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ATO COMPLIANCE PROGRAM 2010/11 – TARGET AREAS

The ATO recently released its compliance program for 2010/11.

In relation to tax compliance for small and medium enterprises the ATO will be focussing on a variety of issues, including the following:

Business activity statements – the ATO will be focussing on compliance issues related to BASs, specifically reported property sales and acquisitions and application of the margin scheme rules.

Capital gains and losses – the ATO will be focussing on the calculation of capital gains and losses including in relation to the application of small business CGT concessions, other CGT concessions or rollovers, calculation of cost base, capital gains and losses on the disposal of shares and property (including non-residents).

Cash economy – the ATO will be focussing on businesses that conduct a high level of cash transactions (such as paying cash-in-hand wages) in order to identify taxpayers that may be using cash transactions to hide income and evade tax obligations. This includes the use of business benchmarks which allow

comparisons between similar businesses to identify typical or expected turnover levels.

Company deregistration – the ATO will be examining the affairs of taxpayers who deregister companies.

Employer obligations – the ATO will be monitoring employers' compliance with their PAYG withholding obligations and superannuation guarantee obligations. In relation to superannuation, the ATO will be focusing on road freight transport, automotive repair and electrical service industries. The ATO will also continue to work with promoters, industry representatives and sporting bodies to provide guidance on withholding obligations for visiting entrepreneurs and sportspersons.

Financial supplies – the ATO will be focussing on the GST consequences of transactions related to financial supplies, especially in relation to the appropriate identification and linking of acquisitions to the making of financial supplies. The ATO will focus specifically on capital raising activities, managed funds or superannuation funds, contributory mortgage schemes, small financial transactions (such as pawnbrokers etc) and mergers and acquisitions.

Fringe benefits tax – the ATO will be focussing on the treatment of motor vehicles, in particular appropriate recording of private use in relation to luxury car purchases and exempt vehicles.

GST – the ATO will be focussing on the GST impact of cross-border transactions, integrity of GST refunds, sales of property and issues concerning retirement villages.

International transactions – the ATO will be focussing on foreign source income, deductions relating to cross border transactions and the application of the thin capitalisation and transfer pricing provisions.

Losses – the ATO will be focussing on the utilisation of losses, especially the incorrect treatment of capital losses as revenue losses.

Personal services income – the ATO will be focussing on contractors to ensure that all PSI is appropriately disclosed, with a particular focus on engineers and computer technology specialists in the mining industry.

Self managed superannuation funds (SMSFs) – the ATO will be focussing on loans to related parties, deductions claimed for exempt current pension income, treatment of losses and re-reporting of member contributions.

Shareholder loans – the ATO will be focussing on amounts paid or distributions made by private companies to shareholders or connected entities to ensure any deemed dividends are appropriately reported.

Trusts – the ATO will be focussing on the TFN reporting obligations of trustees in respect of beneficiaries to whom distributions are made.

TIP

Although the ATO is targeting the areas mentioned above, businesses should not think that this means that the ATO will not be looking at other areas too. They will!

EMPLOYEE SHARE SCHEMES

The new employee share scheme rules have now come into effect, and will affect the taxation of all employee share scheme interests provided on or after 1 July 2009.

These rules broadly require any discount on issue to be assessed upfront unless there is a real risk that the employee may forfeit the interest.

Where there is a real risk of forfeiture, the market value of the interest (less any consideration paid) is generally included in the employee's assessable income at the time that this risk falls away.

Under the new rules, employers that provide employee share scheme interests are required to provide information to the Commissioner and to the relevant employee about the interests provided, and in some cases withhold and remit withholding tax from amounts paid to an employee that has not quoted his/her TFN to the employer.

This information, in the form of an ESS Statement, is required to be provided to employees by July 14 and the Commissioner by August 14 (for taxpayers with a June 30 year end).

Information required to be provided includes:

- details about the provider of the interests (such as ABN and address);
- details about the employee (such as name and TFN); and
- details about the employee share scheme interests, such as amount and market value on issue/acquisition (where the interests are taxed up-front) or market value at the time that the taxing point occurs (if taxing point was deferred but occurred during the income year.)

The ESS Statement containing this information may be amended once lodged with the ATO and can be found at www.ato.gov.au.

Employers should also consider whether they have any employees who have acquired employee share scheme interests but not quoted their tax file number, as the employer may be required to withhold and remit withholding tax from amounts paid to such employees.

TO DO

Taxpayers whose have provided employee share scheme interests during the 2010 income year should ensure they have completed the ESS Statement and provided it to employees and the ATO.

UNPAID PRESENT ENTITLEMENTS

The ATO has finalised its draft ruling on the impact of unpaid present entitlements in favour of private companies in the form of TR 2010/3 and has released a draft practice statement on the application of its position, in the form of PSLA 3362.

This ruling constitutes a significant shift in the way a lot of taxpayers had been treating unpaid present entitlements prior to the release of the ATO's draft ruling. As sections of the ruling apply both before and after the date of its release, taxpayers should carefully consider the application of the ruling in relation to all income years in respect of which income tax returns remain open for amendment.

This ruling relates to when an unpaid present entitlement in favour of a private company will be treated as a "loan" for the purposes of Division 7A, and therefore treated as a deemed dividend to the shareholder of the company, where the trust is a related entity of the shareholder. The ruling broadly applies in the following situation:

- a private company has a present entitlement to an amount from a related trust (i.e. it can call for immediate payment of the amount by the trust);
- the amount remains in the trust rather than being distributed to the private company (i.e. there is an unpaid present entitlement); and
- the amount is used by the trust for its own purposes or intermingled with other trust funds (as opposed to being held by the trust on a sub-trust for the company).

The ruling concludes that a Division 7A loan will arise where:

- a private company beneficiary lends (by agreement, authorisation or ratification) money in satisfaction of an unpaid present entitlement;
- the trustee creates a loan for the benefit of the private company beneficiary pursuant to the trust deed

instead of creating an unpaid present entitlement;

- there is a subsisting unpaid present entitlement and the private company has in substance effected a loan or provided financial accommodation in respect of that unpaid present entitlement; or
- an unpaid present entitlement has been allowed to remain outstanding for use by the trust generally (as opposed to being used or invested or lent for the absolute benefit of the corporate beneficiary).

The draft practice statement sets out practical guidance to assist in the application of the Commissioner's position, including guidance in relation to:

- when a loan agreement may be considered 'express' or 'implied'
- when a 'loan' may be taken to have been made
- the resulting tax consequences if a loan is taken to have been made
- the review period that will apply in relation to such loans (generally the ATO will not review the tax consequences of such loans outside the standard amendment period applicable)
- how to determine whether funds representing the unpaid present entitlement are being used for the company's sole benefit (as opposed to trust purposes) and the evidence that may be used to substantiate the position taken
- how to determine if there is a sub-trust in place
- application of the Commissioner's discretion under Division 7A to deemed loans as per the ruling

NOTE

As these issues are complex, taxpayers should consider the impact of the ruling and the

practice statement on their affairs very carefully.

TRUSTS AND BAMFORD

The Commissioner has released his Decision Impact Statement in respect of the High Court's decision in *Bamford v FCT* [2010] HCA 10 and a practice statement setting out guidance on the application of the current law (PSLA 2010/1).

The DIS acknowledges the High Court's decision in this case i.e. that

- "income of the trust estate" is to be determined with reference to the general law of trusts rather than taxation law;
- the general law of trusts defines income with reference to a governing set of principles;
- however, these principles are merely presumptions that may be displaced by express provision in the trust instrument.
- As such, where the trust deed deems an amount to be "income" of the trust, the amount will constitute "income of the trust estate" for the purposes of applying section 97.

The DIS also reaffirms the view that the proportionate approach (as opposed to the quantum approach) is to be applied when calculating the percentage of the net income of the trust on which a beneficiary is taxable.

The Commissioner has also released PSLA 2010/1 which affirms that the Commissioner will apply the law as set out in the High Court's decision in *Bamford* on a go-forward basis.

Under PSLA 2010/1, taxpayers who relied on either:

- the Commissioner's view; or
- any other view that was reasonably open having regard to other relevant authorities

for the 2010 income year or earlier, will have taken a reasonably arguable position. As a result, such taxpayers will not be liable for administrative penalties on any resulting shortfall amount.

RISK AREA

Taxpayers whose affairs involve the use of trusts should consider whether their income tax returns in respect of the 2010 income year and earlier were lodged in accordance with the High Court's decision in *Bamford*.

GST - LUXOTTICA AND REFUNDS

The ATO has released its Decision Impact Statement in relation to *Luxottica Retail Australia Pty Ltd v Commissioner of Taxation* [2010] AATA 22. This case involves consideration of the GST treatment of frames and lenses in spectacles.

The DIS sets out a particularly narrow view of the circumstances in which a taxpayer will be entitled to a refund of any overpaid GST. Specifically, the Commissioner has noted that a taxpayer may only be entitled to a refund of overpaid GST where that GST will subsequently be refunded to the actual customer.

As such, taxpayers that have inadvertently overpaid GST will need to consider whether a refund will be available for the amount.

TIP

Taxpayers who have overpaid GST may not be entitled to a refund. As such, taxpayers should take special care when preparing their activity statements.

CONTINUING ATO SUPPORT FOR BUSINESSES IN FINANCIAL DISTRESS

For businesses that are experiencing continuing financial distress, the ATO is offering services including flexible payment arrangements, interest-free deferrals of activity statement liabilities, cash flow relief through

reduced uplift factor for PAYG and GST instalments and PAYG instalment variations.

Businesses in hardship should contact the ATO as early as possible to explore available options, otherwise the ATO may seek to take firmer action with businesses that default on payment arrangements, or do not have the capacity to pay.

TIP

Businesses that are struggling in the current economic climate may want to approach the ATO to explore available assistance options.

TAX AGENT REGISTRATION

The scope for registering as a tax agent under the transitional provisions (under the new regime) closed on 31 August 2010.

If you are required to be registered as a tax agent, you will now need to apply based on the standard rules.

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