

TAX IQ SPECIAL REPORT: 2005/06 TAX OFFICE COMPLIANCE PROGRAMME

Taxation Commissioner Michael Carmody has released the Tax Office's compliance programme for 2005/06. This is contained in a 97 page book which you can obtain by telephoning 1300 720 092 or visiting www.ato.gov.au. The programme provides much detail of the activities the Tax Office plans to undertake during 2005/06 to improve compliance and to identify those who have not complied with taxation laws.

Mr Carmody said that the programme aims to target those who failed to meet their obligations, as well as identifying areas of emerging risks.

This is an important document which should be read and understood carefully as it provides a road map of the activities proposed to be undertaken by the Tax Office during this year. Read through this article carefully to discover the areas which will be looked at closely by the Tax Office.

Large corporates and medium sized businesses – particularly those with turnovers of between \$50 million and \$100 million will face increased scrutiny.

The Tax Office will be looking closely at property related tax issues and will expand its use of data matching to check that income from property and share sales is declared and capital gains tax paid.

Increased data matching will also be used to identify non-lodgers.

The programme has been divided into a number of segments. Check carefully the segments applicable to you and your business. If you fall within the group of tax payers being targeted make sure your records and activities are such that they will pass any possible scrutiny.

INDIVIDUALS

Work Related Expenses

Work related expenses for cars, travel, uniforms, laundry and self-education will be checked. The Tax Office will be looking carefully at:

- Claims which seem high compared to the salary and wage income declared;
- Claims that are outside the regular pattern for a particular occupational industry;
- Claims that increased above the prior year where an advisory letter has been sent;
- Where there has been no response to requests for information;
- Returns lodged by tax agents whose claim averages or increases are outside the regular pattern for their clients or their clients' occupations or industries.

This year the Tax Office will focus on the following industries or occupations:

- Construction trades people;
- Food processing and preparing workers;
- Dance, drama and music instructors;
- School teachers and academics; and
- Health care professionals.

The Tax Office expects to conduct about 15,000 risk reviews, which should lead to 4,000 audits of high-risk cases. Taxpayers claiming more than the substantiation limit will be expected to support their claims with written evidence.

Rental Income and Expenses

There are increasing claims for rental property deductions and negative gearing.

The Tax Office will send educational letters to 100,000 taxpayers who entered the rental property market last year and will send advisory letters to 45,000 taxpayers to remind them to check accuracy before lodging. It expects to conduct 6,000 risk reviews leading to 3,600 audits of high-risk cases.

Common errors found include the following:

- Over-stating interest deductions by including borrowing expenses;
- Claiming deductions for a property not genuinely available for rent;
- Claiming initial repairs or renovations as fully deductible rather than as capital;
- Incorrectly apportioning deductions relating to private borrowings or travel;
- Incorrectly claiming deductions for legal and other costs which should be treated as capital; and
- Not declaring all rental income.

Capital Gains Tax

The Tax Office expects to improve its capability to data match external real estate property information with income tax returns and will:

- Significantly expand its programme with Titles Offices, State Revenue agencies, commercial service providers and the Australian Valuation Office to obtain information about property sales;
- Look for emerging risks, including those involving non-residents;
- Examine share registries and public data sources for information of share sales; and
- Match information reported by managed funds with tax returns.

OUR VIEW

Every year the Tax Office publishes its Compliance Programme which provides extensive detail on how and where it intends to target errant taxpayers and conduct tax audits (euphemistically called "risk reviews").

The Tax Office takes pains to congratulate itself on its successes in collecting tax and penalties as a result of its compliance activities. "We have met the challenge" writes Tax Commissioner, Michael Carmody when listing collections as follows:

Individuals	\$ 311 million
Micro businesses	\$1,158 million
Small to medium Businesses	\$ 928 million
Large businesses	\$3,473 million
Other	\$ 86 million
Total	<u>\$5,956 million</u>

"Grossly overstated!" complains the Corporate Tax Association. Apparently, \$1.6 billion of the \$3.4 billion said to have been collected from large businesses as a result of audit activities represented a simple error in completing tax forms due to poor form design. There was no attempt to reduce tax properly payable.

"Taxman's credibility at risk!" opines the *Australian Financial Review* as it discusses Mr Carmody's penchant for gilding the lily.

If collections from large businesses have been so grossly overstated, we wonder about the integrity of other figures shown in the report.

That aside, do carefully read the sections of the programme relevant to your business and circumstances. Take note of the target areas specified. Make sure you have documentation in place in case of an enquiry or review. If in doubt, contact your accountant or send in a reader question.

Be aware of the increased level of data matching and benchmark testing activities. Aim to "audit proof" your records and you won't lose any sleep if selected for a risk review.

Tony Lovett

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The Tax Office expects to carry out 6,000 risk reviews and to complete 3,000 targeted audits of high-risk cases. It will send 22,000 educational letters to purchasers of investment properties and will also send 5,000 pre-lodgement advisory letters.

Investment, Government Benefits and Employment Income

The Tax Office's automatic systems will match return information with large volumes of external information received from companies, employers, financial institutions and the Government agencies to verify:

- Interest and dividend income;
- Government benefits and other payments;
- Health insurance premiums;
- Medicare levy surcharge; and
- Employment income including salary and wages, allowances, lump sum payments and reportable fringe benefits.

The Tax Office expects to contact about 250,000 taxpayers (last year 350,000) and expects to collect an additional \$120 million of taxes short paid.

Superannuation

The Tax Office will focus on ensuring that employers understand their new obligations concerning choice of superannuation funds. Penalties will generally not apply this year if mistakes are corrected within an acceptable timeframe. Penalties will kick in next year.

The Tax Office will endeavour to identify arrangements for illegal access to superannuation and will take action against participants and promoters. It will check to ensure superannuation funds lodge member contribution statements.

It expects to enforce lodgement of 9,500 income tax returns and will be looking to collect surcharge owing for 2004/05 and previous financial years as the abolition did not commence until 1 July 2005. The Tax Office will write to 500,000 individuals reported lost by their superannuation fund.

International Tax Issues

The Tax Office will look at instances where non-resident individuals do not disclose rental income and capital gains from Australian real estate or share transactions and where resident individuals:

- Do not disclose offshore income;
- Do not disclose foreign source employment income;
- High-risk refunds – these are firstly automatically checked by a set of risk criteria. If triggered the Tax Office does not issue a refund until review.

The Tax Office will look for over-claimed tax withheld, excessive interest deductions and the use of fraudulent payment summaries.

Reviews may include:

- Matching the return information with internal data, such as payment summaries;
- Phoning a taxpayer or tax agent to get more detail on particular information in the tax return;
- Phoning a taxpayer's employer to verify employment details;
- Sending a taxpayer a questionnaire to determine whether the relevant tax return information is accurate;
- Undertaking further audit investigation.

The Tax Office expects to review about 37,500 high-risk refunds.

MICRO-BUSINESSES

These are businesses with an annual turnover of less than \$2 million and small superannuation funds with assets of less than \$2 million. There are 2.3 million of these making up 96% of all businesses lodging tax returns. Tax obligations for micro-businesses include:

- Registering for an ABN and for GST;
- Keeping proper records;
- Lodging BAS and tax returns on time;
- Reporting correct income and claiming valid deductions;
- Paying tax obligations on time.

The Tax Office reports that 30% of records examined during record keeping reviews do not meet the required standard and 39% of micro-businesses have a debt with the Tax Office. This year the Tax Office will carry out fewer advisory visits and provide less telephone advice. It will instead concentrate its activities around more complex areas of non-compliance.

It proposes to concentrate on revenue losses arising from businesses carrying out work for cash and on businesses obtaining low documentation loans without lodging tax returns or declaring all their income. It will also increase its focus on collecting outstanding tax debts. It proposes to increase its staffing and resourcing for legal action associated with debt recovery and to increase checks on trustees and auditors of self-managed super funds. Another focus this year will be making sure employers meet their obligations under the choice of super fund rules.

Registration Checks

The Tax Office will:

- Undertake unannounced visits to confirm registration details of businesses;
- Examine tax invoices to identify businesses trading but not correctly registered;
- Match information with that held by other agencies, companies and industry bodies to identify unregistered businesses;
- Conduct tests to ensure registered entities are actually in business; and
- Identify businesses no longer trading and arrange cancellation of their registration.

The Tax Office will undertake:

- 2,270 registration reviews; and
- 350 invoice integrity checks of micro-businesses.

Lodgement Requirements

This year the Tax Office will focus on:

- Use of information from banks and other institutions to identify businesses not lodging or not fully declaring income;
- Solicitors, barristers, accountants and bookkeepers to ensure they are meeting their lodgement obligations;
- Those involved in promoting sports, arts and entertainment, business consultants and financial advisers to ensure they meet their lodgement obligations;
- Monitoring of businesses with significant turnover or high levels of tax payable;
- Using AUSTRAC to ensure that tax scheme promoters and businesses using tax havens, etc meet their lodgement obligations;
- Ensuring income tax and regulatory returns are lodged by self-managed super funds;
- Identifying payers not lodging PAYG Withholding Annual Reports;
- Contacting or visiting new businesses which fail to meet their lodgement obligations.

Record Keeping

Tax Office strategies include:

- Enhancing the record keeping evaluation tool on its web site;
- Producing fact sheets on record keeping tailored to specific industries;
- Producing booklets, software and free workshops to assist in record keeping;
- Working with industry bodies to develop best practices.

This year the Tax Office expects to visit 7,000 businesses to carry out initial record keeping assessments and to make follow-up visits to 1,500 businesses.

Cash Economy

The Tax Office intends to examine high-risk cash economy industries including:

- Property building and construction industries;
- Restaurants, cafes and take-away food outlets;
- Motor vehicle wholesaling and retailing industry;
- Licensed hotels and registered clubs;
- The adult industry;
- Bartering;
- Horse racing;
- Fishing; and
- Tourism.

Compliance activities proposed include:

- Auditing 9,200 businesses;
- Sending letters to 37,000 businesses reporting amounts different from industry norms;
- Following up these businesses and asking them to provide information about previously lodged returns;
- Asking some businesses to provide information before lodgement of their BAS to detect potential errors early;
- Referring some cases to field officers for more detailed reviews;
- Unannounced visits to 11,000 businesses to check identification and registration details;
- Contacting tax agents about micro-business clients where there are significant numbers falling outside industry norms;
- Matching bank transactions with information in tax returns and BAS to identify omitted income and the use of false names;
- Checking business-to-consumer transactions to detect omitted income.

This includes:

- Matching appointment and quote books to invoices;
- Tracing owner builder transactions using local council records;
- Matching information from trade suppliers to businesses;
- Researching local advertisements;
- Notifying proposed monitoring of particular industries and trades through trade publications;
- Including an industry tax tip sheet in letters to micro-businesses in particular industries;
- Following up tips from the community about businesses that may be avoiding tax; and
- Encouraging consumers to obtain documentation for services.

Low Documentation Loans

A pilot study last year showed that around 50% of taxpayers using low documentation loans have an average of 3 years outstanding tax returns.

This year it will work with the finance industry to identify the best way to systematically check lodgement status of people obtaining low documentation loans. The Tax Office will also explore the possibility of matching insurance company records with information it holds.

It will focus more closely on the role of mortgage brokers.

Incorrect and Fraudulent Claims

The Tax Office plans to check more than 62,300 GST refunds this year.

It will match approximately 7.2 million records to identify taxpayers reporting amounts in BAS and tax returns that are outside industry norms. It will also match 3 million third party records to identify potential compliance risks such as businesses not reporting income or inappropriately claiming input tax credits. It will use risk rating engines and profiling techniques to compare the amounts reporting in BAS and tax returns to detect discrepancies.

The Tax Office will:

- Make telephone calls and visits to check the accuracy of information submitted in 3,600 BAS;
- Contact 4,200 micro-businesses to follow up on information received from the community and write to a further 14,000 businesses about issues that may need adjustment;
- Examine 2,700 deferred GST scheme cases;
- Review about 50 micro-businesses in the property and construction industry and undertake a further 300 audits involving property developers;
- Undertake 300 full or complex audits of micro-businesses for serious evasion and fraud;
- Review 900 claims for losses that may be caught by the non-commercial loss rules.

Capital Gains Tax

The Tax Office will undertake 240 reviews, including:

- Businesses that dispose of property but do not disclose capitals gains; and
- Businesses that have reported rental income and claimed rental expenses in previous years, but then either ceased to report that income and expenses or disposal of the property.

The Horse Racing Cash Economy Project is also looking at capital gains issues, including the sale of weanlings and yearlings, race horses sold overseas and horses sold to studs.

Employer Obligations

The Tax Office will review 3,480 identified discrepancies between PAYG withholding credits and the amounts paid by employers.

It will audit 1,068 micro-businesses to ensure they have met their employer obligations. This will include PAYG withholding, superannuation guarantee (including choice of superannuation fund, eligible termination payment and reasonable benefit limit reporting) and fringe benefits tax.

The Tax Office intends to undertake 20 specific fringe benefits tax audits with micro-businesses and review 400 taxpayers who may be subject to alienation of personal services income legislation, particularly those in the building and construction and information technology industries and those who operate through labour hire firms.

Superannuation

The Tax Office considers the following are high-risk:

- Breaches of the in-house asset rules (loans to or investments in related entities);
- Acquiring assets from related parties;
- Personal use of fund assets;
- Assets paid for by the fund but not held in its proper name.

Proposed actions by the Tax Office this year will be:

- Investigating the above high-risk issues;
- Trying to improve lodgement performance for returns, member contribution statements, ETP and RBL limit reports and lost member reporting;
- Notifying professional associations about poor performance by particular auditors;
- Taking action against auditors who fail to fulfil their duties;
- Taking action against promoters and participants of illegal early access schemes;
- Conducting seminars and writing to all newly registered self-managed funds providing information of obligations.

The Tax Office expects to audit 18,692 employers to check compliance with superannuation guarantee obligations and will take action whenever employees tell them that their employer is not making superannuation payments on their behalf.

Excise Obligations

The Tax Office will seek ways to strengthen and expand conditions for holders of tobacco growing licences and improve controls on the physical movement of tobacco. Inspectors will work nationally to detect, identify and prosecute micro-businesses supplying illicit tobacco leaf.

Meeting Payment Obligations

The Tax Office will:

- Increase the use of its information gathering powers;
- Take garnishee action on funds held in businesses or payable to tax debtors;
- Resort to bankruptcy or insolvency action where necessary;
- Require financial institutions to pay a proportion of amounts transacted through business merchant card facilities.

SMALL TO MEDIUM ENTERPRISES

Enterprises in this group have annual turnover between \$2 million and \$100 million. There are approximately 85,000 enterprises in this segment together with 7,800 self-managed super funds. They account for approximately 11% of total tax revenue.

General Approach

New and expanded priorities this year include:

- Addressing tax compliance risks through tax agents. This includes working with agents who have five or more clients selected for risk reviews;
- Undertaking compliance activities earlier and monitoring PAYG instalments to identify discrepancies;
- Ensuring compliance with choice of superannuation fund and other superannuation obligations;
- Consulting with publicly listed companies regarding tax risk management and corporate governance processes;
- Targeting businesses with turnover between \$10 million and \$100 million with greater emphasis on audits;
- Strengthening focus on businesses with turnover between \$50 million and \$100 million paying particular attention to compliance with international tax obligations.

Registration

The Tax Office will aim to identify businesses in building and construction, hotels, clubs, adult entertainment, motor vehicle retailing and barter operating in the cash economy and not reporting transactions.

Employer obligations, PAYG withholding and fringe benefits tax requirements will be monitored and consolidation registrations will be looked at to ensure all relevant entities are brought within the single income tax registration and only eligible entities are included.

Correct Reporting

Using income tax risk profiling the Tax Office has identified a large number of businesses in this segment with a disparity between their economic performance and the amount of tax they pay.

The Tax Office will examine inconsistencies in tax payments compared with the business profitability, industry benchmarks and prevailing economic conditions.

When selecting cases for review, other factors include the level and type of income reported, the deductibility of expenses claimed, financing arrangements, international dealings (especially with related parties), capital gains, losses, research and development, shareholder loans and capital allowances.

The Tax Office will conduct 1,000 reviews involving examination of financials and interviews with the client and/or tax agent. It expects to complete 650 audits and may also examine the financial affairs of business owners and any related entities.

The Tax Office will contact 1,200 businesses by letter or telephone to ask them to explain unusual PAYG payment patterns which could be explained by economic or industry specific factors such as drought, appreciating Australian dollar or increased demand for natural resources. It will also review 6,600 apparently excessive income tax refund claims.

Losses

The Tax Office will pay particular attention to:

- Losses recouped without taking into account changed ownership or failure to meet the same business test;
- Inappropriately claiming deductions or omitting income to create a loss;
- Mis-classifying losses as capital or revenue;
- Utilising loss arrangements to minimise tax where such losses are artificial;
- Transferring losses between non-consolidated entities.

Capital Gains Tax

The Tax Office's review and audit programme will focus on businesses:

- Using significant capital losses to offset capital gains;
- Not reporting capital gains when there are unexplained significant changes to assets and/or accounting profits;
- Claiming small business concessions when they do not satisfy the threshold requirements; and
- Setting up arrangements to reduce capital gains when selling a business or company.

Shareholder Loans and Capital Raisings

The Tax Office will target transactions that have the effect of distributing company profits to shareholders as loans and those where aggressive tax planning is involved. Corporate restructures, capital management activities such as capital raisings, capital reductions and share buy-backs will also be analysed closely.

Service Trusts

Last May the Tax Office issued draft Taxation Ruling (TR 2005/D5) about service fees paid to associated service entities. It will use profiling and review work to identify professional service businesses using service trusts. Its general approach is to allow these businesses 12 months to review their service trust arrangements but will continue its audit programme where:

- The service fees are over \$1 million and represent over 50% of gross fees earned; or
- There are serious questions about whether the services are in fact provided by the service entity.

Goods and Services Tax

The Tax Office has found that in many cases the accounting software and internal controls used by businesses with incomes above \$20 million have not kept up with their growth. Common mistakes include mis-classifying supplies, incorrectly recording transactions between associated entities, incorrectly applying financial supplies rules. As a result businesses have treated taxable sales as GST-free and claimed input tax credits for non-business purchases. It is using computer assisted verification techniques to help audit staff identify these errors and shortcomings in accounting systems and internal controls.

It is paying particular attention to large one-off or unusual transactions such as the trade-in of motor vehicles, claiming input tax credits for an asset that has been acquired by a non-registered entity and imposing GST on the sale of a business as a going concern, when it is actually GST-free, and not remitting the GST to the Tax Office. The Tax Office will investigate 19,000 claims for GST refunds, some of which may result in field audits.

Using cross-matching, analysis of internal records and information from auction houses or State Revenue Offices the Tax Office hopes to identify businesses failing to correctly report and pay GST.

The Tax Office will also review importers who take advantage of deferred GST arrangements. It will contact 3,900 businesses and revoke the eligibility of those not meeting the conditions of the arrangements.

Cash Economy

The Tax Office expects to review 800 cash economy businesses in both targeted cash economy industries and in general trading. This could include reviewing registration, obtaining lodgement and improving future compliance performance through better systems and records.

Employer Obligations

The Tax Office expects to:

- Conduct 500 telephone enquiries, 2,100 profiling reviews and 1,000 audits of employers where reporting on employer obligations does not correspond with other information;
- Help businesses understand their choice of superannuation fund obligations;
- Undertake data matching and evaluation of fringe benefits tax records relating to 20,000 employers' motor vehicle registrations;
- Conduct 6,000 telephone reviews where it has identified discrepancies between PAYG withholding information providing in BAS and the information provided in their Payment Summary Statements.

Superannuation

The Tax Office will:

- Investigate high-risk issues, such as breaches of the in-house asset rules, acquisitions of assets from related parties, personal use of fund assets and fund ownership of assets;
- Focus on lodgement compliance;
- Liaise with professional associations;
- Take action against auditors where there have been failures in carrying out their duties;
- Action against promoters and participants of illegal early access schemes;
- Conducting seminars and writing to newly appointed trustees.

Consolidation

The Tax Office will continue its existing programme of comprehensive reviews and audits of consolidated groups focusing on:

- Incorrect consolidation memberships;
- Incorrect application of loss rules;
- Incorrect application of cost setting rules.

Insolvency

The Tax Office will continue to look carefully at *Phoenix* practices (companies becoming insolvent before paying tax).

The Tax Office has confirmed that most Phoenix activity occurs in businesses that are labour intensive and have an annual turnover of less than \$10 million, with PAYG withholding and GST revenue most at risk.

The Tax Office will look carefully at property, building and construction, road transport, employment agencies, clothing manufacturing and information technology industries.

The Tax Office will supplement the information it holds on tax payment and insolvency patterns of high-risk directors with information from ASIC insolvencies and disqualified directors' databases. It will obtain information from Government agencies, industry associations and insolvency practitioners.

It expects to conduct 140 audits focussing on Phoenix fraud.

LARGE BUSINESS

This segment consists of 1,800 business groups with a turnover of \$100 million or more together with 800 high wealth individuals who (with their families and business entities), control more than \$30 million in assets.

Compliance Focus

Compliance priorities for this year include:

- Monitoring tax payments from corporate groups, particularly those benefiting from the resources boom;
- Monitoring risks arising from consolidation process – restructures, group entities entries and exits, setting new asset costs, capital allowance claims, losses and GST implications;
- Pursuing capital gains tax issues around corporate restructuring and major checking;
- Identifying profit shifting and international related party dealings;
- Detecting arrangements by offshore parties to sell rights related to GST supplies in Australia;
- Checking the validity of high-risk and unusual GST refund claims;
- Checking the validity of bad debt claims by in-house finance companies in large groups;
- Identifying incorrect valuations under the margins scheme;
- Monitoring and responding to risks relating to high wealth individuals;
- Identifying risks relating to debt and equity and international transaction;
- Monitoring intra group transactions such as new management fees between unconsolidated entities;
- Bedding down administration impacts arising from new measures;
- Monitoring share backs and capital management issues;
- Checking that employers comply with their obligations under the new choice of superannuation fund rules.

NON-PROFIT ORGANISATIONS

These include charitable, religious and community service bodies, sporting and recreational clubs, business and professional associations and trade unions, private schools, some hospitals and some large financial and insurance companies. There are 700,000 such organisations in Australia.

Compliance priorities for 2005/06 include:

- Checking that entities are not receiving tax benefits they are not entitled to through the use of closely controlled charities;
- Checking that employers comply with their PAYG withholding, fringe benefits tax, regional benefit limits, reporting and superannuation guarantee obligations;
- Monitoring GST treatment of transactions;
- Helping indigenous organisations meet their tax obligations;
- Monitoring the involvement of some tax scheme promoters with non-profit organisations; and
- Understanding why organisations voluntarily register for GST;
- Checking various entities that undertake commercial activities to test whether their activities put their concessional status at risk;
- Testing the integrity of endorsed deductible gift recipients and tax concession charities; and
- Checking that employers provide choice of superannuation fund to employees.

TAX AGENTS

There are 26,000 registered tax agents who lodge 75% of income tax returns for individuals and 97% of business-related returns. The Tax Office's primary focus is to help and support tax agents. Last year, 2 million phone calls from agents were answered through its premium phone service. There were 357 presentations to tax agency seminars and 6,880 visits to tax agents.

Compliance Focus

The Tax Office monitors compliance with lodgement obligations on a market segment basis, as well as monitoring the tax agent lodgement programme. It uses information from activity statements, other Government departments, banks and public data bases to detect deductions and refunds inconsistent with occupation and industry trends, disparity between economic performance and amount of tax paid, income levels at variance with business conditions and inconsistencies in information sourced from the various bodies.

This year the Tax Office is focussing compliance activity on:

- Work-related expenses;
- Rental income and expenses;
- Capital gains tax;
- GST, including registrations and refunds;
- Cash economy industries;
- Record keeping;
- Employer obligations;
- Losses;
- International tax issues;
- Aggressive tax planning; and
- Self-managed superannuation funds.

Supporting Tax Agents

The Tax Office will continue to provide the following support to enable tax agents to comply with an increasingly complex legislation:

- Tax agent portal – which provides tax agents with direct electronic links to Tax Office systems;
- Lodgement programme – providing tax agents with significant extensions of time for lodgement of client returns;
- Relationship manager programme – providing tax agents with a national case manager service, visits and product and service updates;
- Premium phone service enabling tax agents to quickly reach the appropriate area by use of fast key codes;
- Compliance tool kit – an electronic guide providing detailed information about compliance activities;
- Electronic tools;
- Checklists and calculators.

OTHER INTERMEDIARIES

The Tax Office is looking closely at the role of bookkeepers and BAS service providers, legal practitioners, software developers, superannuation fund auditors, insolvency practitioners and third party data providers. It aims to decide how it can work with these groups and their clients to provide better support.

INTERNATIONAL TAX ISSUES

The Tax Office uses a number of techniques to identify taxpayers who have international dealings to ensure they pay their appropriate share of Australian tax. It uses AUSTRAC data to identify money moving into and out of Australia, it receives information from 18 treaty partners about the amount of income received by Australian taxpayers. Information on international dealings is required to be provided in Schedule 25A by non-individual taxpayers with foreign income or expenditure.

During 2005/06 it will focus on:

- Tax havens and bank secrecy;
- Profit shifting;
- GST international issues;
- Off-shore assets and foreign income;
- Australian tax obligations of non-residents;
- International tax law reform.

AGGRESSIVE TAX PLANNING

This often involves transactions that have little or no economic substance and are created predominantly to obtain a tax benefit that is not intended by the law.

Compliance priorities include:

- Monitoring capital gains tax planning schemes;
- Monitoring arrangements creating GST benefits not intended by the law;
- Focussing on promoters and advisers creating tailored arrangements for particular taxpayers which can be adapted and marketed to others;
- Working with other tax authorities to combat aggressive tax planning;
- Improving systems to obtain information about promoters and advisers who devise tax planning arrangements;
- International arrangements aimed to avoid tax globally;
- Finalising work associated with schemes marketed before 30 June 2003;
- Recovering outstanding taxes relating to schemes;
- Increasing focus on promoters or facilitators of offshore arrangements.

The Tax Office has identified Australian residents disposing of offshore assets through structures linked to tax havens and tax haven entities providing invoices to Australian taxpayers so that tax deductions could be claimed even though no underlying service or goods were provided. It will also look at situations where taxpayers' businesses are restructured so that the income passes through a chain of trusts and onto a loss company.

EVASION AND SERIOUS FRAUD

This involves the deliberate engagement in criminal behaviour to evade tax obligations or to fraudulently use the system to obtain an improper financial benefit. It may involve stealing the identities of other people, creating false identities, forging documentation, not declaring income from illegal activities, not registering in the system at all, creating dishonest arrangements to avoid tax liabilities, and creating false transactions to dishonestly obtain a benefit or payment.

Such cases when discovered, are investigated and serious breaches are referred to the Commonwealth Director of Public Prosecutions to consider for criminal prosecution.

Various research tools, databases and systems and extensive networks with law enforcement and other agencies are used to detect serious non-compliance. These include:

- Comprehensive intelligence databases registering intelligence about potential tax fraud. This includes some 40,000 annual referrals, information gathered from field visits and disseminated by other agencies;
- Using data mining tools including cross-matching information with AUSTRAC data;
- Incorporating new tests to help identify fraud;
- Examining suspicious new applications for ABNs;
- Reviewing and evaluating system controls;
- Examining high-risk refunds and credits before issue.

By 30 June 2005 there were approximately 270 briefs before the DPP and the Australian Government solicitor awaiting prosecution for tax and excise fraud. This year the courts will finalise about 170 prosecutions. The Tax Office expects to raise more than \$100 million from over 300 audits involving evasion and serious fraud.

Reader Questions:**MOTOR VEHICLE EXPENSES - SUBSTANTIATION****Question:**

If a motor car is jointly owned and the taxpayers earn income from a partnership, would each taxpayer be able to claim up to 5,000km under the cents per kilometre method? Are they using the car for their separate income earning activities?

Answer:

Taxation Determination TD 93/17 states, "where two or more taxpayers own or lease a car, and each uses that car separately for income producing purposes, each is entitled to claim a deduction using the cent rate per kilometre method up to 5,000km." If they are using the car jointly the total deduction will be limited to 5,000km.

Provided they are using the car separately on partnership business, they can each claim up to 5,000 km. Each taxpayer should make the claim in their personal tax return as a deduction from partnership income and you should retain some evidence as to their separate use of the vehicle.

TRUCK DRIVERS**Question:**

Do long distance truck drivers receiving a travel allowance need to substantiate their expenses up to \$67.55 per day or will diary records of days away suffice?

Answer:

Providing they are employed (not owner-drivers) they do not need to substantiate expenses up to \$67.55 per day. Diary records will suffice.

PROPERTY TRANSFERS**Question:**

Could you advise the procedure to transfer ownership of an investment property currently held by a company to the directors who want to have it in their own name as joint tenants? Issues such as stamp duty and the legal requirements are our chief concern.

Answer:

A company is a separate legal entity. A transfer of the property from a company to its directors/shareholders will involve full ad valorem stamp duty and also CGT considerations. For CGT purposes the transfer will be treated as a sale at market value. If that is in excess of the cost base, CGT will be payable by the company at 30%.

If the transfer is to proceed you should obtain a valuation of the property and arrange for a lawyer to effect the transfer and pay the requisite stamp duty. The valuation should be used for stamp duty purposes and also to determine the CGT payable.

GST – COMMERCIAL PROPERTY**Question:**

What is the definition of a commercial rental property? Does a shop fit the definition?

Answer:

Commercial property is any property which is not residential. Hence a shop fits the definition of a commercial property.

Question:

Is it compulsory for a commercial rental property to register for GST even though the business makes less than \$50,000 investment income a year.

Answer:

No. Registration is not necessary unless the total income exceeds \$50,000 per year. You can voluntarily register and if you do you will be able to claim input tax credits for any expenses but will have to add GST to the rent charge. This may be appropriate because the tenant of the shop can claim an input tax credit for GST included in the rent.

STS DEPRECIATION**Question:**

When entering the Simplified Tax System (STS) for the first time is the opening pool balance the total of "opening adjustable values" as per one's depreciation schedule?

Answer:

Yes. The initial opening balance of the pool is the total of opening adjustable values (written down values) of all depreciating assets that are automatically allocated to the pool as at the beginning of your first STS year.

PAYG VARIATIONS**Question:**

I received two tax bills and questioned my accountant saying I could not pay afford to pay them. He said to send them back and he would vary them. He changed the PAYG bill to nil. How can he do this? Can you explain how a figure of \$2,200 is correct and a figure of nil is also correct?

Answer:

PAYG instalments are normally payable at the end of each quarter and are based on Tax Office estimates of your income. If your income falls it is possible to have the assessments varied accordingly.

CGT – ROLLOVERS**Question:**

I have a client who has a patent registered in his own name. He would like the patent transferred to a wholly owned company using the Div 122 rollover.

The patent has been developed over 20 years and has had minimal sales to date. The client is currently holding discussions with some large organisations interested in producing and marketing the product both in Australia and overseas. What methods of valuation are acceptable in valuing the intellectual property?

Answer:

You need an independent valuation. There are a number of different methods that you can use to make the valuation. These are too involved to discuss in *Tax IQ Monthly* and we suggest you talk to a forensic accountant who could do the job for you.

Can we suggest you revisit the proposal to transfer the patent to a company? From the information you supplied the patent would have little value at present (possible future exploitation of the patent is uncertain and cannot be taken into account in a current valuation). If there are substantial subsequent increases in the value of this patent it will be locked into a company with its attendant CGT problems. Would it not be better to transfer the patent to a discretionary trust without using a CGT rollover? This may cost some minimal tax now but your client would have a much better vehicle for an asset which is expected to improve markedly in value in the future.

INTEREST DEDUCTIONS**Question:**

I am going to purchase shares from a shareholder for my company. Currently, the shareholding is held by my family trust. If I put the new shares in the family trust, would I be able to get the interest deduction? What if I borrow money from the bank in my name and lend to my family trust without receiving interest?

Answer:

As we understand your question you are operating a business from a company, the shareholders of which are your family trust and someone else. You intend to have your family trust purchase the shares in the operating company from the other shareholder.

In this case it would be best to have the family trust borrow the money from the bank and purchase the shares. The interest payable by the family trust to the bank would be deductible on the grounds that you intend to earn income from dividends payable in the future. If you borrow the money yourself without an expectation of receiving income, you would not be able to claim a tax deduction.

FBT – EMPLOYEE MEALS

Question:

Bonus Special 1 Tax Savings 2005 states that you can claim a deduction for the cost of tea, coffee and light lunches provided to employees on work premises during working hours. These are exempt from FBT.

What constitutes light lunches and is there a limitation of cost per employee? To date I have heard various comments pertaining to limitations and I cannot see that this is evident in tax law. This is not entertainment, nor bonus, nor gift. It is part of the company's normal trading and provides for a better working environment.

Answer:

There are no limitations of cost but you must be sure that there is no element of meal entertainment.

Income Tax Ruling IT 2675 states "Light meals are treated in the same way as morning and afternoon tea. It is not the provision of entertainment to provide sandwiches and other "hand food", salads, orange juice etc that are intended to, and can, be consumed on the taxpayer's premises or work site. As "light" meals become more elaborate, they take on more of the characteristics of entertainment. There is no particular point at which this will become obvious. Normal business practice will be the yardstick." If alcohol is provided this will constitute the provision of entertainment.

CGT – MAIN RESIDENCE

Question:

We have a client who has recently moved into a retirement home but has retained her own home for a time as a backstop. She has rented her home out. How long can she continue to rent out the property without it being considered as an investment property and therefore subject to CGT on sale?

Answer:

Six years provided she has no other main residence. If she moves back into the property for a short time before the six years are up and moves out again the six year exemption recommences.

ENTERTAINMENT EXPENSES

Question:

Can I take a client out for a meal to discuss planned work and claim the meal?

Answer:

No. This is regarded as non-tax deductible entertaining expenses.

PRE-CGT LAND AND IMPROVEMENTS

Question:

I have owned 40 acres of land since May 1982 in the name of a discretionary family trust. I finished building a house on the land 3 years ago. What is the CGT situation?

Answer:

The land was purchased before introduction of CGT and remains exempt. Improvements on pre-CGT land costing more than the threshold figure are treated as separate assets and would be subject to CGT on sale. On sale of the property you apportion the sale price between the land and the house. Proceeds for sale of the land will be CGT exempt while any gain between the cost and sale price of the house would be subject to CGT.

The threshold figure in 2001/02 was \$97,721. It is only if the cost of the house was more than that, do you have to treat the house as a separate asset. Otherwise the entire proceeds are CGT free. The fact that the house on the land is your main residence does not effect the situation. Exemptions for main or principal residences are only effective if you own the house personally.

Question:

Two years ago we moved from our home of 30 years and bought a new home in a different location. It has taken two years to sell our old home and now we wonder if we are liable for capital gains tax on the original home. It has been used in the last two years by a family member, not for rental purposes.

Answer:

Your original home will be totally exempt from CGT because it was purchased before the introduction of CGT on 19 September 1985.

DEATH AND DISABILITY INSURANCE

Question:

Can a super fund claim a tax deduction for death and disability and income protection insurance paid from the super fund account?

Answer:

Yes.

CARRY FORWARD LOSSES

Question:

What is the tax consequence on carry forward losses on the death of a taxpayer? Our client died in November 2004. Would his losses be available to be transferred to his estate?

Answer:

No. All tax losses are lost on the death of a taxpayer and cannot be transferred to anyone else.

CGT SMALL BUSINESS CONCESSIONS

Question:

A husband and wife operate day care centres in partnership. They sold one centre in June 2004 and made a capital gain of \$1.1 million.

They constructed another day care centre and it started operating in August 2004.

Both partners are over 55.

They are entitled to the 50% CGT discount and also the 50% active asset exemption. This reduces the capital gain to \$275,000.

Can they utilise the small business rollover for the new day care centre completed in August 2004. Alternatively, can they utilise the retirement exemption even though the partnership was not wound up and is currently operating a new day care centre? If so is there any standard form to use when claiming the retirement exemption?

Would your answer be different if the new day care centre was transferred to a family trust during September 2005?

Answer:

You can utilise the small business rollover and apply the remaining gain of \$275,000 to reduce the cost base of the new child care centre because it was acquired less than 12 months before the sale of the first centre. Alternatively you can apply the retirement exemption. As both partners are over 55 there is no need to rollover the amount into a superannuation fund. Further there is no need for them to cease business activities and retire. There are no standard forms and the retirement exemption is declared when lodging the relevant tax return.

In the event that the new day care centre is transferred to a family trust this will constitute a CGT event and result in a substantial capital gain if you have elected to apply the small business rollover.

TRAVELLING EXPENSES

Question:

Tax IQ Monthly August Issue published figures for travelling expenses which did not require substantiation. Why is there a band of two amounts for high cost country centres?

Answer:

The ruling provides a list of some 28 country centres which are regarded as high cost. The two amounts shown in the table represent the highest and lowest figures. If you are interested in finding the amounts for each centre you can visit www.ato.gov.au click Rulings and Law, then click Taxation under Public Determinations, then click 2005, then TD 2005/32. This will take you to the actual Determination.