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Re-characterisation of income from trading businesses

The ATO has released Taxpayer Alert TA 2017/1 to say it is reviewing arrangements that try to fragment integrated trading businesses to re-characterise trading income as more favourably taxed passive income. The ATO is concerned with cases where a single business is divided in a contrived way into separate businesses. The business income expected to be subject to company tax is artificially diverted into a trust and, on distribution from the trust, that income is ultimately subject to no tax or to a lesser rate than the corporate rate of tax.

The ATO explains that "stapled structures" are one mechanism being used in these arrangements, but the review will not be limited to arrangements involving stapled structures.

TIP: Taxpayer Alert 2014/1 deals with similar arrangements where trusts "mischaracterise" property development receipts as concessionally taxed capital gains to obtain a lower tax rate.

ATO warning: research and development claims in building and construction industry

The ATO and the Department of Industry, Innovation and Science have released Taxpayer Alert TA 2017/2 and TA 2017/3 as a warning to businesses that are not being careful enough in their claims or seeking to deliberately exploit the research and development (R&D) Tax Incentive program. The alerts relate to particular issues identified in the building and construction industry, where specifically excluded expenditure is being claimed as R&D expenses. The alerts provide clarification for a wide range of businesses who had been incorrectly claiming ordinary business activities against the R&D tax incentive.

Intangible capital improvements made to a pre-CGT asset

The ATO has issued Taxation Determination TD 2017/1. It provides that for the purposes of the "separate asset" rules in the *Income Tax Assessment Act 1997* (ITAA 1997), some intangible capital improvements can be considered separate capital gains tax (CGT) assets from the pre-CGT asset to which the improvements are made, if the improvement cost base is more than the improvement threshold for the income year when CGT event happened, and it is more than 5% of the capital proceeds from the event.

This determination updates CGT Determination No 5 to apply to the ITAA 1997 provisions, without changing the CGT determination's substance.

TIP: Contact us if you would like more information about how this determination applies to your CGT situation.

Personal services income diverted to SMSFs: ATO extends offer

Since April 2016, the ATO has been reviewing arrangements where individuals divert personal services income (PSI) to a self managed super fund (SMSF). The arrangements, described in Taxpayer Alert TA 2016/6, involve individuals (typically SMSF members at or approaching retirement age) performing services for a client but not directly receiving consideration for the services. Instead, the client sends the consideration for the services to a company, trust or other non-individual entity.

The ATO has previously asked taxpayers to help identify and resolve these issues before 31 January 2016, offering to remit the related penalties. That offer has now been extended to 30 April 2017.

Depreciating assets: composite items

Draft Taxation Ruling TR 2017/D1 sets out the Commissioner of Taxation's views on how to determine if an entire composite item is a depreciating

asset or whether its component parts are separate depreciating assets. The draft ruling says that a "composite item" is an asset made up of a number of components that can exist separately. Whether one or more of the item's components can be considered separate depreciating assets is a question of fact and degree to be determined in the particular circumstances. For a component of a composite item to be considered a depreciating asset, the component must be separately identifiable as having commercial and economic value.

TIP: The draft ruling usefully lists the main principles to take into account when determining whether a composite item is a single depreciating asset or is made up of multiple depreciating assets. Contact us if you would like to know more.

Tax risk management and governance review guide released

The ATO has released a tax risk management and governance review guide to help businesses develop and test their governance and internal control frameworks, and demonstrate the effectiveness of their internal controls to reviewers and stakeholders. The guide sets out principles for board-level and managerial-level responsibilities, and gives examples of evidence that a business can provide to demonstrate the design and operational effectiveness of its control framework for tax risk. The guide was developed primarily for large and complex corporations, tax consolidated groups and foreign multinational corporations conducting business in Australia, but the ATO says the principles can be applied to a corporation of any size if tailored appropriately.

Overtime meal expenses disallowed because no allowance received

A taxpayer has failed in claiming deductions for overtime meal expenses before the Administrative Appeals Tribunal (AAT). The AAT denied his appeal because he was not paid an allowance under an industrial agreement.

The AAT noted that whether overtime meal expenses are deductible according to the tax law depends on whether the taxpayer receives a food or drink allowance under an industrial instrument. The AAT agreed with the Commissioner of Taxation that the taxpayer had not received an allowance of this kind and, in fact, had not received any allowance at all.

Time extension to review objection decisions disallowed – again!

The Administrative Appeals Tribunal (AAT) has refused to allow a taxpayer extra time to apply for review of a decision made by the Commissioner of Taxation. The taxpayer had previously made the same application for an extension, seven years after the Commissioner's decision, but both the AAT and the Federal Court refused it.

In this later case, the AAT found that the taxpayer's application should not be allowed because he had still not adequately explained why it took him seven years to ask for an extension and a decision review. **TIP:** This decision illustrates that a taxpayer can continue to apply to the AAT for extension of time to apply for review of the Commissioner's decision disallowing an objection, even after being previously rebuffed. The additional application must include new claims and the taxpayer's case must have merit.

No deduction or capital loss for apparent guarantee liability

The Administrative Appeals Tribunal (AAT) has affirmed that two family trusts that were involved in a building and construction business with other related entities were not entitled to a deduction or a capital loss for $4.3 million that they claimed related to a guarantee liability. The AAT found that the documentary evidence and the oral evidence from the relevant trust controllers was not sufficient support for their claim that the guarantee obligation existed. The AAT noted that unusual features of the "guarantee deed" that put into question whether the trusts were genuinely subject to a guarantee obligation – including that the deed did not record any actions that the guarantors were to perform if the debtor defaulted.

Taxpayer denied deduction for work expenses of $60,000

The Administrative Appeals Tribunal (AAT) has confirmed that a mechanical engineer with a PhD qualification was not entitled to deductions for various work-related expenses totalling approximately $60,000. The expense claims in question (for vehicle, self-education and other work expenses), were denied because the taxpayer was unable to establish the required connection between the outgoing amounts and the derivation of his assessable income as a mechanical engineer. Furthermore, in relation to a range of miscellaneous expenses (such as mobile phone and internet charges, professional membership fees, conference fees and depreciation), the AAT found that most of the deductions were not substantiated with sufficient (or any) evidence. The AAT did not exercise its discretion to allow these deductions on the basis of the "nature and quality" of any other evidence regarding the taxpyer's incurring the expenses.

TIP: This case clearly shows the importance of properly substantiating any claims you make for work-related expense deductions. Contact us to discuss.