

# the Spry Roughley report

## explanatory memorandum

August 2011

**CURRENCY:** This issue takes into account all developments up to and including 15 July 2011.

### ATO Announces Compliance Focus Areas

The Commissioner has released the ATO's Compliance Program for 2011–12, highlighting the compliance issues attracting ATO attention and what it is doing to address them. The program covers individuals, micro businesses, small to medium enterprises (SMEs), large businesses, Project Wickenby, tax practitioners, superannuation, promoter penalty laws, and non-profit organisations.

Some of the key focus areas from the Program include that the ATO:

- plans to enhance its tax fraud detection and management;
- will concentrate on sham contracting arrangements;
- will continue its extensive data matching and risk profiling activities;
- plans to reduce phoenix arrangements through a coordinated program of reviews and audits of directors;
- focus on those who fail to report some or all cash transactions;
- will check employers' super guarantee payments;
- will identify businesses who have received government payments and review those suspected of not correctly reporting income or not meeting their PAYG withholding and superannuation obligations;
- will examine businesses operating outside its small business benchmarks;
- will extend its focus on lodgment compliance within private groups, including wealthy Australians;
- will implement strategies to deal with concerns the ATO has with trustees of self-managed super funds;
- will examine claims for work-related deductions made by real estate employees, carpenters and joiners, earthmoving plant operators and flight attendants;
- will review or audit businesses where claims have been incorrectly made for the small business CGT concessions;
- will be contacting the owners and shareholders of private companies to verify their compliance with the requirements under Div 7A;
- will continue to monitor trust compliance in relation to distributions and on-time lodgment;
- will focus on SMSF compliance, in particular on newly registered funds, to ensure they have not been established to provide illegal early release of superannuation funds to their members.

Source: ATO 2011–12 Compliance Program [www.ato.gov.au/content/00284023.htm](http://www.ato.gov.au/content/00284023.htm)

## Trust Streaming: Extension to Record Beneficiaries' Entitlements

The ATO says it recognises that the passage of the legislation so close to the end of the income year in which it is to apply (i.e. 2010–11 income year) will cause practical difficulties for tax agents and trustees.

Under the changes in the Bill, in order for a beneficiary to be specifically entitled to a franked distribution of a trust, the beneficiary's entitlement to the franked distribution must be recorded in the accounts or records of the trust no later than the end of the income year. However, as regards the timing of recording such an entitlement for the 2010–11 income year, the Commissioner says he has agreed to adopt a similar approach to that set out in Income Tax Rulings IT 328 (Trusts: interpretation of s 101 in relation to ss 99 and 99A under 1964 amending legislation [as at 20 May 1966]) and IT 329 (Discretionary trusts: s 101 – resolutions of trustee [as at 11 July 1980]) in respect of "present entitlement" to trust income.

Therefore, the Commissioner has decided to put in place two administrative arrangements:

- he will extend the time for trustees to record a beneficiary's entitlement to a franked distribution for the purpose of the new legislation for the 2010–11 income year only. For trusts with a 30 June balance date, the Commissioner says he will accept that a relevant record made in respect of a franked distribution by 31 August 2011 meets the requirements of the new law for the 2010–11 income year in any case where ITs 328 and 329 would permit the trustee to take steps within that same period to make beneficiaries presently entitled to trust income for the purpose of Div 6 (the Commissioner intends to withdraw ITs 328 and 329 for the 2011–12 and later income years). For trusts that balance earlier than 30 June 2011 (or later than 30 June 2011 but before 31 August 2011), the Commissioner will likewise accept a relevant record made by 31 August 2011. As the new law permits relevant records to be made in respect of capital gains no later than two months after the end of the relevant income year, the Commissioner says there is no need for this arrangement to be extended to a beneficiary's specific entitlement to capital gains; and
- the ATO will not select cases for review or audit in respect of the 2010–11 income year for the sole purpose of determining whether the purported streaming of capital gains or franked distributions by a trustee is tax effective. This will not apply where there has been a deliberate attempt to exploit weaknesses or deficiencies in the law. In those cases, the Commissioner says the ATO will apply the law "as we understand it to operate".

Source: ATO publication "Improving the taxation of trust income", 6 July 2011 [www.ato.gov.au/content/00274021.htm](http://www.ato.gov.au/content/00274021.htm)

## Trust Streaming, Car Fringe Benefits, Dependent Spouse Offset and Other Changes

On 29 June 2011, the *Tax Laws Amendment (2011 Measures No 5) Bill 2011* received Royal Assent as Act No 62 of 2011. It had passed all stages without amendment and contains the following amendments:

- **Streaming of capital gains and franked distributions:** the Bill amends Subdiv 115-C and Subdiv 207-B of the ITAA 1997 to ensure that, where permitted by the trust deed, the capital gains and franked distributions (including any attached franking credits) of a trust can be effectively streamed for tax purposes to beneficiaries by making them "specifically entitled" to those amounts. The Bill also amends Div 6 of Pt III of the ITAA 1936 to include specific anti-avoidance rules to address the potential opportunities for tax manipulation that can result from

the inappropriate use of exempt entities as beneficiaries. Note the ATO has issued an administrative treatment regarding amendments: see below.

- **Car fringe benefit taxation changes:** the Bill amends the Fringe Benefits Tax Assessment Act 1986 to change the current statutory formula method for determining the taxable value of car fringe benefits by replacing the current four statutory rates with a single statutory rate of 20%, regardless of kilometres travelled.
- **Dependent spouse offset finishes for under 40s:** the Bill amends the ITAA 1936 to implement the 2011–12 Budget measure to phase out the dependent spouse tax offset.
- **Other changes:** the Bill contains changes concerning: trust beneficiaries, averaging and farm management deposits (FMDs), and the National Rental Affordability Scheme (NRAS).

Refer back to the July edition of the explanatory memorandum for further details on the amendments.

### Low Income Taxpayer Offset Ends for Most Minors

On 27 June 2011, the Tax Laws Amendment (2011 Measures No 4) Bill 2011 received Royal Assent as Act No 43 of 2011. It had passed all stages without amendment and contains amendments to remove the low income tax offset for minors. The amendments apply to assessments for the 2011–12 income year and later income years. Other amendments contained in the Bill will:

- reduce in 2011–12 PAYG instalments – sets the GDP adjustment for PAYG instalment taxpayers who use the GDP adjustment method at 4%. Date of effect: applies to PAYG instalment amounts for the 2011–12 income year that become due on or after the day after the Bill receives Royal Assent i.e. on or after 27 June 2011;
- allow the percentage of insurance costs for certain total and permanent disability (TPD) policies that can be claimed as deductions by superannuation funds to be specified in regulations. Date of effect: the amendments commence on Royal Assent i.e. on 27 June 2011, applicable to insurance policy premiums paid in the 2011–12 income year and later income years; and
- amend the definition of “reportable employer superannuation contributions” in s 16-182, Sch 1 to the Taxation Administration Act 1953 to exclude contributions required by an “industrial instrument”. Date of effect: the amendments commence on Royal Assent i.e. 27 June 2011, applicable to income years starting on or after 1 July 2009.

Refer back to the July edition of the explanatory memorandum for further details on the amendments.

### Building Contractors Face Reporting Proposal

The Assistant Treasurer, Mr Shorten, has released a consultation paper on the 2011–12 Budget proposal to introduce a reporting regime for payments made to contractors in the building and construction industry. In broad terms, the reporting regime will require businesses in the building and construction industry to report annually to the ATO payments they have made to contractors in the industry. The reporting regime is proposed to start on 1 July 2012.

According to the paper, the ATO has identified a high level of non-compliance by contractors in the industry. This includes issues with complying with GST requirements, record-keeping requirements, and the personal services income rules. Other issues include businesses engaging contractors that may actually be employees (i.e. “sham contracting”), incorrect reporting of ABNs, and involvement in

the “cash economy”. The paper also indicates that increased ATO efforts to address such problems (eg audits, education programs) in the past “have been met with limited success”.

The aim of the reporting regime is to improve compliance with taxation obligations of contractors in the industry by providing the ATO with sufficient information to allow data-matching for review and targeted audits. According to Mr Shorten, the reporting regime will help “ensure that all contractors comply with their taxation obligations and pay their fair share of tax.”

Under the regime, businesses will report annually to the ATO any amounts paid to contractors in the industry, along with each contractor’s ABN. The regime will only require businesses to report information that they are already required to collect and record under the existing taxation law. The information will also allow the ATO to focus its resources in order to provide assistance and education to those identified as having a problem with compliance, based on a lack of knowledge or awareness.

Mr Shorten said the Budget proposal will not introduce any new requirements for contractors to report payments made to them. He said contractors will only be required to report on payments they make to sub-contractors in the building and construction industry, and otherwise comply with existing obligations in respect of reporting of taxable income.

The paper suggests the reporting regime can operate through the existing Payment, ABN and Identification Verification System (PAIVS) in Pt 5-30 in Sch 1 to the Taxation Administration Act 1953. The proposal utilises the “transaction reporting by purchasers” component of the PAIVS (Div 405 in Sch 1 to the TAA). Under this component, the legislation would operate to require a “purchaser” to report details to the ATO of “suppliers” who they have paid for a “supply”. The paper notes that regulations would be inserted into the Taxation Administration Regulations 1976 to define the key terms of “purchaser”, “supplier” and “supply”. The paper also suggests that the existing penalty provisions within the PAIVS system (currently 20 penalty units) would provide purchasers with the incentive to meet their reporting obligations.

The paper raises various questions for consultation which broadly concern:

- “supply” – what payments are subject to reporting;
- “purchaser” – who is required to report;
- “supplier” – who will be reported on; and
- administration – what is required to be reported and how will this occur.

The Assistant Treasurer said the outcomes of the consultation will inform the drafting of regulations to introduce the reporting regime. The outcomes will also inform a further public consultation on options to introduce a similar reporting regime for payments to contractors in the commercial cleaning industry, to be conducted by the Government in 2011–12, Mr Shorten said.

Public consultation closed on 27 June 2011.

*Source: Treasury consultation paper “Reporting of Taxable Payments for Contractors in the Building and Construction Industry”, 30 May 2011 [www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2046](http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2046); Assistant Treasurer’s media release No 85, 30 May 2011  
<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/085.htm&pageID=003&min=brs&Year=&DocType>*

## Unpaid Directors' Fee Schemes and Private Companies on ATO Radar

The ATO has issued Taxpayer Alert TA 2011/4 warning taxpayers of an arrangement where a private company claims a deduction for unpaid directors' fees.

The arrangement broadly involves a private company making resolutions prior to 30 June in relation to the amounts payable to directors that reflect the company is irrevocably committed to the payment. The company claims a deduction for the payment, but the actual payment is never made (or a minimal amount is paid the following year) to the directors. The directors do not include any amount in their assessable income and may enter into loan arrangements with the company in relation to the fees.

"We are concerned that some companies may be using this arrangement to claim amounts that are never intended to be fully paid out. As the fees aren't returned as income until received, this practice results in a mismatch of deductions and income," Mr D'Ascenzo said.

Among other things, the ATO says the arrangement may be considered a sham and Pt IVA may apply to the arrangement or any part of it. Further, it says any entity involved in the arrangement may be a promoter for the purposes of Div 290 of Sch 1 of the TAA.

Source: Taxpayer Alert 2011/4 <http://law.ato.gov.au/pdf/tpa/tpa1104.pdf>; ATO media release No 2011/31, 2 June 2011 [www.ato.gov.au/corporate/content.aspx?doc=/content/00281629.htm](http://www.ato.gov.au/corporate/content.aspx?doc=/content/00281629.htm)

## ATO Reminds Employers of Superannuation Obligations

The ATO has released details of common super obligation mistakes made by employers including:

- paying insufficient super contributions;
- missing the quarterly cut-off dates (28 October, 28 January, 28 April, 28 July);
- super obligations in relation to contractors;
- not keeping accurate records;
- not passing on an employee's TFN to their super fund; and
- not lodging a superannuation guarantee charge statement.

The ATO reminds employers that super contributions need to be made for contractors employed under a contract that is wholly or principally for the contractor's labour, even if the contractor has an ABN.

The ATO also says employers must provide the TFN of their employees to the nominated super fund within 14 days of receiving the information. It says failure to provide the information may result in penalties.

**TIP:** The ATO has been selecting various industries to focus its compliance activities. This year, in its compliance program, the ATO intends to target the following industries in relation to superannuation guarantee obligations: cafes and restaurants; real estate services; carpentry services; computer system design and related services; and accommodation.

Source: ATO publication "Common mistakes made by employers", 23 June 2011 [www.ato.gov.au/businesses/content.aspx?doc=/content/00283610.htm](http://www.ato.gov.au/businesses/content.aspx?doc=/content/00283610.htm); ATO 2011-12 Compliance Program [www.ato.gov.au/content/00284023.htm](http://www.ato.gov.au/content/00284023.htm)

## Tribunal Denies Deduction for Interest on Loans Made to Trust

The AAT has confirmed that husband and wife taxpayers were not entitled to a deduction for interest on loans made to a discretionary trust which ran their building business or a deduction for interest on their investment properties which they made available to the trust for accommodation for building contractors. The AAT did so on the basis that there was an insufficient nexus between the interest and the derivation of assessable income in terms of the beneficiaries being “presently entitled” to distributions of trust income.

The taxpayers argued that various trust resolutions made requiring the trustee to give “due consideration” to apply trust income to the beneficiaries in return for the making of the loans to the trust and making available the accommodation had the effect of rendering them “presently entitled” to trust distributions. They also claimed that this resulted in more than an “expectation” of a trust distribution. In short, the taxpayers argued that the resolutions amounted to “binding agreements” which gave them “a vested and indefeasible interest once the agreements were minuted”, and therefore established the necessary nexus between the expenditure and assessable income.

However, the AAT found that the resolutions did not render the taxpayers “presently entitled” to distributions of trust income as the promise made by the trustee was only to give “due consideration” to making trust distributions when it came to exercise its discretion at a future time. Furthermore, the AAT said that if the resolutions had amounted to an immediate “vested and indefeasible interest”, then there would have been no need to refer to the trustee’s acknowledgment that it would give “due consideration” to distributing trust income. (But the AAT found that resolutions made in respect of years of income which were not in dispute did have the effect of creating an immediate and indefeasible right to income.)

The AAT also dismissed the claim that the husband was presently entitled to the trust income by way of being a default beneficiary. It did so on the basis that, as his entitlement as a default beneficiary was dependent on the trustee choosing not to exercise its discretion in favour of some other beneficiary, then the making of the above resolutions would have been unnecessary. It also noted that it would undermine the provisions of the trust deed which required the exercise of the discretion by the trustee. Finally, the AAT found it appropriate to maintain the 25% shortfall penalties imposed for failing to take reasonable care.

*AAT Case [2011] AATA 431, Re Antonopoulos and FCT, AAT, Ref No 2010/121-122, Frost SM, 22 June 2011*  
[www.austlii.edu.au/au/cases/cth/AATA/2011/431.html](http://www.austlii.edu.au/au/cases/cth/AATA/2011/431.html)

## Personal Services Income Rules Applies to Taxpayer

The AAT has confirmed that the PSI rules in Pt 2-42 of the ITAA 1997 applied to a taxpayer who provided his services as a draftsman through his private company to include over \$67,000 as personal income in the years in question. In doing so, the AAT found that the neither the “unrelated clients” test in s 87-20 nor the “business premises” test in s 87-30 applied to relieve him of personal liability. At the same time, the AAT upheld 25% shortfall penalties for failing to take reasonable care.

In relation to the “unrelated clients” test, the AAT found that the taxpayer’s contact of various clients by way of phone or email messages through his personal contacts or relationships in the industry (or to whom he was recommended by other clients) did not amount to “making offers or invitations to the public at large or a section of the public” as required by s 87-20(1)(b) in order to meet the unrelated clients test. In particular, the AAT found that “word of mouth” advertising and “direct offers” did not meet this requirement. In doing so, the AAT also distinguished the decision in *FCT v Yalos Engineering Pty Ltd* (2009) 75 ATR 744.

[Note: In *Yalos*, the Federal Court set aside the decision in AAT Case [2009] AATA 390, *Re Yalos Engineering Pty Ltd v FCT*. In that case, the Tribunal directed the Commissioner to make a personal services business (PSB) determination in relation to the personal services income derived by the taxpayer even though the taxpayer did not meet any of the PSB tests to be excluded from the PSI regime. This was because in the Tribunal's view, the taxpayer could have been expected to meet the unrelated clients test but for the unusual circumstances that existed in the 2004 and 2005 income years – those circumstances were the extension of a contract because of unforeseen problems with the project in question. The Court agreed with the Commissioner that the Tribunal had overlooked the requirement that, even where unusual circumstances existed, it was necessary to consider whether the taxpayer would have satisfied (or could reasonably have been expected to meet) the unrelated clients test “but for” those circumstances. The Court found that the Tribunal had reached its decision that a PSB determination should be made without addressing the application of the unrelated clients test. Accordingly, the Court remitted the matter back to the Tribunal for hearing and determination consistent with its judgment.]

In relation to the “business premises” test, the AAT found that the drafting services provided by the taxpayer in the year in question were performed usually at the client's premises – and that any drafting work performed at his own premises was ancillary in nature and could be compared to an employee taking work home in the evening or on weekends. The AAT also dismissed the taxpayer's claim that the premises (where he also carried on another business in partnership with his wife) were used predominantly for his drafting service business in terms of the area of floor space used. In doing so, the AAT found there was no basis for this approach and that, in terms of turnover, the premises were predominantly used for the other business.

Finally, the AAT found it was appropriate to maintain a 25% shortfall penalty imposed for failing to take reasonable care essentially on the basis that the evidence was indicative of the fact that the taxpayer ought to have known the claims were “opportunistic and speculative”. Likewise, the AAT maintained 25% shortfall penalties for an incorrect claim for travel expenses on the basis that the taxpayer failed to take reasonable care and that there was no evidence he was required to travel in the course of providing his services at the various fixed locations where he worked.

*AAT Case [2011] AATA 386, Re Cameron and FCT, AAT, Ref Nos 2008/5933 - 5935, Block DP, 6 June 2011*  
[www.austlii.edu.au/au/cases/cth/AATA/2011/386.html](http://www.austlii.edu.au/au/cases/cth/AATA/2011/386.html)