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Client Information Newsletter — Tax and Super

November 2016

Don't let a tax debt put you in a spin

Whether you're running a business or are just an individual trying to make ends meet, there is nothing worse than finding yourself in a situation where you have a tax debt owing to the ATO, which most likely will also be accruing a general interest charge and perhaps even a shortfall interest charge.

The Australian tax system operates under a system of self-assessment, and this applies regardless of the type of tax being assessed, whether that is GST, FBT or income tax. However even with the guidance available from tax professionals like ourselves, it is not unheard of for taxpayers to still face the prospect of being saddled with a tax debt that's still on hand long after its due date.

This can be brought about due to cash flow difficulties or perhaps the effects of personal hardship. Each unfortunate circumstance can prevent affected taxpayers from meeting their obligations on time, ending up with them carrying the tax debt.

About this newsletter

Welcome to HID Group's 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 in this newsletter, please contact us via the details below.

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Don't let a tax debt put you in a spin... *cont*

> If you have difficulty meeting your tax debts, then a payment plan can be arranged with the ATO to alleviate such difficulties.

Missing a tax deadline will lead to the resulting outstanding debt being subject to the ATO's general interest charge (GIC). The current rate of interest charged (for the October to December 2016 quarter) is 8.76% (compounding daily). We can seek to have such interest charges remitted in certain circumstances (more below).

Let's be clear. The ATO takes debt collection very seriously, as there is substantial revenue at stake. A report last year from the Inspector-General of Taxation on debt collection highlighted that collectable tax debt had grown to more than $20 billion in 2013-14.

According to the report, most of this (about 60% of total collectable tax debt) relates to individuals and micro businesses. To its credit, the ATO's stated strategic focus is to "prevent debts arising", but where they do arise it has also vowed to "take the most effective recovery action at the most appropriate time".

PREVENTING TAX DEBT IN THE FIRST PLACE

They say that prevention is the best cure. We can offer guidance on good record keeping and managing cash flow, as these are the keys to avoiding a tax debt.

Particularly relevant for small business owners, there are certain measures that we can help you with to prevent a tax debt from arising. Namely:

- keeping your GST and income tax payments separate from other finances
- managing your cash flow properly and predict your monthly income and expenses, and
- updating your business records frequently.

Knowing as and when a debt arises, and when it is payable, becomes key to ensuring that cash flow issues are appropriately managed. To our knowledge, the ATO is at this stage trialling digital tools and apps that can help business taxpayers in this regard, which we are keeping an eye on and will pass on more information as it comes to hand.

GETTING INTO A PAYMENT PLAN

If you have difficulty meeting your tax debts, then a payment plan can be arranged with the ATO to alleviate such difficulties.

Payment arrangements can generally be applied for online with our help, usually for individuals and sole traders with an income tax or an activity statement debt of $100,000 or less. But for greater amounts or for more complex cases, a pre-emptive telephone call is generally recommended (and in some cases necessary), to clear up what needs to be put in place. We can help with both application processes.

The ATO may take different actions depending on the taxpayer, the type of debt and amount of the debt, although it is generally accepted that the ATO has favoured leniency in granting payment arrangements to struggling taxpayers who have smaller amounts owing.

In determining whether the debt poses a recovery risk, the ATO classifies debt into six categories, or debt levels, according to the amount owing:

Debt level	Amount of debt
1	<$2,500
2	$2,500 – $7,499
3	$7,500 – $24,999
4	$25,000 – $49,999
5	$50,000 – $99,999
6	>$100,000

MANAGING A LOWER DEBT LEVEL (LESS THAN $25,000)

It is generally easier for taxpayers with lower debt levels (levels 1 to 3) to enter into a payment arrangement. If your debt falls within this range, it is more than likely that you will be able to arrange for a late payment or obtain an instalment plan. We can make this call on your behalf.

Be mindful to maintain the payment plan, the following must be satisfied:

- all tax credits/refunds will be used to reduce your tax debt until it's paid off, but won't replace the required instalment payment

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Don't let a tax debt put you in a spin... *cont*

> For taxpayers with a tax debt at the highest level, it is advisable that we contact the ATO immediately to discuss the situation.

- GIC will accrue until the debt is paid
- you can make additional voluntary payments or pay off the remaining debt at any time, and
- you must lodge activity statements and tax returns and pay any associated liabilities on time.

The last point is important. Even if you can't pay the tax debt by the due date, you are still required to lodge your tax return or activity statement on time to avoid a penalty.

Timely lodgment will also show the ATO that you are aware of your obligations and doing your best to meet them. This can help if you need further ATO assistance down the track.

If you subsequently find it impossible to pay an instalment, a good option will be for us to contact the ATO on your behalf when this first becomes apparent. This is an important initiative, as not only can early negotiations lead to possibly varying the payment plan, but critically, this can pre-empt the ATO simply ending the payment plan — which in the worst case scenario could mean having to pay the full amount plus interest quite soon, or facing further recovery action.

CALCULATING THE RIGHT REPAYMENT

The ATO offers a payment plan calculator to assist in providing a picture of how long it will take to pay off debt, or how much is required to be paid within a fixed period (ask us about this calculator). You should be mindful that GIC will still apply for outstanding debt, however there is a possibility that this can be remitted depending on your circumstances.

MANAGING A HIGHER DEBT LEVEL ($25,000 AND ABOVE)

If you owe $25,000 or more to the ATO, obtaining an instalment plan might be more difficult. We will need to submit a request to the ATO on your behalf, and prove that you can ultimately repay the debt, and that you have made reasonable efforts to raise the funds.

The ATO will assess the viability of the request to ensure the tax debt can be paid and ongoing commitments met. Again, GIC will accrue on the unpaid debt but can be remitted by the ATO depending on circumstances.

MANAGING A DEBT LEVEL GREATER THAN $100,000

For taxpayers with a tax debt at the highest level, it is advisable that we contact the ATO immediately to discuss the situation. The ATO will do a detailed assessment and will work with us to set up a payment plan that is manageable and suitable. You will most likely need to provide us with the following information, within an agreed timeframe, for the ATO's assessment:

- a proposal to pay all amounts owed to the ATO in the shortest possible timeframe, while allowing all future tax obligations to be met by the due date
- details on how the debt arose
- steps taken to mitigate the debt (for example, loan applications)
- the most recent statement for each bank or financial institution account held
- the following documents for the year to date and the two preceding financial years
  - detailed profit and loss statement, or statement of financial performance
  - detailed balance sheet, or statement of financial position
- details of any overdraft or loan facilities, including term loans, hire purchase and leasing facilities (include the balances owing, the monthly repayment amount for each debt commitment and the limit for overdrafts)
- aged creditors listing
- aged debtors listing, and
- any other relevant information that may help the ATO assess the proposal.

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Don't let a tax debt put you in a spin... *cont*

WHEN THERE IS A DISPUTE OVER THE AMOUNT PAYABLE

Sometimes there may be a notice of assessment that appears incorrect and has given rise to an additional amount payable – for example, this could be the result of a mistake that you inadvertently made in a past tax return or even a mistake made by the ATO.

In such cases, with the requisite supporting documents provided, we should be able to successfully seek an amendment to the erroneous assessment.

Be mindful that there is a time limit for amending tax assessments. Specifically, two years for eligible individuals and small businesses and four years for other taxpayers, from the day that the notice of assessment is issued.

Note however that even though the tax assessment in question is in dispute, you are still expected to pay the outstanding tax amount by the due date. It may however be possible that we can seek a deferral of tax payment until the dispute has been resolved. The ATO is generally more agreeable about allowing a deferral if you have a good payment history. However, GIC will still apply.

Overdue amounts, disputed or otherwise, will incur interest, which is a shortfall interest charge (SIC) for any shortfall of tax payable, and a GIC for any interest on fees and penalties. (Also note that under certain circumstances such interest can be claimed as a deduction. Ask us if this may be applicable to you.)

MANAGING A SMALL BUSINESS TAX DEBT

If you are a small business owner and satisfy the following conditions, you may be eligible to apply for an interest-free payment arrangement for the tax debt for up to 12 months.

These conditions require that the business:

- has an annual turnover of less than $2 million
- has a recent activity statement debt of $50,000 or less, which has been outstanding for no longer than 12 months
- has a good payment and lodgment compliance history, including:
  - no more than one payment plan default within the last 12 months, and
  - no outstanding activity statement lodgments
- is unable to obtain finance (such as loan) through normal business channels, and
- is able to demonstrate ongoing viability.

As noted earlier, once a taxpayer has an agreement with the ATO for a payment plan, it is necessary to stick with the plan. Otherwise, the interest free period will end immediately. Interest will be remitted as long the payment plan is maintained.

Even if you have already entered into another payment plan with the ATO, you can change to this interest-free payment plan if you satisfy the eligibility criteria. The interest-free period will start from the date you enter into the new plan.

IF YOU ARE AFFECTED BY SERIOUS HARDSHIP OR NATURAL DISASTER

Serious hardship

If paying off a tax debt would cause serious personal hardship, for example not being able to provide food and accommodation for your family due to a serious accident preventing you from working, the ATO may be able to release you from some or all of the debt.

Note however that this is only available to individual taxpayers, including people operating as sole traders and partners in partnerships. It is not available to "structures" such as companies, trusts or partnerships.

Natural disasters

If you have been affected by a natural disaster, such as flood, bushfire or drought, remember that there is special assistance from the ATO. Where eligible, the ATO will allow more time to lodge tax returns, pay tax debts without charges, or by instalments, and waive any penalties or interest depending on your circumstances.

A CHEAPER WAY?

Note that if you have a cheaper source of financing (say a mortgage offset facility), the interest rate from accessing funds from such accounts will generally be lower than the penalty rates that the ATO applies via the general interest charge. It may be in your best interest to access those funds to settle an ATO debt.

For business taxpayers, interest incurred on funds borrowed to repay a tax debt can be deductible as a cost of doing business (ask us about this). However, if an individual has taken out the loan to settle a tax debt that is not related to operating a sole trader business, the ATO views such interest incurred as not being deductible on the basis that it was not incurred in the course of the taxpayer deriving their assessable income and also because it is private in nature. ■

5 tips to get home office deductions right

You might be sick of the daily commute, or want more flexibility of hours – or it could be that you have a talent or skill and feel sure that this can translate into a fulfilling career in your own business. Or it could just be that the idea of working from home seems to offer a better work/life balance.

So if you're in the position to be able to have your cake and eat it too, there just may be icing for that cake in the form of tax advantages.

Indeed Australian Bureau of Statistics (ABS) reports indicate that home-based work is prevalent in the Australian community. The 2006 Census showed that 426,523 Australians said they worked from home, and the 2011 survey had 443,939 similarly employed. The upward trend is expected to continue, and it will be interesting to see what data comes out of the recently completed 2016 Census.

Deductible expenses that crop up from working at home are generally classified by the ATO as being either:

- "occupancy" expenses, or
- "running" expenses.

As a rule of thumb, someone operating a home business from a dedicated area of the house will be able to claim both types of expenses. Employees who do some work from home for convenience are generally only entitled to claim running expenses but not occupancy costs. Of course there are exceptions to this general rule and it depends on the person's circumstances.

OCCUPANCY COST DEDUCTIONS

These relate to expenses for using the home, obviously, but not necessarily directly tied to the business itself. These can be rental costs, perhaps mortgage interest if you qualify, council rates or insurance premiums.

To claim a deduction for any occupancy expense, the area you set aside for working needs to have the "character of a place of business". In other words, the room in your house that hosts "Hilda's Hair Salon" or "Collin's Consulting" should have the characteristics of a place that is exclusively set aside to offer the product or service that the home-based business is involved in.

Taxpayers can generally claim the same percentage of occupancy expenses as the percentage area of their home that is used to make income (for example, if the home office is 10% of the total area of the home, then you can claim 10% rent costs, council rates and so on). However opting to claim occupancy expenses, especially mortgage interest, will mean you will be expected to account for any capital gain attributable to that same business area of the home when the house is sold.

The physical size of the business area is not always the most appropriate measure. The ATO may for example also accept an apportionment based on the proportionate market value of the area used for the business compared to the rest of the property, if this differs markedly from proportionate size. The ATO will also expect you to pro-rate your deductions on a time basis if you use the room for private purposes for a part of the year.

5 tips to get home office deductions right ... *cont*

NO SPECIFIC WORK AREA – NO OCCUPANCY EXPENSE DEDUCTIONS

You may still work from home but may not have a particular area set aside primarily or exclusively for these income-producing activities. Tim the teacher, for example, could be writing student reports next to the kitchen radio one day or on the front porch another day. There is no defined area from which the work is done, but Tim can still claim deductions for some utility usage such as gas or electricity (running expenses – see below). He just needs to apportion expenses and be able to show how he reached these amounts.

Then there are phone costs for business use, and even the decline in value of "plant and equipment" (chair, desk, computer) to the extent that those items were used for his income producing activities. He will however be unable to make any claims based on renting or owning the house, and also rates or insurance (that is, occupancy costs).

RUNNING EXPENSES

These can generally be viewed as those costs that directly result from using facilities in the home to help run the business, or to enable you to do a bit of work from home. These would include electricity, gas, phone bills and perhaps cleaning costs.

Running expenses may be deductible where someone with a home office can establish that they have incurred additional expenditure on the running expenses as a result of their income producing activities. Essentially, taxpayers can claim a deduction actually incurred through their income earning activities that is ***additional to their private expenditure*** (our emphasis).

See table below.

BUNDLED PHONE AND INTERNET PLANS

Households commonly subscribe to "bundle" plans, giving the household access to two or more services (typically phone, internet, and subscription television services) from the same service provider. One periodic (usually monthly) fee is charged for the single bundle which is always lower than the sum of the fees that the taxpayer would have to pay if they subscribe to each service separately, which affects the calculation of the amount that is deductible.

It is necessary to appropriately match work-related use to particular costs. The ATO suggests that the bundle cost can be separated into different components as follows:

- an apportionment based on the supplier's breakdown of the relative cost of the bundled components
- an apportionment based on the relative costs of the bundled components as if they were purchased separately from the same supplier, or
- if there is no breakdown available, then apportion based on information from a comparable supplier.

THE "CENTS PER HOUR" METHOD – AN EASIER WAY TO CALCULATE RUNNING EXPENSES DEDUCTIONS

The ATO offers taxpayers an administrative concession for calculating running expenses deductions. The home office deduction can be calculated at the rate of 45c per hour (from 2014-15; 34c per hour from 2010-11 to 2013-14.)

You must keep a record of number of hours worked at home, but are relieved of the burden of calculating the deductible amount for each type of running expense.

So if you've been diligently working away at home, whether as an employee or in your own business, speak to us about claiming all your rightful deductions. ■

ⓘ WHAT TYPES OF EXPENSES ARE DEDUCTIBLE?

Category	Examples	Deductible if "home office"
Occupancy expenses: expenses which relate to ownership or use of a home and which are not affected by the taxpayer's income earning activities	Rent, mortgage interest, council rates, water rates, land taxes, house insurance premiums	…is a place of business
Running expenses: expenses which relate to the use of facilities within the home	Electricity charges (heating/cooling, lighting), cleaning costs, depreciation, leasing charges, costs of repairs on items of furniture and furnishings	…is a place of business, **or** … is a place private study

SMSF compliance for 2016-17

The ATO has announced the approach it intends to take over 2016-17 with regard to SMSF compliance. It says trustees will see some key shifts in the ATO's emphasis, both in terms of the activities it undertakes and the levels of enforcement action it applies.

The ATO says its key focus areas will be:

- to support trustees who are willing to engage with it to self-correct and rectify regulatory issues in their fund
- to bring "more intensity and effort" to its compliance activities and enforcement actions in cases where trustees won't engage with the ATO, and/or are deliberately and persistently not complying with their obligations, or are operating outside the system
- to bring more intensity and focus to activities that review and assess the independence and quality of SMSF audits and stronger enforcement actions
- to maintain and build on strategies aimed at preventing non-compliance or other issues for SMSFs – including identifying at-risk new entrants into the system, contacting them to ensure they understand their obligations as trustees and taking "appropriate action" (in some instances removing them from the system)
- making it easier for SMSF trustees to comply with their regulatory and income tax obligations. The ATO provides Practical Compliance Guide (PCG 2016/5, ask us for a copy if you are interested) which sets out the "safe-harbour" terms on which SMSF trustees may structure their LRBAs consistent with arm's-length dealing. The ATO is also developing further material intended to provide clearer guidance and examples, especially in relation to pension underpayments

Looking ahead, the ATO says it will also focus on supporting and assisting trustees to comply with any requirements that may arise from new measures put in place by the government.

Regulatory issues identified in auditor contravention reports

Regulatory contraventions reported to the ATO through auditor contravention reports (ACRs) are one of its key sources of intelligence about levels of compliance. The ATO has committed to consider every ACR that is submitted, but has also made clear that for the 2016-17 year, under some circumstances, its response will change.

In the 2015 income year, 22,000 contraventions were reported for 8,200 funds. The ATO says more than 50% of these contraventions had been rectified when reported in the ACR. Previously, following the receipt of an ACR, if the ATO assessed a fund as high risk, it would automatically select it for a comprehensive audit. However this year the ATO says it will be changing this approach. Instead, where trustees are willing to engage with the ATO, they will be supported to self-correct and rectify compliance issues through the ATO's "early engagement and voluntary disclosure service" and/or through targeted mail outs.

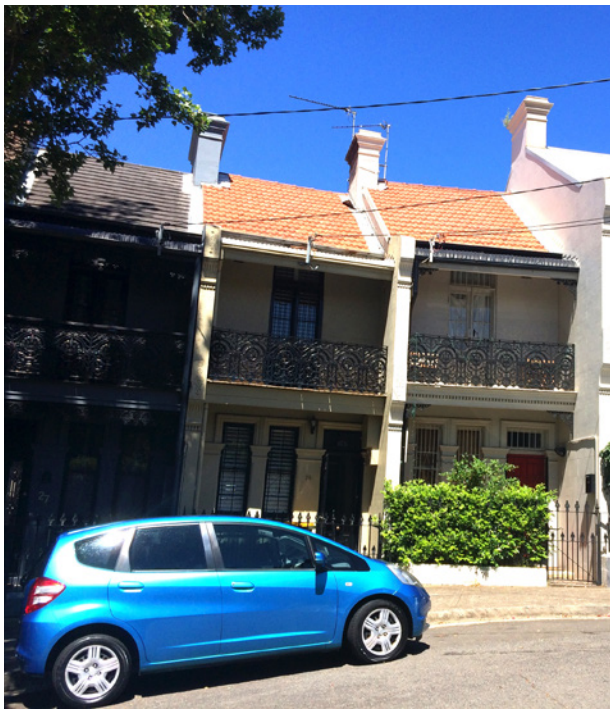
The ATO says this shift in emphasis, together with an increased focus on SMSF auditor independence and quality, will free it to focus on more intensive compliance activities and enforcement outcomes. It says the ongoing focus will be on:

- trustees who aren't willing to engage with the SMSF regulator
- trustees who are deliberately and/or persistently not complying with their obligations
- trustees deliberately operating outside the system (for example, not lodging annual returns and/or undergoing an annual independent audit)
- trustees seeking to adopt aggressive income tax positions (for example, implementing dividend stripping arrangements, personal income diversion arrangements or other contrived arrangements involving related parties.

Also on the ATO's radar

The ATO has also highlighted some of the schemes that trustees should watch out for, and which it is concerned about for the current financial year. These include:

- **dividend stripping** – where the shareholders in a private company transfer ownership of their shares to a related SMSF so that the company can pay franked dividends to the SMSF. The purpose is to strip profits from the company in a tax-free form
- **non-arm's length limited recourse borrowing arrangements** (LRBAs) – when an SMSF trustee undertakes an LRBA established or maintained on terms inconsistent with an arm's-length dealing
- **personal services income** – where an individual (commonly with an SMSF in pension phase) diverts income earned from personal services to the SMSF where it is concessionally taxed or treated as exempt from tax. ■



Getting a tax valuation from the ATO

We all know that the ATO is the guardian of the tax laws, administers tax regulations and can provide advice and guidance on how they apply.

But not every personal situation fits neatly with the tax laws as they stand. Sometimes, an individual may need help understanding and meeting their tax obligations. In such circumstances, private rulings are one form of ATO advice that we can help you access.

Under the tax law, you can apply for a private ruling about the value of a thing, such as an item of plant. Particularly under capital gains tax, there are a number of instances where a valuation may be necessary.

In doing this, there are two choices:

- ask the ATO to provide the valuation, or
- provide the ATO with a valuation of the item and ask it to confirm that valuation.

The ATO may take the option to use a professional valuer to undertake or review your own valuation. The valuer usually charges the ATO a fee, which the law allows it to pass on to you. Consequently, when you apply for a private ruling requiring a valuation, it is also required that you pay for the work of the valuer.

The ATO cannot provide a private ruling to determine or confirm either the:

- appropriateness of a valuation methodology, or
- value for a future event.

Cost to you for valuation

Whenever the ATO uses a professional valuer, it will first give an estimate of how much the valuer will charge. This amount is generally required to be paid before the ATO will proceed.

We can however withdraw your application for a private ruling if you do not want to proceed with, or pay the cost of, the valuation, which will be confirmed in writing by the ATO. If however the valuation work has already started, it will generally be required that you pay for the work already undertaken.

If you provide the ATO with a valuation that meets the requirements set out in the ATO guidance *Market valuation for tax purposes* (ask us for a copy), it will generally cost less to confirm it than to undertake a new valuation.

If the ATO decides that the valuation you have provided is not acceptable, before it issues a private ruling the ATO will ask if you want to either:

- submit a new valuation for review, or
- ask the ATO to provide the valuation.

You will need to pay any further costs the professional valuer charges to the ATO. And if the ATO does not receive any such advice, it generally will issue a private ruling stating that your valuation is not acceptable and that it will not provide an alternative valuation.

Getting a tax valuation from the ATO ... *cont*

What happens when applying for a private ruling about the value of an item?

When the ATO receives the application for a private ruling that asks to determine or confirm the value of a thing, the following occurs:

- if it needs to use a professional valuer, before it starts the valuation process it will tell you, and ask you to agree in writing to use a professional valuer
- it will ask for your input when selecting and instructing a valuer
- it will ask the professional valuer to provide a quote for the work – either to value the thing, or to review the valuation that has been supplied
- the ATO will provide you, via this office, with a copy of the valuer's quote, which contains
  - the cost of their work
  - the time it will take to provide a report
  - any additional information they require to complete the work.

For complex valuation cases, the valuer may need to do the work in stages. In these situations, they will provide a quote for each stage before starting work on it. And before the valuer starts work, the ATO will ask you to:

- pay the estimated amount for the relevant stage, and
- provide any additional information the valuer requests.

Within 28 days of receiving the quote, you need to pay the quoted amount, which may be the whole amount or the amount for the stage in question.

The ATO generally does not ask the valuer to do the work until payment is received. Once the ATO receives your payment, it will:

- ask the valuer to start the work, and
- send you a receipt for your payment.

The receipt the ATO issues is also a tax invoice – we may be able to claim for you the GST included in the valuer's fee as a GST credit. Also note that as the cost of the valuation work is considered to be a cost of managing your tax affairs, it may be deductible for income tax purposes.

The ATO will tell you:

- when the valuation is finished or confirmed, and
- if there are any changes to the final cost of the valuation or review.

It will then either:

- refund any extra amount you paid, or
- ask you to pay any shortfall.

If there is a shortfall, this will need to be paid before the ATO will provide your private ruling. Generally however, it can complete your private ruling within 28 days of receiving the valuer's report.

Private rulings involving a valuation may take longer than other private rulings because of the possibility of having to engage a professional valuer. Generally, the ATO will make contact within 14 days of receiving such an application to discuss an appropriate reply date.

Contact us if you need assistance in this area. ■

This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs. Liability limited by a scheme approved under professional standards legislation.