the Spry Roughley report

explanatory memorandum

July 2012

ATO targets disclosure of foreign sources of income

The ATO has issued Taxpayer Alert TA 2012/1 warning taxpayers of arrangements under which Australian resident taxpayers do not correctly include income and other taxable amounts from foreign sources in their assessable income for Australian tax purposes.
The arrangements involve Australian resident taxpayers deriving foreign source income that is either received in Australia or accumulated offshore. The ATO says foreign source income may include (but is not limited to) the following:

- interest accrued in an offshore bank account;
- income derived from a foreign investment (eg dividend or rental income);
- income from an asset that has been inherited from an overseas source;
- a foreign pension or annuity;
- certain foreign employment income;
- foreign business income;
- foreign trust income;
- capital gains arising from the disposal of overseas assets; and
- attributable income from interests in offshore entities, even if the income has not been distributed.

In the arrangement as described by the ATO, the taxpayer does not disclose their interest and/or their involvement in deriving the foreign source income by:

- accumulating and/or reinvesting the income offshore;
- transferring the funds to Australia in the form of a loan; or
- accessing funds though the offshore bank account for use in Australia or elsewhere with debit or credit cards.

The ATO says in certain circumstances, a promoter or third party may act as a beneficiary of the offshore structure or investment to conceal the true nature of the investment.

In relation to the arrangements, the ATO says foreign source income is assessable under s 6-5 of the ITAA 1997 and Div 6 of Pt III of the *Income Tax Assessment Act 1936* (ITAA 1936). It also says any income accrued offshore may be attributable to taxpayers under Pt X of the ITAA 1936. The ATO notes that taxable capital gains may also arise to the taxpayer on the disposal of offshore assets under Pts 3-1 and 3-3 of the ITAA 1997.

Further, the ATO says arrangements that contain the features above may be considered a sham and Pt IVA may apply. For taxpayers who make full voluntary disclosures to the ATO, the Commissioner said any penalties imposed may be reduced by 80%.

Source: Commissioner's press release 2012/06, 21 March 2012
www.ato.gov.au/corporate/content.aspx?doc=/content/00313647.htm

Taxpayer Alert TA 2012/1
http://law.ato.gov.au/atolaw/view.htm?Docid=TPA/TA20121/NAT/ATO/00001

Investment loan interest payment arrangements

Taxation Determination TD 2012/1 states that Pt IVA of the ITAA 1936 can apply to deny a deduction for some, or all, of the interest expense incurred in respect of an "investment loan interest payment arrangement" of the type described in the Determination. The Determination was previously released in draft as TD 2011/D8, and is essentially unchanged from the draft.

Arrangement

The kinds of investment loan interest payment arrangements that the Determination is concerned with have features such as the following:

- The taxpayer owns at least two properties; one property is the taxpayer's residence and the other is used to derive rent.
- The taxpayer has an outstanding loan that was used to acquire the residence, an outstanding loan that was used to acquire the investment property and a line of credit or similar borrowing facility with an approved limit.
- The respective interest rates on the home loan and investment loan are typically the same or about the same. The interest rate on the line of credit is typically (but not always) higher by a small margin (eg by 0.15%).
- The investment loan is typically an interest-only loan for a specified period with principal and interest repayments required thereafter, or the interest-only period may be extendable.
- The line of credit typically has no minimum monthly repayment obligations, provided the balance remains below the approved limit.
- The home loan, investment loan and the line of credit are each secured against the taxpayer's residence and/or investment property.
- The line of credit is drawn down to pay the interest on the investment loan as it falls due. Where no repayments are required on the line of credit, the taxpayer does not make any repayments, which results in interest on the line of credit being capitalised and compounded. Where monthly interest repayments are required on the line of credit, the taxpayer meets such repayments from their cash flows.

- Typically, all the taxpayer's cash inflows (including those which the taxpayer might otherwise reasonably be expected to use to pay the interest on the investment loan) are deposited into their home loan or an "acceptable loan account offset account", which has the effect of reducing the interest otherwise payable on the home loan.

- If the line of credit reaches its approved limit before the home loan has been repaid, the taxpayer may apply to increase the limit on the line of credit in conjunction with a corresponding decrease in the available "redraw" amount for the home loan.

The ATO says a key feature of the arrangements is the use of the line of credit to pay the interest on the investment loan. This results in all, or most of, the interest on the investment loan being, in effect, capitalised. That is, the payment of the investment loan interest is deferred. This deferral has the economic effect of allowing the taxpayer to repay the home loan at a faster rate than would otherwise be possible; the taxpayer is able to pay an amount equivalent to the deferred investment loan interest on the home loan.

Application of Pt IVA

In the context of applying para 177D(b) to an investment loan interest payment arrangement, the ATO makes the following general observations:

- The manner in which the scheme is entered into or carried out is generally explicable only by the taxation consequences. For instance, apart from the purported availability of additional tax deductions, the ATO considers that it makes little (if any) financial sense for the taxpayer to, in effect, fund repayments on a home loan using a line of credit with a higher interest rate than the home loan.

- In many of these arrangements a careful analysis of the terms and conditions indicates that the interest rate on the line of credit is both notionally and in substance higher than the interest rate payable on the home loan.

- Apart from the purported availability of additional tax deductions, the taxpayer's financial position under the scheme is generally no better (and possibly worse) than it would have been if the arrangement had not been entered into. The increase in the line of credit balance is matched by an equal reduction in the balance (or effective balance) of the taxpayer's home loan.

- The circumstances often demonstrate that the arrangement will only last for the period during which the taxpayer has non-deductible interest expenses (eg home loan interest) and that once the debt that gave rise to the non-deductible interest expense is repaid, the taxpayer is likely to revert to making the payments on their investment loan out of their cash flow rather than using the line of credit. In many cases, the taxpayers is simply reverting to what they were doing prior to entering the arrangement.

- If the taxpayer's residence is used as security for either the investment loan or the line of credit, the taxpayer will not actually own an unencumbered home any faster under the scheme than would have been the case if they had not entered into the arrangement.

The ATO considers it is open for a reasonable person to conclude, having regard to the matters in para 177D(b), that one or more of the parties that entered into or carried out the scheme did so for the dominant purpose of enabling the taxpayer to obtain a tax benefit in connection with the scheme.

Date of effect

The Determination applies to years of income commencing both before and after its date of issue.

Source: Taxation Determination TD 2012/1
http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20121/NAT/ATO/00001&PiT=99991231235958

ATO reporting requirements for builders and contractors

The *Taxation Administration Amendment Regulation 2012 (No. 1)* has been registered and gives effect to the Government's 2011–12 Budget announcement that it would introduce a reporting regime requiring certain businesses in the building and construction industry to report annually to the ATO the details of payments made to contractors in the industry.

Division 405 in Sch 1 to the *Taxation Administration Act 1953* (TAA) requires entities that are paying for a "supply" that has been specified in the regulations to report the payments they make for such supplies to the ATO. This essentially means purchasers must report certain transactions for which they have been issued an invoice. The new subreg 64(1) provides that, for the purposes of s 405-5 of Sch 1 to the TAA, a supply is made by a supplier to a purchaser if:

- the purchaser is carrying on a business that is *primarily* in the building and construction industry;
- the purchaser has an ABN; and
- the supplier supplies to the purchaser: (i) building and construction services; or (ii) a combination of goods and building and construction services, unless the supply of services is *incidental* to the supply of the goods.

New subreg 64(6) specifies activities that are considered to be "building and construction services". Examples of occupations and work activities that would satisfy the definition of "building and construction services" include architectural work (including drafting and design), installation of hard-wired alarm systems (security, fire, smoke, etc), asphalt and bitumen work, gas plumbing, demolition, electrical work, land clearing, installation of hot water systems, assembly, installation or erection of pre-fabricated houses, bricklaying, installation of septic tanks and building of room components (eg kitchens, bathroom components, laundry components, cupboards, etc).

New subreg 64(5) provides tests for determining if a purchaser is carrying on a business that is *primarily* in the building and construction industry. The test is satisfied if:

- in the current financial year, 50% or more of the purchaser's business activity relates to building and construction services;
- in the current financial year, 50% or more of the purchaser's business income is derived from providing building and construction services; or
- in the financial year immediately preceding the current financial year, 50% or more of the purchaser's business income was derived from providing building and construction services.

The supply of building and construction services will be *incidental* where the supply of the service "is not of substance when compared to the supply of the goods".

Certain exclusions

The new regulations provide for certain exclusions from the requirement to report:

- ***Consolidated or MEC groups*** – New subreg 64(2) ensures that transactions need not be reported if both the supplier and the purchaser are members of the same consolidated group or multiple entry consolidated (MEC) group.

- ***Withholding payments*** – New subreg 64(3) ensures that transactions need not be reported if the payment is a withholding payment as defined by s 995-1 of the ITAA 1997.

Draft regulations

Draft regulations were released for public consultation in December 2011. The final regulations are substantially similar to the draft regulations, although there some differences which mainly concern new subregs 64(1) and 64(5).

Date of effect

The Regulation commences on 1 July 2012.

Source: Taxation Administration Amendment Regulation 2012 (No. 1) www.comlaw.gov.au/Details/F2012L00666

Deduction for property expenses denied

The Administrative Appeals Tribunal (AAT) has held that a taxpayer failed to discharge the onus of proof in relation to the deductibility of expenses incurred in buying, renovating and selling properties for the income years ended 30 June 2003 and 30 June 2004.

Background

The taxpayer was incorporated in 1995 and was in the business of buying and selling properties. In 2003, the taxpayer was placed under external administration. The Commissioner selected the taxpayer for audit in 2009 in relation to omitted income and expenses for the 2003 and 2004 financial years. Following a request by the Commissioner, the taxpayer lodged income tax returns for the relevant years but reported nil taxable income.

The Commissioner determined the returns were inaccurate and issued amended assessments for 2003 with a taxable income of $1,263,500, and for 2004 with a taxable income of $2,450,000. The figures related to the proceeds of sale from two properties, a deposit on the failed sale of one of the properties, rental and lease income and dividends.

The Commissioner also imposed shortfall penalties of $189,525 for 2003 and $367,500 for 2004. The taxpayer objected to the amended assessments and the penalties, arguing that the Commissioner had not taken into account the costs incurred in purchasing and maintaining the properties.

Decision

The AAT found that the taxpayer had failed to discharge the onus of proof arising under s 14ZZK(b) of the TAA to show that the assessments were excessive. It noted that the taxpayer was unable to produce documentary evidence in relation to stamp duty, legal expenses, renovations, wages and directors' fees, interest and legal expenses. In relation to the external administration fee claimed by the taxpayer, the AAT said the costs were not allowable as a deduction under s 8-1 of the ITAA 1997.

The AAT also noted that one of the directors of the taxpayer agreed with the Commissioner's estimates of rental and leasing income, but disagreed with the Commissioner on the other income the taxpayer derived during the relevant years. However, the director could not provide any evidence to refute the Commissioner's estimates.

In relation to the penalties, the AAT said it was satisfied that the taxpayer's conduct in the case was appropriately categorised as reckless and subject to a 50% administrative penalty. The AAT also did not consider a remission of GIC to be justified as the taxpayer "failed to provide any grounds to substantiate its objection". The AAT therefore affirmed the amended assessments and penalties issued by the Commissioner.

Re Sobel Investments Pty Ltd and FCT [2012] AATA 180 *www.austlii.edu.au/au/cases/cth/AATA/2012/180.html*

Pitfalls of "late" super payment

The AAT has affirmed the Commissioner's decision to impose an excess contributions tax assessment and deny a taxpayer's request for excess contributions amounts to be reallocated to a previous financial year pursuant to s 292-465 of the ITAA 1997.

Background

On 30 June 2007, the taxpayer attempted to transfer $60,000 from a family discretionary trust into his self managed superannuation fund. The transfer was a concessional contribution and the taxpayer intended that $40,000 be allocated to himself and $20,000 to his spouse. However, because 30 June 2007 was a Saturday, the amount was not credited via his bank to the super fund until 2 July 2007. The excess concessional contributions for the 2008 financial year amounted to almost $54,000 and the Commissioner imposed excess contributions tax of around $17,000. The taxpayer requested that the $40,000 amount be reallocated to the previous year pursuant to the discretion s 292-465.

The taxpayer submitted that it was reasonable for him to have expected that the transfer of funds would have been instantaneous. He contended that the transaction had been recognised by the bank as having been effected on 30 June 2007, even if the withdrawal and deposit of funds had not taken place until 2 July 2007 (as shown in bank records). Further, it was argued that, had the transfer been on a business day, it would have been effective virtually instantaneously. The taxpayer further argued that a reallocation of his $40,000 contribution would be consistent with the object of Div 292, which is to encourage individuals to make contributions "gradually over the course of the person's life".

Decision

Although the AAT said the taxpayer appeared "to have acted with good intentions at all times", it found the circumstances did not enliven the discretion under s 292-465. The AAT said in relation to "electronic funds transfers to a superannuation provider, the Commissioner's practice is to deem the contribution as having been made *when the funds are credited to the superannuation provider's account*". It found that the funds were not credited to the super fund's account until 2 July 2007.

Moreover, the AAT was of the view that "special circumstances" did not exist in this instance. The AAT said the taxpayer "chose to trust the technology or, more specifically, to speculate as to the effectiveness of the manner in which he was anticipating that the technology would operate". It added that "[e]very other taxpayer was faced with the same situation". It concluded that "[t]hese were not *special circumstances* unique to this [taxpayer] or this situation" and that it "was incumbent upon the [taxpayer] to ensure that the transfer was effective".

The AAT was not of the view that the imposition of excess contributions tax in the circumstances was "unjust, unreasonable or inappropriate". In conclusion, the AAT held there were no grounds for the Commissioner to make a determination under s 292-465 to disregard or reallocate the amount in question to the 2007 financial year.

Re Chantrell and FCT [2012] AATA 179
www.austlii.edu.au/au/cases/cth/AATA/2012/179.html

Doctor found to be a share trader

The AAT has held that a medical doctor was engaged in a share trading business not only in relation to listed shares she acquired, but also in relation to units she acquired in a listed aged care property trust that she had purchased from her family trust (albeit for more than their market value at the time).

Moreover, it was these units that generated an unrealised loss of over $1 million on the basis of them having a closing value of "nil" and which, as a result, enabled to her to reduce her other taxable income of $329,000 for the year ended 30 June 2009 below nil, ie to a loss.

The Commissioner argued that the taxpayer was not carrying on any business of trading and that the aged care property trust units in the family trust were acquired for the purpose of long-term investment. He also argued that the units had been wrongly acquired by the taxpayer for their acquisition cost by the trust of $1 per unit despite the fact that at that time their market value was 70 cents.

On the other hand, the taxpayer claimed that she was carrying on a business of trading in all the listed shares and units. She also claimed that the units acquired from the family trust were trading stock and that therefore she was entitled to a deduction equal to the gross proceeds of sale of any shares or units sold in that year less her relevant "cost of goods sold".

In arriving at its decision that the taxpayer was carrying on a share trading business both in respect of the listed shares and units, including the units in the aged care property trust, the AAT took into account the following factors:

- the nature of the activities and whether they have the purpose of profit-making;
- the complexity and magnitude of the undertaking;
- an intention to engage in trade regularly, routinely or systematically;
- operating in a business-like manner and the degree of sophistication involved;
- whether any profit/loss is regarded as arising from a discernible pattern of trading; and
- the volume of the taxpayer's operations and the amount of capital employed by her.

The AAT remitted the matter to the Commissioner for re-consideration and the issue of an amended assessment in accordance with the AAT's findings that: (i) the taxpayer was carrying on a business of share trading in the relevant years of income; (ii) the aged care property trust units were trading stock of that business; and (iii) the taxpayer's taxable income for the year ended 30 June 2009 was nil. However, the AAT also said that the exact quantification of the taxpayer's consequent carry forward loss could be left for determination by the Commissioner at a later date.

Re Wong and FCT [2012] AATA 254
www.austlii.edu.au/au/cases/cth/AATA/2012/254.html

FBT rates and thresholds for 2012–13

The ATO has released five determinations dealing with FBT rates, thresholds, etc for the 2012–13 FBT year (ie the FBT year commencing on 1 April 2012).

- ***TD 2012/3:*** for the purposes of s 135C of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA), the record-keeping exemption threshold is $7,642 (up from $7,391 for the 2011–12 FBT year).

- ***TD 2012/4:*** for the purposes of s 28 of the FBTAA, the indexation factors for valuing non-remote housing are:
    - NSW – 1.060;
    - Vic – 1.040;
    - Qld – 1.028;
    - SA – 1.042;
    - WA – 1.035;
    - Tas – 1.039;
    - ACT – 1.056; and
    - NT – 1.026.

- ***TD 2012/5:*** for the purposes of Div 7 of Pt III of the FBTAA, the following amounts represent a reasonable food component of a living-away-from-home allowance for expatriate employees (for larger family groupings, add $150 for each additional adult and $75 for each additional child):
    - 1 adult – $250;
    - 2 adults – $400;
    - 3 adults – $450;
    - 1 adult and 1 child – $325;
    - 2 adults and 1 or 2 children – $450;
    - 2 adults and 3 children – $524;
    - 3 adults and 1 child – $524;
    - 3 adults and 2 children – $599; and
    - 4 adults – $599.
- ***TD 2012/6:*** the rates to be applied on a "cents per kilometre" basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car are:
    - 0 to 2500cc: 48 cents/km;
    - over 2500cc: 57 cents/km; and
    - Motorcycles: 14 cents/km.
- ***TD 2012/7:*** the benchmark interest rate is 7.40% pa (down from 7.80% pa for the 2011–12 FBT year). The benchmark is used to calculate the taxable value of:
    - a fringe benefit provided by way of a loan; and
    - a car fringe benefit where an employer chooses to value the benefit using the operating cost method.

Sources:

TD 2012/3 http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20123/NAT/ATO/00001&PiT=99991231235958;

TD 2012/4 http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20124/NAT/ATO/00001&PiT=99991231235958;

TD 2012/5 http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20125/NAT/ATO/00001&PiT=99991231235958;

TD 2012/6 http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20126/NAT/ATO/00001&PiT=99991231235958;

TD 2012/7 http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD20127/NAT/ATO/00001&PiT=99991231235958;

Car expenses – rates per km for 2011–12

The *Income Tax Assessment Amendment Regulation 2012 (No. 1)* has been registered and sets the "cents per kilometre" rates for calculating tax deductions for car expenses in the 2011–12 income year. Those rates remain unchanged from the 2010–11 year and are:

Car expense rates per km for 2011–12			
Type of car	**Engine capacity – non-rotary engine (cc)**	**Engine capacity – rotary engine (cc)**	**Kilometre rate (cents)**
Small car	0 - 1,600	0 - 800	63
Medium car	1,601 - 2,600	801 - 1,300	74
Large car	2,601 +	1,301 +	75

The cents per km method can be used for the first 5,000 business kilometres only. If a taxpayer wishes to claim for more than 5,000 business kilometres, he or she must use one of the other methods outlined in Div 28 of the ITAA 1997.

Source: Income Tax Assessment Amendment Regulation 2012 (No. 1) www.comlaw.gov.au/Details/F2012L00835

Private health insurance rebate changes looming

Income testing of the 30% private health insurance rebate starts on 1 July 2012. Essentially, singles earning over $84,000 per annum and families earning over $168,000 will be entitled to a reduced rebate that is less than the current 30% rebate. The ATO says that it will write directly to taxpayers who may be affected by these changes. This letter will provide information to assist those people in determining whether their entitlement to the rebate will decrease.

The ATO advises that taxpayers do not need to do anything. However, if they will be affected by the means testing, they may consider contacting their private health insurer to reduce the rebate they currently receive as a premium reduction in order to avoid incurring a liability at tax time in 2013.

The ATO will also write to taxpayers who claim a private health insurance tax offset, or pay a Medicare levy surcharge, to inform them of the changes (and of recent changes to the Medicare levy surcharge). No further action is required by these taxpayers, the ATO has advised.

TIP: The ATO has issued an FAQ on changes to the private health insurance rebate and the Medicare levy surcharge. Some of the questions include:

- Can you make a claim for a private health insurance tax offset in your 2011–2012 tax return for premiums that provide insurance cover for a future income year?
- When is a premium paid to a private health insurer?
- When is a premium considered to be paid when you have an arrangement with your employer to pay the premium?

Sources: ATO publication "Private health insurance rebate and Medicare levy surcharge", 15 May 2012, www.ato.gov.au/taxprofessionals/content.aspx?doc=/content/00319457.htm

ATO publication (see TIP above) "Changes to private health insurance rebate and Medicare levy surcharge", 4 June 2012, www.ato.gov.au/individuals/content.aspx?doc=/content/00233246.htm

CGT small business concessions denied

The Administrative Appeals Tribunal (AAT) recently held that a taxpayer had not met the maximum net asset value test for the purposes of the CGT small business concessions in respect of a capital gain made on selling shares to his family trust. This was because a liability incurred in respect of a related loan made to the family trust was secured by way of a mortgage over assets owned by another related company, and not over assets owned by the entity whose assets were to be taken into account under the test.

Background

The taxpayer was a director and shareholder of a series of interlocking companies. In particular, he was a director and shareholder of P Price and Co Pty Ltd, a director of Phillips Fabrications Pty Limited and a director of the corporate trustee of the Phillips Family Trust. On 30 January 2006, the taxpayer sold his shares in Phillips Fabrications to the Phillips Family Trust for $3.4 million.

P Price and Co Pty Ltd was also the owner of real property from which Phillips Fabrications carried on its business. On 30 January 2006 (the day that the taxpayer sold his shares), P Price and Co mortgaged the property to a bank for a loan of $1.4 million to be made to the Phillips Family Trust. However, this loan was not credited to the trust's bank account until 1 February 2006.

The Commissioner issued an amended assessment to the taxpayer on 14 September 2009 to include a capital gain of $1.7 million (which the taxpayer had originally excluded on the basis that he was entitled to apply the 50% reduction under the CGT small business concessions). The Commissioner also imposed a shortfall penalty of $163,687 for failing to exercise reasonable care in preparing his original return.

The issue for consideration was whether the liability for the loan of $1.4 million could be taken into account for the purposes of the maximum net asset value test. The taxpayer argued that it could on the basis that, upon the execution of the mortgage over the land owned by P Price and Co Pty Ltd on 30 January 2006, there existed a contingent liability on the part of P Price and Co Pty Ltd, thus reducing its asset position by the sum of $1.4 million.

The Commissioner argued that the liability could not be taken into account because it did not come into existence until 1 February 2006 when the loan was credited to the family trust's bank account (ie after the CGT event).

Decision

The AAT decided against the taxpayer. It first noted that, although the CGT event (ie the sale of the shares) may have been dependent upon the bank making the advance to the family trust, the loan had not in fact been made at the time of the CGT event, nor had any event arisen that might have led the bank to seek to execute its rights under the mortgage against the Phillips Family Trust, as opposed to seeking recourse against other entities that had offered securities in order to secure the advance (ie P Price and Co Pty Ltd). A mere "contingent" liability was not a sufficient liability that could be applied under the maximum net asset value test (in accordance with the authority in *FCT v Byrne Hotels Qld Pty Ltd* [2011] FCAFC 127).

The AAT then found that for a liability to be taken into account under the test, a relationship must exist between the liabilities and assets of *the entity in issue* (ie the Phillips Family Trust), not any assets held by other connected entities (ie P Price and Co Pty Ltd). In this case, because the advance was made to one entity (the Phillips Family Trust) and the mortgage was over land owned by another entity (P Price and Co Pty Ltd), the loan liability could not be taken into account.

As a result, the AAT concluded that the CGT assets of P Price and Co Pty Ltd could not be reduced by the loan liability associated with the sum advanced to the Phillips Family Trust. The Commissioner's amended assessment was therefore confirmed.

At the same time, the AAT confirmed the shortfall penalties that the Commissioner had imposed. It said that at relevant times, the taxpayer was aware of the correct authority on the issue (namely, *Byrne Hotels*) and the taxpayer's contended position was contrary to that authority. The AAT found that, in these circumstances, the taxpayer's return was lodged without due care and attention. It also noted that if the taxpayer thought that he had a reasonably arguable case, he could have sought a private ruling.

Re Phillips and FCT [2012] AATA 219, www.austlii.edu.au/au/cases/cth/AATA/2012/219.html

Director penalty regime – take two!

The Tax Laws Amendment (2012 Measures No. 2) Bill 2012 and the ***Pay As You Go Withholding Non-compliance Tax Bill 2012*** were introduced into the House of Representatives on 24 May 2012.

This is the Government's second attempt to extend the director penalty regime. Its first measures were withdrawn from Parliament in 2011 in order to allow for further consultation.

The latest No. 2 Bill will amend the Taxation Administration Act 1953 (TAA) by:

- extending the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts;
- ensuring that directors cannot discharge their director penalties by placing their company into administration or liquidation when PAYG withholding or superannuation guarantee remains unpaid and unreported three months after the due date; and
- in some instances, making directors and their associates liable to PAYG withholding non-compliance tax (effectively reducing credit entitlements) where the company has failed to pay amounts withheld to the Commissioner.

The purpose of the amendments is to deter company directors from engaging in phoenix activities or using amounts that should be paid to the Commissioner or superannuation funds for the company's or other purposes. (Note: The tax on directors and their associates will be imposed by the ***Pay As You Go Withholding Non-compliance Tax Bill 2012***.)

Extending regime to unpaid super guarantee amounts

Under the new measures, directors of companies will be personally liable for their company's failure to meet its superannuation guarantee obligations. However, new directors will only be liable where they become a director after the company has failed to meet its obligation by the due day if, 30 days after becoming a director, the obligation has still not been met.

To make a director personally liable, the superannuation guarantee charge will be treated as payable even if it has not yet been assessed. Accordingly, existing directors will be liable to a director penalty at the end of the lodgement day (or later day as allowed by the Commissioner) if the company has not lodged its superannuation guarantee statement and paid the corresponding superannuation guarantee charge by the end of that day.

The estimates regime will also be able to be used to estimate the unpaid and overdue amount of a superannuation guarantee charge liability.

Recovering penalties

In order to recover a director penalty from a director, the Commissioner will need to issue a director penalty notice and wait until the end of 21 days after issuing that notice before commencing proceedings. The Commissioner will also be able to send a copy of a director penalty notice to a director's registered tax agent.

A director penalty will be remitted if, before receiving a director penalty notice, or within 21 days of receiving a director penalty notice, any of the following things happen: (i) the company complies with its obligation; (ii) an administrator of the company is appointed; or (iii) the company begins to be wound up. However, where three months has lapsed after the due day and the underlying liability remains unpaid and unreported, the director penalty will not be remitted as a result of placing the company into administration or of the company beginning to be wound up.

Note that new directors will not be subject to the restricted remission options until three months after they became a director of the company, regardless of how long the company has been liable for the debt.

Defences

Where the Commissioner seeks to collect a director penalty, the existing defences in the director penalty regime will be available to a director, namely:

- if, because of illness or some other good reason, the director was not involved in the management of the company and it was reasonable for that director not to be involved; or
- if the director took all reasonable steps to ensure the directors caused the company to meet its obligation to pay, appoint an administrator or be wound up. Note, however, that a director will not be considered to have taken reasonable steps simply because they assert that no reasonable steps were available.

Further, a director will not be liable to a director penalty if they can establish that the penalty resulted from the company treating the *Superannuation Guarantee (Administration) Act 1992* (SGA Act) as applying to a matter in a particular way that was reasonably arguable, provided the company took reasonable care in connection with applying the SGA Act.

Note that if the Commissioner collects amounts from third parties in order to discharge a director penalty, the director will still be able to avail themselves of the above defences. To do so, the director will need to provide information to the Commissioner within 60 days of receiving notice that the recovery has occurred or receiving a copy of a notice issued to a third party under s 260-5 in Sch 1 to the TAA. That information must satisfy the Commissioner of the matters relevant to make out one of the defences.

PAYG withholding non-compliance tax

Company directors and their associates will be liable to pay tax where their company has a "PAYG withholding liability" for an income year (ie an amount the company withholds but fails to pay to the Commissioner) and the director or associate is entitled to a credit for amounts withheld by that company during the income year. However, the tax will not be recoverable unless the Commissioner issues a notice to the individual director or associate.

A company director will be liable to pay the PAYG withholding non-compliance tax where the company of which they are a director has withheld more amounts from withholding payments than it has paid to the Commissioner for the director's income year – including where any amount of the company's PAYG withholding for the director's income year is still outstanding after its due date.

To be liable, it will be necessary that the director also has an entitlement to a PAYG withholding credit that is attributable to an extent to an amount withheld by the company from payments made by the company to the director (such as directors' fees). Liability to pay the PAYG withholding non-compliance tax will arise for an individual who either:

- was a director when the company was due to pay the withheld amounts to the Commissioner but failed to do so (in full); or
- became a director after the payment of withheld amounts to the Commissioner was due (and not paid) if, 30 days after they started as a director, they are still a director and the overdue withholding amount is still unpaid.

The amount of tax payable by the director will be the lesser of: (a) the total amounts withheld from payments made to the individual by the company in the individual's income year (ie the extent that the credit is attributable to amounts withheld from payments made by the company of which the individual was a director); and (b) the company's PAYG withholding liability for payments made during the income year.

The PAYG withholding non-compliance tax is due and payable on the same date that the original income tax must be paid by the individual for that financial year. General interest charge (GIC) will also be imposed.

Reduction in director's PAYG withholding non-compliance tax

A director will be able to argue that they had grounds for allowing the company not to meet its PAYG withholding obligations (either before or after the liability to pay the tax arises). The first ground is that a director may not be responsible for the company's non-compliance because they were not involved in the management of the company and it was reasonable for them not to be involved because of illness or some other good reason.

The second ground is that the director took all reasonable steps to ensure that the directors caused the company to pay the withholding liability, an administrator of the company to be appointed or the company to begin to be wound up. Alternatively, the director will be able to satisfy the Commissioner that there were no reasonable steps that could have been taken to ensure any of those things happened. In determining what would be reasonable steps for the director to have taken, the Commissioner will need to have regard to all of the relevant circumstances.

Associates of directors

An individual who is an "associate" of a company director (as defined in s 318 of the *Income Tax Assessment Act 1936*) will potentially be liable to pay PAYG withholding non-compliance tax if amounts withheld by the company have not been paid to the Commissioner by the last day for remitting any of the amounts withheld during the associate's income year.

To be liable to pay the PAYG withholding non-compliance tax, it will be necessary that the associate is entitled to a credit that can be attributed to some extent to amounts withheld from payments such as wages paid to them by the company during the income year. To be subject to the tax, the associate will also need to have been an associate of a director, and the director a director of the company, either:

- when that company was due to pay the withheld amounts to the Commissioner but failed to do so (in full); or

- after the unpaid withholding amount became due if, 30 days later, the director is still a director and the overdue PAYG withholding remains unpaid. In the case of new directors, the associate will need to have been an associate of the director for the full 30-day period.

Importantly, merely being an associate of a director will not mean that an individual is liable to pay the tax. Two alternative tests will determine their liability. The first test will be met if the Commissioner is satisfied that, due to the associate's relationship with the director or their relationship with the company, the associate knew, or could reasonably be expected to have known, that the company had failed to pay amounts withheld to the Commissioner. The Commissioner will also need to be satisfied that the associate did not (among other things) take reasonable steps to influence the director to cause the company to notify the Commissioner about the amount withheld, or take reasonable steps to influence the director to cause the company to pay the withheld amounts to the Commissioner, etc. Note also that an associate is not required to be actively involved in the company's finances to be liable.

As an alternative, the second test of an associate's liability will be met if, where the associate was an employee of the company, the Commissioner is satisfied that the associate was treated more favourably than other company employees. Whether there is more favourable treatment will depend on the circumstances of each case.

The amount of tax payable by the associate will be the same as for a director (see above).

Recovering unpaid PAYG withholding non-compliance tax

If a director or their associate is liable to pay PAYG withholding non-compliance tax, or GIC, and they have failed to do so, the Commissioner will only be able to commence proceedings to recover the tax after issuing a notice to the individual. A notice will be taken to be conclusive evidence of the making of the notice and that the amount and all particulars of the notice are correct, subject to objection and review proceedings under Pt IVC of the TAA.

A company will be able to pay some or all of its PAYG withholding liability after the individual director or an individual associate of the director has become liable to pay an amount of PAYG withholding non-compliance tax. Note that in accordance with existing law, the credit or credits will be able to be offset against existing debts, such as a PAYG withholding non-compliance tax debt. Alternatively, if their PAYG withholding non-compliance tax has been paid, it may entitle the individual to a refund.

Notices issued for the purpose of enabling the Commissioner to collect the PAYG withholding non-compliance tax will only be able to be issued no later than two years after the notice of assessment for the individual's income tax for that income year is issued. A director or an associate who receives a notice enabling the Commissioner to recover an amount of PAYG withholding non-compliance tax will be able to object against the decision.

Date of effect

Broadly, these amendments will commence on the day on which this Bill receives Royal Assent.

Other amendments

Other important amendments contained in the No. 2 Bill include the following:

- ***Consolidation tax cost setting rules*** – the Bill will amend the ITAA 1997 to modify the consolidation tax cost setting and rights to future income rules so that the tax outcomes for consolidated groups are more consistent with the tax outcomes that arise when assets are acquired outside the consolidation regime. Proposed date of effect: various, depending on acquisition time.

- ***TOFA consolidation interaction and transitional provisions*** – the Bill will amend the TOFA consolidation interaction provisions in the ITAA 1997 and the transitional provisions in the TOFA Act. The purpose of the amendments is to ensure that the tax treatment of financial arrangements that are part of a joining/consolidation event is consistent with the TOFA tax timing rules and that the tax treatment of liabilities that are, or are part of, a financial arrangement takes into account changes in the value of the liability other than the repayment of the liability. Proposed date of effect: various.

Sources: Tax Laws Amendment (2012 Measures No. 2) Bill 2012, www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4834

Pay As You Go Withholding Non-compliance Tax Bill 2012, www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4829

Minors and low income tax offset changes

The ***Tax Laws Amendment (2012 Measures No. 3) Bill 2012*** was introduced into the House of Representatives on 24 May 2012.

The Bill will amend the *Income Tax Assessment Act 1936* (ITAA 1936) to ensure that a trustee who is assessed on the income of a minor will not have access to the low income tax offset (LITO) in circumstances where the income is considered to be unearned income of that minor.

The amendment implements the 2011–2012 Budget announcement that the Government will bring to an end the ability of minors (children under 18 years of age) to access the LITO to reduce the tax payable on their "unearned income" such as dividends, interest, rent, royalties and other income from property. The proposal was designed to discourage income splitting between adults and children, including through the use of trusts.

The Bill will insert new subpara (6) into s 159N of the ITAA 1936. This will provide that a trustee who is liable to be assessed under s 98 of the ITAA 1936 in respect of a share of the net income of a trust estate in respect of a beneficiary is not entitled to a rebate of tax under s 159N to the extent that Div 6AA of Pt III of the ITAA 1936 (ie the legislation dealing with unearned income of minors) applies to that share.

According to the Government, these amendments will ensure that the policy objective of restricting the availability of the LITO for unearned income of minors is properly applied in respect of trustee tax assessments.

Date of effect

The proposed amendments will apply to assessments for the 2011–2012 and later income years.

Other amendments

Other important amendments contained in the No. 3 Bill include the following:

- ***Employment termination payment (ETP) tax offset*** – the Bill will amend the ITAA 1997 so that access to the ETP tax offset and the amount of offset received will take into account an individual's taxable ETP as well as any other taxable income in the year they receive the ETP. From 1 July 2012, any taxable component of an ETP that takes a person's total taxable income in a year above $180,000 will be taxed at marginal rates. This amendment implements the 2012 Budget announcement to limit the availability of the ETP tax offset. Proposed date of effect: 1 July 2012.

- ***Clean energy payments*** – the Bill will amend the ITAA 1997 to provide an income tax exemption for clean energy payments made to recipients of payments under the ABSTUDY scheme, Veterans' Children Education Scheme and Military Rehabilitation and Compensation Act Education and Training Scheme, the transitional farm family payment and exceptional circumstances relief payment. Proposed date of effect: will apply to assessments for the 2011–2012 and later income years.

- ***Seasonal Labour Mobility Program*** – the Bill will create a new final withholding tax regime that applies to income derived by non-resident workers participating in the Seasonal Labour Mobility Program. The formal imposition of income tax, and the establishment of the applicable rate of tax, is provided for by means of the ***Income Tax (Seasonal Labour Mobility Program Withholding Tax) Bill 2012***, which was also introduced into the House of Representatives on 24 May 2012. Proposed date of effect: 1 July 2012.

- ***Taxation of blends of gaseous and aviation fuels*** – the Bill will amend the *Excise Act 1901* so that blends of the same types of gaseous fuels or the same types of aviation fuels, where each amount of the gaseous fuel or aviation fuel has been taxed at a different rate as a result of time-related excise phase-in arrangements or time-related carbon price changes, will not be treated as excise manufacture and therefore subject to additional duty. Proposed date of effect: 1 July 2012.

Source: Tax Laws Amendment (2012 Measures No. 3) Bill 2012, www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4831

Non-resident tax rate increases on the way

The ***Tax Laws Amendment (Income Tax Rates) Bill 2012*** was introduced into the House of Representatives on 24 May 2012. This will amend the *Income Tax Rates Act 1986* (Rates Act) to align the personal income tax rates for non-residents for Australian tax purposes more closely with the personal income tax rates for Australian resident taxpayers, by:

- merging the first two personal marginal tax rate thresholds for non-residents into a single threshold; and

- aligning the rate for this new threshold to the second marginal tax rate for residents (32.5% from 1 July 2012, increasing to 33% from 1 July 2015).

This follows the changes to resident tax rates that have been made by the *Clean Energy (Income Tax Rates Amendments) Act 2011.* This included raising the tax-free threshold and increasing the second marginal tax rate for residents to 32.5% from 1 July 2012 and again to 33% from 1 July 2015.

The current tax rates for non-residents are:

Non-residents: 2011–2012 income year	
Taxable income ($)	**Tax payable**
0 – 37,000 37,001 – 80,000 80,001 – 180,000 180,001+	29% $10,730 + 30% of excess over 37,000 $26,630 + 37% of excess over 80,000 $63,630 + 45% of excess over 180,000

As a result of the proposed changes, the tax rates for non-residents that will apply for the next three income years are:

Non-residents: 2012–2013, 2013–2014 and 2014–2015 income years	
Taxable income ($)	**Tax payable**
0 – 80,000 80,001 – 180,000 180,001+	$32.5% $26,000 + 37% of excess over 80,000 $63,000 + 45% of excess over 180,000

The rates that will apply from the 2015–2016 income year onwards are:

Non-residents: 2015–2016 and later income years	
Taxable income ($)	**Tax payable**
0 – 80,000 80,001 – 180,000 180,001+	$33% $26,400 + 37% of excess over 80,000 $63,400 + 45% of excess over 180,000

Non-resident minors

The Bill will also amend ss 15(2) and 15(4) of the Rates Act so that the income tax rates for non-resident minors are consistent with the amendments to the non-resident rates. The practical effect of these amendments will be that where the taxable income of a non-resident minor:

- does not exceed $416, the amount of tax payable in respect of that income shall not exceed: (i) 32.5% of that eligible taxable income in the 2012–2013, 2013–2014 and 2014–2015 income years; and (ii) 33% of that eligible taxable income in the 2015–2016 and later income years; and
- exceeds $416 but does not exceed $732, the amount of tax payable in respect of that income shall not exceed: (i) the sum of 32.5% of $416 and 66% of the amount by which that eligible taxable income exceeds $416 in the 2012–2013, 2013–2014 and 2014–2015 income years; and (ii) the sum of 33% of $416 and 66% of the amount by which that eligible taxable income exceeds $416 in the 2015–2016 and later income years.

As a result of the proposed changes, the tax rates for non-resident minors that will apply for the next three income years are:

Non-resident minors: 2012–2013, 2013–2014 and 2014–2015 income years	
Div 6AA income ($)	**Tax payable**
0 – 416 417 – 732 733+	32.5% of entire amount $135.20 + 66% of excess over $416 45% of entire amount

The rates that will apply from the 2015–2016 income year onwards are:

Non-resident minors: 2015–2016 and later income years	
Div 6AA income ($)	**Tax payable**
0 – 416 417 – 732 733+	33% of entire amount $137.28 + 66% of excess over $416 45% of entire amount

Date of effect

These changes will apply for the 2012–2013 and later income years.

Source: Tax Laws Amendment (Income Tax Rates) Bill 2012, www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4816

Commissioner's new power to withhold refunds

The ***Tax and Superannuation Laws Amendment (2012 Measures No. 1) Bill 2012*** was introduced into the House of Representatives on 1 March 2012. It will amend the TAA to provide the Commissioner with a legislative discretion to withhold entitlements to "high risk" refunds pending refund integrity checks of a taxpayer's claim.

This will apply to all refunds and payments arising under taxation laws that the Commissioner administers (eg income tax, GST, etc). The discretion will be contained in a proposed new section (s 8AAZLGA) of the TAA.

The proposed changes have been introduced in response to the Full Federal Court's decision in *FCT v Multiflex* (2011) 197 FCR 580, which involved a dispute as to whether the Commissioner was required to pay a GST refund to a taxpayer who was being audited. In that decision, the Court dismissed the Commissioner's appeal and upheld the Federal Court's earlier order to issue a writ of mandamus, directing the Commissioner to comply with s 35-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and s 8AAZLF of the TAA by immediately paying the taxpayer the net amount notified in its GST return. The High Court later refused the Commissioner's application for special leave to appeal.

The Government has said the amendments seek to restore the Commissioner's previous administrative practice of retaining certain refunds for verification prior to payment "to protect the integrity of the tax system". There is currently no legislative provision that allows the Commissioner to retain a refund to check the validity of a claim, even if the Commissioner suspects it might be incorrect. The proposed amendments will change that by providing the Commissioner with a legislative discretion to retain a refund.

Key features of the proposed changes include the following:

- The Commissioner will be required to pay a refund that a taxpayer is entitled to under a taxation law within the time it takes to undertake the necessary administrative steps to process the taxpayer's return and make the payment.

- The Commissioner will be given a legislative discretion to retain an amount for verification purposes, consistent with the Commissioner's administrative practice prior to the decision in *Multiflex*. These amendments will operate in conjunction with s 8AAZLF, which provides that the Commissioner has an upfront obligation to pay a running balance account surplus or credit.

- The discretion is intended to allow the Commissioner to consider the correctness of the information provided by the taxpayer before refunding an amount the Commissioner would otherwise have to refund. It is not intended that the Commissioner use this discretion to withhold a refund where the Commissioner and the taxpayer merely disagree about how the law applies to the facts.

- In circumstances where it would be reasonable to require verification of information provided by the taxpayer relating to an amount that the Commissioner would otherwise have to refund, the Commissioner will be able to retain the refund for the purposes of verifying the information.

- The Commissioner will also be able to retain an amount if the taxpayer requests that the Commissioner retain the amount for verification purposes.

- In deciding whether to retain the amount, the Commissioner will need to have regard to a number of factors, including, but not limited to, the impact on the entity's financial position (eg the impact on the taxpayer's immediate cash flow, solvency and borrowing needs), the impact on the revenue and the likelihood that there is fraud or evasion or intentional disregard or recklessness as to the operation of a taxation law. It should be noted that no single factor will be determinative and the applicability of each factor will depend on the specific circumstances of each case.

- If the Commissioner wishes to retain the amount beyond an initial period of time (generally 14 or 30 days), the Commissioner will need to inform the taxpayer before that period ends. The continued retention of the amount after this period will also be subject to the same objective test of reasonableness.

- If the Commissioner decides to retain an amount, he will be required to inform the taxpayer: (i) in the case of a running balance account surplus, by the running balance account interest day (which will generally be 14 days after giving the Commissioner the notified information); or (ii) for other credits, within 30 days of the taxpayer giving the Commissioner a notice containing the amount claimed.

- The Commissioner will be able to satisfy his obligation to inform in a number of ways, including by telephone, electronic mail or post. If the Commissioner is unable to contact the taxpayer, he will be taken to have satisfied the obligation to inform by serving a document to the taxpayer's preferred address for service in accordance with Pt 2A of the *Taxation Administration Regulations 1976*.

- If the Commissioner fails to inform the taxpayer that he is retaining an amount under s 8AAZLGA by the specified day, he will need to refund the amount to the taxpayer on the day after that date.

- Taxpayers will be able to object to the Commissioner's decision to retain a refund if the Commissioner has not refunded the amount, made an assessment under Div 105 in Sch 1 to the TAA or otherwise amended the assessment giving rise to the refund entitlement after a set period of time.

Date of effect

These amendments are proposed to take effect from the date of Royal Assent.

Other amendments

Other important amendments contained in the Bill include the following:

- ***GST-free health supplies*** – the Bill will amend the GST Act to ensure that a supply made by a health care provider to an insurer, a statutory compensation scheme operator, a compulsory third party scheme operator or a government entity is treated as a GST-free supply to the extent that the underlying supply from the health care provider to an individual is a GST-free health supply. Proposed date of effect: 1 July 2012.

- ***GST treatment of appropriations*** – the Bill will amend the GST Act to restore the policy intent that the non-commercial activities of government-related entities are not subject to GST. Proposed date of effect: 1 July 2012.

- ***Indexation of super concessional contributions cap*** – the Bill will amend the ITAA 1997 to temporarily pause the indexation of the superannuation concessional contributions cap so that it will remain fixed at $25,000 up to and including the 2013–2014 financial year. Proposed date of effect: 1 July 2013.

- ***Super – refund of excess contributions*** – the Bill will amend the ITAA 1997, the *Superannuation (Government Co-contribution for Low Income Earners) Act 2003*, the TAA and the *Taxation (Interest on Overpayments and Early Payments) Act 1983* to allow eligible individuals the option of effectively having excess concessional contributions of up to $10,000 refunded to them. However, if the refund is accepted, the excess concessional contributions will be assessed as income for the year of the excess contributions (rather than the individual paying excess contributions tax). Proposed date of effect: these amendments will apply to excess concessional contributions of an eligible individual for the 2011–2012 and later financial years.

- ***Disclosure of superannuation information*** – the Bill will make amendments to permit the ATO to disclose details of an individual's superannuation interests and superannuation benefits to a regulated superannuation fund or public sector superannuation scheme, an approved deposit fund, retirement savings account (RSA) provider or their administrators. Proposed date of effect: from the date of Royal Assent.

- ***Super – payslip reporting*** – the Bill will amend the *Supervision Industry (Supervision) Act 1993* to require employers to report, on payslips, any information prescribed in the regulations about superannuation contributions. Regulations to be made will in turn require employers to report the amount of superannuation contributions, as well as the date on which the employer expects to pay them. Proposed date of effect: the amendments will apply to contributions accrued after the date of proclamation. In the absence of a proclamation, the amendments will commence 12 months after Royal Assent.

Source: Tax and Superannuation Laws Amendment (2012 Measures No. 1) Bill 2012, www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4761

Living-away-from-home concessions to be tightened

The Government has released draft legislation for its proposed reform of living-away-from-home allowances (LAFHAs) and benefits as announced in the 2011–2012 Mid-Year Economic and Fiscal Outlook and in the 2012–2013 Federal Budget. Public consultation closed on 29 May 2012.

Overview

The draft legislation will amend the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) and *the Income Tax Assessment Act 1997* (ITAA 1997) to reform the taxation treatment of LAFHAs and benefits. This will:

- treat a LAFHA as part of an employee's assessable income rather than as a fringe benefit;

- better target the concessional treatment by allowing a deduction: (a) to employees who maintain a home in Australia for their own personal use and enjoyment at all times while required to live away from home for their work; (b) for reasonable expenses incurred and substantiated for accommodation and food beyond a statutory amount; and (c) for a maximum period of 12 months in respect of an individual employee for a particular work location; and

- tax employers on living-away-from-home (LAFH) fringe benefits (direct provision of accommodation and food) provided to employees who would not be eligible to claim an income tax deduction had they incurred the expenses directly.

However, the proposed measures will not affect:

- the tax concession for "fly-in fly-out" arrangements, as these employees will not be subject to the 12-month time limit; or
- the tax treatment of travel and meal allowances, which are provided to employees who have to travel from their usual place of work for short periods (generally up to 21 days).

Current position

The payment of a LAFHA is currently taxed as a fringe benefit under the FBT law. The Government regards the proposed amendments as necessary because the current law is being interpreted broadly and the concessions are now being widely exploited in a manner inconsistent with the original policy intent.

How LAFHAs and LAFH benefits will be taxed

Under the proposed reforms, LAFHAs will be treated the same as other allowances, ie as assessable income under the ITAA 1997. Allowances will be included as assessable income of the recipient under either s 6-5 as ordinary income or under s 15-2. This treatment will also apply to allowances paid to oil and gas rig workers as described in s 30(2) of the FBTAA.

Employers will be taxed on LAFH fringe benefits (direct provision of accommodation and food). The taxable value of these benefits will be determined under the usual FBT rules in Div 5 for expense payment fringe benefits, in Div 11 for property fringe benefits and in Div 12 for residual fringe benefits. Further, if an employee would have met the conditions in the income tax law for claiming a deduction for LAFH benefits (see below), their employer will be able to reduce the taxable value of the fringe benefits because of the operation of the otherwise deductible rule.

Deduction for LAFH expenses

An employee will be able to claim a deduction for accommodation and food and drink expenses incurred when living away from home in the following circumstances:

- they are required by their employer to live away from their usual place of residence in Australia to perform the duties of their employment. An employee will not be able to move to a location and subsequently find employment and then claim to be living away from home;
- the employee’s usual place of residence in Australia in which the employee (or their spouse) has an ownership interest continues to be available for their use and enjoyment all times while they are living away from it;
- the expense on accommodation or food or drink is for the employee or their spouse or child; and
- it is reasonable to expect that the employee will return to their usual place of residence upon completion of the job.

Meaning of "usual place of residence"

Importantly, "usual place of residence" will take on its ordinary meaning. However, it must be a residence in which the employee or the employee's spouse has an ownership interest, ie it is either owned or leased by the employee or the employee's spouse. This could include a caravan, provided it is a permanent place of residence.

It is important to note that adult children living in the family home typically do not have an ownership interest in the dwelling. Therefore, such employees who move from the family home to work interstate will not be entitled to a LAFH deduction.

Reasonableness

An employee who meets the requirements outlined above will be eligible to claim a deduction for food and drink and accommodation expenses incurred while living away from their usual place of residence. However, the expenses are only deductible to the extent they are reasonable.

Substantiation requirements

To be able to claim accommodation and food expenses, certain substantiation requirements will need to be met. The expenditure on food and accommodation needs to be substantiated by the employee by obtaining written evidence in accordance with Subdiv 900-E of the ITAA 1997.

Written evidence for accommodation expenses could include a lease agreement, mortgage document or receipts for accommodation. Written evidence for food and drink would be the receipts for expenses actually incurred.

To minimise the cost of compliance for employees, substantiation will not be required for food expenses unless the expenses exceed an amount specified in a determination by the Commissioner. However, if employees claim amounts in excess of the specified amount, the full amount will need to be substantiated.

Time limit for LAFH deduction

An employee will only be able claim a deduction for accommodation or food expenses for the first 12 months that their employer requires them to live away from their usual place of residence in Australia for their employment. However, the 12-month limitation does not apply to fly-in fly-out workers.

Date of effect

The measures are proposed to apply from 1 July 2012.

Transitional rules will apply to ***permanent residents*** who had employment arrangements for LAFHAs and LAFH benefits in place prior to 7:30 pm (AEST) on 8 May 2012. These employees will not be required to maintain a home in Australia and the concession will not be limited to a maximum of 12 months until the earlier of 1 July 2014 or the date a new employment contract is entered into, but not so as to give anyone an additional 12 months after the transitional arrangements end.

Transitional rules will also apply to ***temporary residents*** who are maintaining a home in Australia and who had employment arrangements for LAFHAs and LAFH benefits in place prior to 7:30 pm (AEST) on 8 May 2012. The 12-month limitation will not apply to temporary residents or foreign residents maintaining a home in Australia until the earlier of 1 July 2014 or the date a new employment arrangement is entered into, but not so as to give anyone an additional 12 months after the transitional arrangements end.

Sources: Treasury exposure draft of legislation, "Fringe Benefits Tax (FBT) Reform living-away-from-home benefits", 15 May 2012 www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Fringe-Benefits-Tax-FBT-Reform-living-away-from-home-benefits

Assistant Treasurer's media release No 029, 15 May 2012, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/029.htm&pageID=003&min=djba&Year=&DocType=0