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Public Accountants and Registered Tax Agent

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Tax returns and The Taxman

Although the shoebox has (hopefully) been relegated to the pages of quaint tax history, the principle of taxpayers needing to keep adequate records and receipts lives on. But the better organised and ordered tax recordkeeping is, the better a tax agent or accountant will be able to do what they do best — to make the most out of a client's financial circumstances and work effectively towards a better tax outcome.

For taxpayers expecting a refund, or who have their fingers crossed for one, the sooner they get organised the sooner they will see the money. But as the government has withdrawn its proposal to allow a no-questions-asked "standard deduction" for work-related expenses, taxpayers are still expected to be able to back up claims for deductions (if claims are for more than $300, although the Tax Office will still expect there to be a justifiable basis for lesser claims).

The basic rule is that claims can be made for expenses incurred as part and parcel of earning assessable income. There are limited exceptions, which is where the expertise of a tax agent or accountant will quickly sort out what is allowable or not. But proof of expenditure is necessary, and this is where good record-keeping practices are essential. And remember, although a taxpayer may be getting essential help and advice from their accountant or tax agent, the ultimate responsibility, and liability, rests with taxpayers themselves.

On the ATO radar

Professions. The Tax Office has singled out certain professions for greater scrutiny for claims made for the 2011-12 income year. Its compliance program singled out deductions claimed by people employed as earthmovers, flight attendants, carpenters and joiners (including apprentices) and real estate employees. It says these occupations have been found to be at higher risk of making deduction errors, so anyone falling into one of these categories needs to be sure of the work-related expenses they are entitled to claim.

For 2012-13, it says it will double-check deductions made by people employed as plumbers, information technology (IT) managers, coffee shop proprietors, plasterers and non-commissioned Defence Force personnel. A further problem it will focus on is the blurring of the distinction between the status of employee or contractor (for workers in the industries where contracting is prevalent). It should be noted however that even though these areas are flagged for attention over the income year ahead, it is not uncommon for the Tax Office to scrutinise the current batch of tax returns for similar problems.

Data matching. Of course a large part of the Tax Office's compliance armoury is its use of data matching, which as its name suggests involves comparing information that

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About this newsletter

Welcome to Geoffrey Cliff & Associates' client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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it has been given by taxpayers with data that others hold. Sources of third party information include banks and financial institutions, which are required by law to pass on information, as well as welfare organisations and of course employers. The list includes Centrelink, WorkCover, land title offices and planning authorities, property title transfers, tenancy agreements, share registers, managed investment funds, building contractors – and many more.

This can help identify people who appear to be living beyond their means – where their reported income is inconsistent with their spending. The Tax Office for example can compare a person's reported income to information from government licensing bodies for luxury cars or boats.

Superannuation. Another hotspot for Tax Office scrutiny will be over-contributing to superannuation. The contribution caps were made a lot tighter from July 1, 2012, and a last-minute rush to boost superannuation before the cap was lowered could well have put many pre-retirees in danger of over-contributing for the 2011-12 year. The Tax Office seems to be taking a hard line on super contribution caps, so if calculations were incorrect, or the contributions were recorded by the super fund after deadline (not helped this year by June 30 being a Saturday), the ensuing excess contributions tax can be punishing. One saving grace is the recently legislated ability to have any inadvertent over-contribution amounts reallocated to ordinary assessable income (up to a value of $10,000, available once-only, and only for concessional contributions).

Split loan arrangements — a combination of an investment loan, a home mortgage and a credit facility — are also in the taxman's sights. These schemes have been promoted as "mortgage management plans", and are marketed as a way to pay off one's home loan faster. But the Tax Office takes the view that these schemes are essentially a tax avoidance mechanism and has stated that interest deductions relating to split loan arrangements may be denied after a surge in such schemes last financial year.

Share dividend income is also under scrutiny, as the Tax Office reports a growth in investment tax return mistakes over recent years. But as with all of the above, keeping adequate records will give tax agents the best chance to keep tax returns compliant. Include records of reinvested dividends, bonus share details, any gifting (in or out) of equities or inherited shares.

Rental property. Statistics have also exposed rental property loss claims as a growing concern, therefore expect the Tax Office to keep a close eye on these. Remember the purchase cost of land bought on which to construct a rental property is not deductible, but forms part of the cost base for capital gains calculations, as are initial repairs carried out to a property in order to lease it out. Again, it is advisable to keep all records of transactions to do with rental property.

Penalties

Giving a tax agent all the relevant facts will certainly help ensure taxpayers stay on the right side of the tax laws. But should anyone's tax affairs stray from the straight and narrow, the penalties can be onerous. While there are several categories of tax misdemeanours, and various levels of fines applied, the general (but not the only) method of determining the penalty is to base this on an allocation of "penalty units".

Currently a penalty unit is given a value of $110, and depending on the "crime" a multiple of units may be assigned. For example, not retaining required records can invite a 20-unit penalty; not providing access to a tax officer may cost another 20 units, or not paying an amount electronically on time could be hit with a five-unit penalty. The penalty for failing to lodge a tax return is also made worse by the passage of time it is overdue, as it has more units added after 28 days overdue, more after 56 days and so on. Interest can also be charged on penalty amounts.

Documentation checklist

Depending on financial circumstances, here is a checklist of the sort of paperwork that may be needed to ensure tax agents are given a smoother tax return task:

- ✓ PAYG summaries, or Centrelink statements if any. Include any foreign sourced income
- ✓ Eligible termination PAYG summary for superannuation and redundancy payments
- ✓ Details of all bank interest, including any withholding tax; also provide branch, BSB and account number
- ✓ Dividend distribution payment advices (generally two each year), trust distribution statements and/or deceased estate payments

- ✓ Purchase and/or sale documentation regarding assets for capital gains calculations (shares, rental property, land, trust units etc)
- ✓ Rental property income and expense details, including loan and agent statements
- ✓ If claiming motor vehicle expenses, logbook or diary of business travel undertaken. If logbook, include speedo reading at June 30. If not claiming a rate per kilometre, include details of all expenses (repairs, lease or loan payments, registration, insurance, fuel etc)
- ✓ Details of work-related expenses (professional subscriptions, travel, self education, journals, stationery, friendly tax agent's fee etc). Capital items costing more than $300 each require date of purchase and description
- ✓ Home office expenses; include size of office (eg one room of 10sqm in a 200sqm house), or claim using 34-cents per hour (ask our office for details on this) with a log recording one month's data
- ✓ All gifts and donations made
- ✓ Medical out-of-pocket expenses over $2,060 for the 2011-12 year
- ✓ Partner's income (include Centrelink statement for family payments, child support, and tax-free pensions)
- ✓ Private health insurance statement for year ended June 30, 2012.

While much of the above will apply to individuals and sole traders, business-specific records may also include details of PAYG paid and copies of income and business activity statements. ■

Resident or non-resident: What's the difference?

The Tax Office views "residency" in an entirely different way to other Australian governmental agencies that deal with things like immigration, visas and citizenship. An individual will be an Australian resident for tax purposes if they "reside" in Australia, adopting the ordinary meaning of the term, or satisfy at least one of the three statutory tests. These are:

- **Domicile test.** The person's domicile is in Australia unless the Commissioner of Taxation is satisfied that the person's permanent place of abode is outside Australia
- **The 183 day test.** The person is present in Australia for at least 183 days in an income year, unless the person's usual place of abode is outside Australia and they do not intend to take up residence in this country
- **Commonwealth superannuation fund test.** The person is a contributing member of the fund for Commonwealth government officers.

The term "reside" is defined in the Oxford dictionary as "*to dwell permanently, or for a considerable time, to have one's settled or usual abode, to live in a particular place*". The Commissioner considers that the length of time a person is present in Australia is not in itself determinative (although it can be a factor), however weight is given to evidence of continuity, routine or habit consistent with someone who resides in Australia. In tax ruling TR 98/17 the factors the Tax Office says it typically gives weight to are:

- intention or purpose of presence
- family and business/employment ties
- maintenance and location of assets, and
- social and living arrangements.

The ruling also states that patterns over a six month period (or rather 50% of a financial year, or 183 days) is generally sufficient to determine whether behaviour is consistent with being a resident. Overall however, while there are many ways of determining if your personal situation makes you a "resident" or a "non-resident", you will be an Australian resident for tax purposes if you:

- have always lived in Australia
- have moved to Australia to live here permanently
- have been in Australia for more than half of the financial year (unless your usual home is overseas and you do not intend to live in Australia), and
- have been in Australia continuously for six months or more and your usual place of abode is in Australia.

Advantages and disadvantages

The main difference in tax status is that non-residents are not eligible for the tax-free threshold, so income is taxed right from the first dollar. For the 2012-13 year, there is no incremental tax rate up to $80,000 income but a straight-up rate of 32.5%, although thereafter

the rates equal Australian resident rates. (Tax rates for 2011-12 were 29% up to $37,000, 30% to $80,000, thereafter equal to resident rates.)

Non-residents do not pay the Medicare levy (and therefore cannot claim Medicare benefits), and will have 10% of any interest earned from Australian bank accounts withheld for tax, subject to any "double taxation agreement" which may impose a different rate (see below). The interest is not included in assessable income, but a non-resident will need to provide an overseas address otherwise tax will be withheld at the much higher rate of 45%.

Non-residents can't claim to have tax reduced by way of schemes called "tax offsets" and various other support schemes available to residents, such as financial help for children's schooling expenses, family payments, help with healthcare and so on. Also some deductions available to Australian residents for expenses "incurred in earning income" may be unavailable to non-residents.

For example, a non-resident on a 457 visa who has moved to Australia from overseas typically won't be able to access (from October 1, 2012) the Living Away From Home Allowance concessions, which are more readily available to resident taxpayers.

Coming here

A non-resident may have the right visas and permissions to work, but another administrative necessity is to have a tax file number (TFN). This is an important requirement for everything to do with Australian tax, but is also necessary for another significant reason; if you don't have a TFN, tax will be deducted from your wages at the top tax rate.

And yet an individual may be a resident of Australia and of another country simultaneously, as Australia's "tax residency" tests are not affected by a taxpayer's residency status in another country. Australia has "double taxation agreements" with several countries, so that certain categories of workers pay tax on their own country's terms, such as self-employed professionals, teachers and those working for foreign companies that have a physical workplace in Australia.

Most double taxation agreements have residency "tie-breaker" rules, where a dual resident will be deemed to be solely a taxpaying resident of only one of the countries. Residency determinations should always include a check of whether a double taxation agreement with the other involved country is in place or not. Check with this office if you suspect this may be the case.

If a non-resident gets rental income from an Australian property, they will need to include this in their income tax return. But if the only income with an Australian source is in the form of interest from bank accounts, unfranked dividends or royalties, there will be no need to lodge an income tax return if withholding tax has been paid.

Temporary residents

The tax law exempts anyone qualifying as a "temporary resident" from Australian income tax on all ordinary and statutory income from a foreign source. The exemption does not apply to foreign employment

Summary of differences in residential status

Resident for tax purposes	Non-resident for tax purposes
Reduced tax rates at lower income levels	Pays tax on every dollar (no tax-free threshold)
Taxed on global income	Only taxed on Australian sourced income
Pays Medicare levy (can claim on medical expenses)	No Medicare liability (can't make claims)
Interest income assessed at taxpayer's marginal tax rate	Interest taxed at flat 10%, or 45% if no overseas address (or TFN) provided
Liable for capital gains tax (CGT) on worldwide assets	CGT only on "taxable Australian property" (most commonly real property)
Tax offsets available and allowances such as LAFHA	No offsets, typically no LAFHA (limited exceptions for temporary residents)

income earned during a period of temporary residency here. Temporary residents are also treated as non-residents for capital gains tax purposes, with some slight exceptions (ask this office for more details if applicable to your situation). Further, they may also be exempt from the withholding tax provisions in respect of investment income.

A person is considered a temporary resident if they:

- hold a temporary visa under the Migration Act 1958 (where they are permitted to remain in the country for a specified time or until a specified event occurs)
- are not an Australian resident within the meaning of the social security provisions
- do not have a spouse who is an Australian resident.

There are no special income tax rates for temporary residents. A person who meets the requirements to be a temporary resident will be classified as such notwithstanding that they would have been classified as a resident under normal rules.

Going there

In cases where an Australian goes overseas for employment, even for some years, the maintenance or relinquishing of resident status very much depends on individual circumstances. In the case where an Australian takes up a post overseas but retains a domicile in Australia, the Tax Office is likely to consider that the taxpayer retains residency.

Should however the taxpayer rent out their home here, due to an extended time of overseas employment, the likely outcome could be that the Tax Office may consider them as a foreign resident for tax purposes. The outcomes are very much determined on a case-by-case basis.

Further consideration of the residency status of Australians going overseas will be touched upon in a future newsletter. ■

Get ready for your SMSF audit

Any mention of the word “audit” is likely to elicit a frustrated groan or a fearful shake of the head from many of us, but what self-managed superannuation fund (SMSF) trustees need to realise is an audit can be a good thing. As tedious as it may sound, an audit is useful in providing an overview of the status of your SMSF – including an assessment of the fund’s compliance as well as a report of the relevant contraventions, if any.

So when do these audits take place? SMSFs have to appoint an “approved auditor” at least 30 days before the due date of the SMSF annual return. An SMSF that is not a new entrant or that has outstanding previous year returns has a deadline of October 31 this year while newly registered SMSFs have to lodge by February 28 next year.

There is no rush as such to complete this audit but bear in mind – if any compliance contraventions are identified, the auditor should immediately alert the trustee who can then rectify these contraventions before the audit is finalised and lodged. That way, a trustee can avoid being penalised by the Tax Office or worse still, risk their fund being deemed non-compliant and losing its tax concessions. A handy tip of course is to check last year’s audit report to see what action, if any, was requested by the auditor.

Also, bear in mind that the Tax Office is homing in on three major areas under its SMSF compliance program for 2012 – non or late lodgements, compliance breaches without an auditor contravention report, and unrectified auditor contravention reports. And of all offences, the Tax Office says failure to lodge an annual return is most prevalent.

If trustees have gone through past actions and rectified them, below is a list of what else the Tax Office may be looking out for:

1. Sole purpose test

SMSFs are only eligible for the tax concessions they currently enjoy because of the sole purpose test. To adhere to this test, SMSFs need to be maintained solely to provide retirement benefits to their members, or their dependants if a member dies before retirement.

The Tax Office says the most common breaches of the sole purpose test are:

- investments that offer a pre-retirement benefit to a member or associate
- providing financial help or a pre-retirement benefit to someone, to the financial detriment of a fund.

By way of example, a breach of the sole purpose test would occur if SMSF members use, or have direct access to, collectables such as art or wine held by the fund.

To further determine if an SMSF has breached the sole purpose test, an auditor will look at:

- the SMSF's trust deed, and
- the character and purpose of the SMSF's investments to check that investment arrangements do not provide prohibited financial assistance and that trustees, family and friends are not given access to fund assets for private use.

2. Investments

Preparing an investment strategy is one of the key tasks that SMSF trustees need to complete. There is no right way to prepare a strategy; rather it is unique to your approach to investment and risk. That aside, there are common pitfalls that the Tax Office looks out for, so trustees should check that they have:

- not provided financial assistance to a member or relative using resources of the fund
- not intentionally acquired assets from related parties of the fund (unless they are listed securities, business real property or in-house assets up to the 5% limit)
- all investments revalued to current market value so it is ready for the auditor (this is typically done by June 30 each year)
- purchased and sold assets at a fair market value and that money was actually paid by looking at their valuation reports and bank statements
- made and maintained all investment transactions at arm's length
- drawn up a formal lease agreement, where applicable
- made certain that all SMSF investments – bank accounts, shares, unit trusts – are appropriately registered in the name of the trustees of the fund.

The auditor may ask for a land title search for any property held by the fund so prepare by locating the Lot and DP numbers so they are ready in time for the audit. Also collate all insurance policy documents for the auditor to show that assets of the SMSF are appropriately insured and take the time to review all policies to ensure sufficient cover is in place.

3. Separation of assets

A basic rule for SMSF trustees is that they have to keep their SMSF money and other assets separate from all personal money and assets belonging to them – effectively operating a separate bank account for the SMSF and manage all investments, income and expenses in the name of the fund. Trustees are urged to keep appropriate records and pay meticulous attention to details to avoid a breach.

4. Contributions

Trustees can make concessional and non-concessional contributions or can take advantage of the government's co-contribution scheme. However, make sure any member over 65 has met the work test if they have made contributions to the fund. If a fund member fails to meet the work test, the trustees have only 30 days to refund the contributions received

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Clarification: Fuel tax; concessional contributions cap change

In our June 2012 edition, a production error was made in relation to the fuel tax rise and further clarification was sought regarding the wording of the changes in the concessional contributions cap, both of which were contained in our article *Changes from July 1, 2012*.

- The Road User Charge – collected by the government from fuel which is used by registered vehicles with a gross mass of greater than 4.5 tonnes operating on a public road for business purposes – will increase from 23.1 cents to 25.5 cents per litre. This will reduce the fuel tax credit paid to eligible heavy vehicle operators from 15.043 cents to 12.643 cents.
- 2012-13 concessional contributions cap changes from $50,000 to $25,000 for individuals aged 50 and over to align with the contributions cap of everyone else. The government has deferred the higher concessional contributions cap of $50,000 for individuals aged 50 and over with superannuation balances of less than $500,000 from July 1, 2012 to July 1, 2014.

We apologise for any inconvenience caused and hope this clears up any confusion regarding the two matters. ■

by the fund. If not refunded within the time limit, a breach has occurred and may result in an auditor contravention report.

5. Administrative obligations

Trustees may be surprised to learn that as important as the responsibilities above is the duty of keeping proper and accurate records. Under super laws, SMSF trustees must document and take minutes of all decisions concerning the operation of their fund. Below is what trustees should keep aside in case their auditor needs to have a look at them:

- minutes of all meetings for a minimum of 10 years or since the establishment of the fund if the fund is less than 10 years old with details of all major decisions made including asset purchases, commencement of pensions, appointment of new members and review of investment strategy
- accounting records for a minimum of five years or since the establishment of the fund if the fund is less than five years old
- signed trustee declarations for trustees who became members of the fund after July 1, 2007
- proper accounting records in a statement of financial position and an operating statement
- copy of trust deed
- election or notice to be a regulated fund
- current audit engagement letter
- trustee representation letter
- investment strategy that gives consideration to risk, return, liquidity and diversification
- financial report on the fund
- working papers including copies of all relevant documents that are important in providing evidence that support your findings and opinion
- management letter or completed audit finalisation report.

The list above is not a complete guide on how trustees can prepare for their SMSF audit, so consult this office for more information. ■

Emergency money from your super fund: The rules

Compassionate reasons can serve as grounds for withdrawing pre-retirement or preserved super to cover medical and related emergencies – but strict rules apply. Overseen by the Department of Human Services, the compassionate grounds benefit allows super to be withdrawn in one or more of five specific circumstances, after taking into account a member's financial capacity.

The member of a superannuation fund seeking funds under the compassionate grounds benefit provisions must provide proof that without access to money from their super fund, the specific expense could not be met.

The trust deeds of the super fund, whether that fund is an SMSF or private or industry fund, must also permit the payment of this type of benefit.

The special circumstances warranting early release of money from the super fund apply where:

- a member, or their dependant, requires medical or dental treatment. Certification is needed from two medical practitioners, including one specialist, that the treatment is essential to treat a life-threatening illness or injury, or to alleviate chronic pain or mental disturbance
- medical transport is required in order for the member or dependant to access the specified treatment. This also needs to be signed off by the same two medical practitioners
- it is needed to pay for a member's palliative care, or the palliative care, death, funeral or burial costs of a member's dependant
- home or car modifications are needed in the case of severe disability being suffered by the member or their dependant
- money is needed for mortgage repayments to prevent the forced sale of a home. Proof is required in the form of official notification from the lender that foreclosure is imminent. A maximum of three months' mortgage repayments and 12 months' interest on the outstanding loan balance can be made available.

Any tax payable will depend on the components of the benefits released, and may be tax-free if you are over preservation age. Release due to terminal illness has no age requirement and is tax-free. Check with our office for personalised advice. ■

SMSF related party off-market transfer ban delayed

Off-market transfers of certain assets, such as shares, between related parties and self-managed superannuation funds (SMSFs) will cease to be allowed under proposed changes to the law. However the start date of the ban has been moved from July 1, 2012 to one year later.

Frequently referred to as in-specie contributions, the government's move to ban non-market transactions that result in a contribution being made to an SMSF in the form of an asset came as a response to the growing trend of SMSF members making in-specie contributions of property into their SMSF. The practice has developed from the practicality of people not having spare cash but perhaps valuable assets they could contribute to their SMSF.

In-specie contributions however are generally made without (in the case of shares) actually selling and re-purchasing the securities on the open market (hence "off-market" transfers). Therefore the government has taken the view that these are not transparent and can be open to abuse through, for example, asset value manipulation to achieve more favourable capital gain outcomes.

However there are also problems with transfers made on-market, in that the Corporations Law disallows

the selling and immediately buying back of equities — known as "wash trades" — with serious penalties applied for breaching of these provisions.

Delaying the planned ban on off-market transfers may allow the government to come up with a legislative solution to the dichotomy that SMSFs would have otherwise had to work around. We will inform readers as more information comes to hand.

Apart from the delay to the ban on off-market transfers, the following table details other Stronger Super measures that have been deferred until next year. ■

Stronger Super recommendation	Announced start date	Amended start date
ATO should be provided with the power to issue administrative penalties against SMSF trustees	July 1, 2012	July 1, 2013
ATO should be provided with the power to issue relevant persons with a direction to rectify specified contraventions within a specified reasonable time	July 1, 2012	July 1, 2013
ATO should be given the power to enforce mandatory education for trustees who have contravened SIS legislation	July 1, 2012	July 1, 2013
The government should amend existing tax laws so that amounts illegally early released be taxed at the superannuation non-complying tax rate	July 1, 2012	July 1, 2013
Legislation should be passed to provide for criminal and civil sanctions to enable the ATO to penalise and discourage illegal early release scheme promoters	July 1, 2012	When the legislation receives royal assent

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