



## The Tax Commissioner's hit list

Every so often the Australian Taxation Office (ATO) sends a 'shot across the bow' warning taxpayers where their gaze is focussed. Last month in a speech to the National Press Club, Tax Commissioner Chris Jordan did exactly that. Part of the reason for this public outing is the gap between the amount of tax the ATO collects and the amount they think should be collected – a gap of well over 6% according to the Commissioner.

*"The risks of non-compliance highlighted by our gap research so far in this market are mainly around deductions, particularly work related expenses. The results of our random audits and risk-based audits are showing many errors and over-claiming for work related expenses – from legitimate mistakes and carelessness through to recklessness and fraud. In 2014-15, more than \$22 billion was claimed for work-related expenses. While each of the individual amounts over-claimed is relatively small, the sum and overall revenue impact for the population involved could be significant,"* the Commissioner stated.

### Individuals – the hit list

- Claims for work-related expenses that are unusually high relative to others across comparable industries and occupations;
- Excessive rental property expenses;
- Non-commercial rental income received for holiday homes;
- Interest deductions claimed for the private proportion of loans; and
- People who have registered for GST but are not actively carrying on a business.

While small in value, the ATO are also concerned about the amount of people who appear to be claiming deductions by default for items such as clothing expenses. In 2014–15, around 6.3 million people made a claim for \$150 for work related clothing - the level you can claim without having to fully substantiate your expenses. Those 6.3 million claims amounted to \$1.8 billion in deductions.

### Small business – the hit list

- Those deliberately hiding income or avoiding their obligations by failing to register, keep records and/or lodge accurately;
- Businesses that report outside of the small business benchmarks for their industry;
- Employers not deducting and/or not sending PAYG withholding amounts from employee wages;
- Employers not meeting their superannuation guarantee obligations;
- Businesses registered for GST but not actively carrying on a business;
- Failure to lodge activity statements; and
- Incorrect and under reporting of sales.

If your business is outside of the ATO's benchmarks, it's important to be prepared to defend why this is the case. This does not mean that your business is doing anything wrong, but it increases the possibility that the ATO will look more closely at your business and seek an explanation.

### Private groups – the hit list

- Tax or economic performance not comparable to similar businesses;
- A lack of transparency in tax affairs;
- Large, one-off or unusual transactions, including transfer or shifting of wealth;
- A history of aggressive tax planning;
- Choosing not to comply or regularly taking controversial interpretations of the law;
- Lifestyle not supported by after-tax income;
- Treating private assets as business assets; and
- Poor governance and risk-management systems.

### Property developers – the hit list

- Developers using their SMSF to undertake or fund the development and subdivision of properties leading to sale;
- Where there has been sale or disposal of property shortly after the completion of a subdivision and the amount is returned as a capital gain;
- Where there is a history in the wider economic group of property development or renovation sales, yet a current sale is returned as a capital gain;
- How profit is recognised where related entities undertake a development (i.e., on the development fees as well as sales of the completed development);
- Whether inflated deductions are being claimed for property developments;
- Multi-purpose developments - where units are retained for rent in a multi-unit apartment, to ensure that the costs are appropriately applied to the properties produced.

These are just a small sample of the ATO's area of focus. Other areas include tax and travel related expenses and self-education expenses. We'll guide you through the risk areas pertinent to your individual situation but if you are concerned about any of the 'hit list' areas mentioned, please contact us.

### Main residence exemption removed for non-residents

The Federal Budget announced that non-residents will no longer be able to access the main residence exemption for Capital Gains Tax (CGT) purposes from 9 May 2017 (Budget night).

# YOUR KNOWLEDGE



Now that the draft legislation has been released, more details are available about how this exclusion will work.

Under the new rules, the main residence exemption – the exemption that prevents your home being subject to CGT when you dispose of it – will not be available to non-residents. The draft legislation is very ‘black and white.’ If you are not an Australian resident for tax purposes at the time you dispose of the property, CGT will apply to any gain you made – this is in addition to the 12.5% withholding tax that applies to taxable Australian property with a value of \$750,000 or more (from 1 July 2017).

Transitional rules apply for non-residents affected by the changes if they owned the property on or before 9 May 2017, and dispose of the property by 30 June 2019. This gives non-residents time to sell their main residence (or former main residence) and obtain tax relief under the main residence rules if they choose.

Interestingly, the draft rules apply even if you were a resident for part of the time you owned the property. The measure applies if you are a non-resident when you dispose of the property regardless of your previous residency status. Special amendments are also being introduced to apply the new rules consistently to deceased estates and special disability trusts to ensure that property held by non-residents is excluded from the main residence exemption.

The rules have also been tightened for property held through companies or trusts to prevent complex structuring to get around the rules. The draft amends the application of CGT to non-residents when selling shares in a company or interests in a trust. The rules ensure that multiple layers of companies or trusts cannot be used to circumvent the 10% threshold that applies in order to determine whether membership interests in companies or trusts are classified as taxable Australian property.

*The residency tests to determine who is a resident for tax purposes can be complex and are often subjective. Please contact us if you would like to better understand your position and the tax implications of your residency status. Simply living in Australia does not make you a resident for tax purposes, particularly if you continue to have interests overseas.*

## What everyone selling a property valued at \$750k or more needs to know

Every vendor selling a property needs to prove that they are a resident of Australia for tax purposes unless they are happy for the purchaser to withhold a 12.5% withholding tax. From 1 July 2017, every individual selling a property with a sale value of \$750,000 or more is affected.

To prove you are a resident, you can [apply online](#) to the Tax Commissioner for a clearance certificate, which will remain valid for 12 months. While these rules have been in place since 1 July 2016, on 1 July 2017 the threshold for properties reduced from \$2 million to \$750,000 and the withholding tax level increased from 10% to 12.5%. The intent of the foreign resident CGT withholding rules is to ensure that tax is collected on the sale of taxable Australian property by foreign residents. But, the mechanism for collecting the tax affects everyone regardless of their residency status.

Properties under \$750,000 are excluded from the rules. This exclusion can apply to residential dwellings, commercial premises, vacant land, strata title units, easements and leasehold interests as long as they have a market value of less than \$750,000. If the parties are dealing at arm’s length, the actual purchase price is assumed to be the market value unless the purchase price is artificially contrived.

If required, the Tax Commissioner has the power to vary the amount that is payable under these rules, including varying the amounts to nil. Either a vendor or purchaser may apply to the Commissioner to vary the amount to be paid to the ATO. This might be appropriate in cases where:

- The foreign resident will not make a capital gain as a result of the transaction (e.g., they will make a capital loss on the sale of the asset);
- The foreign resident will not have a tax liability for that income year (e.g., where they have carried forward capital losses or tax losses etc.); or
- Where they are multiple vendors, but they are not all foreign residents.

If the Commissioner agrees to vary the amount, it is only effective if it is provided to the purchaser. The withholding rules are only intended to apply when one or more of the vendors is a non-resident. However, the rules are more complicated than this and the way they apply depends on whether the asset being purchased is taxable Australian real property or a company title interest relating to real property in Australia.

*Please contact us if you need assistance navigating the foreign resident CGT withholding rules or are uncertain about how the rules are likely to apply to a transaction.*

### Quote of the month

"The Entrepreneur always searches for change, responds to it, and exploits it as an opportunity."

*Peter Drucker*