach said, “The probability threshold is now being applied at an earlier point and could result in more tax liabilities being recognised. Previously, a tax liability was only recognised if the directors assessed it was probable that the entity would be required to pay additional tax.”

ATO Deputy Commissioner Jeremy Hirschhorn said that in applying the new rules, companies should consider the ATO's public guidance about what it is likely to dispute, as well as the ATO's success in determining the likely resolution of matters when it does raise disputes.

Mr Hirschhorn said that thanks to the ATO's improved management of disputes, it "has a success rate in matters that ultimately go to litigation of more than 75%, and a recent track record in settled matters of recovering about 75% of the disputed tax on average". When companies are in doubt as to their tax positions, he said, the ATO strongly encourages them to engage with it to obtain certainty "rather than be exposed to significant uncertain positions, which rarely improve with time".

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