

client alert | explanatory memorandum

October 2008

Tax Office Compliance Program 2008/09

The Tax Office has released its Compliance Program for 2008/09, which sets out the Tax Office's compliance priorities for that year.

Individuals

Investors

The Tax Office states that it will match information on asset transactions from state and territory title and revenue offices, securities exchanges and share registries, and reports from managed funds to ensure individuals are reporting their capital gains tax obligations correctly. It further states that it will write to taxpayers who purchased investment properties, shares or units in a managed fund in the 2007/08 financial year to inform them of their capital gains tax obligations if they dispose of these assets. In addition, the Tax Office states that it will focus on whether capital gains distributed to investors in managed funds have been correctly classified.

The Tax Office will check that managed investment schemes are implemented as described in their product rulings and identify schemes that have proceeded without product rulings. The Tax Office will increase its monitoring of aggressive new financial products and arrangements to ensure financial products (including tax exploitation schemes) comply with tax and superannuation laws. It encourages taxpayers who have participated in any aggressive tax planning schemes to come forward early and make full and voluntary disclosures so as to take advantage of the provisions that allow reductions in any penalties which may be imposed.

Rental properties

The Tax Office has said that it will focus on the following areas for rental property owners:

- claims for body corporate fees where the fees are to cover the cost of capital improvements or capital repairs;
- claims for capital works where the capital works exceed the construction expenditure;
- incorrect claims for stamp duty deductions on the purchase of a property title, which has been classified as borrowing expenses;
- incorrect classification of expenditure as repairs and maintenance instead of being capital costs;
- incorrect completion of rental schedules; and
- incorrect deductions for interest expenditure.

The Tax Office said that it will contact tax agents whose clients have unusual patterns of rental claims. It will write to new rental property owners advising the owners of how to report rental income and claim deductions. It will also write to taxpayers identified as being at risk of not complying with the tax laws, reminding them to ensure the accuracy of their tax returns.

Senior executives and directors

The Tax Office will expand its compliance activities of senior executives and directors to include:

- senior executives of private companies; and
- resident senior executives of foreign-owned companies.

It will focus on remuneration packages and any failure to report equity benefit and cash or share bonuses. The Tax Office has stated that where compliance action with senior executives identifies significant issues that are relevant to other employees, it will extend its compliance work to the larger population.

Work-related expenses claims

The Tax Office will review and audit activities, particularly in relation to nurses, medical practitioners and chefs. The Tax Office said it would also focus on 'out of pattern' claims for self-education, car and travel expenses.

Micro enterprises

The term 'micro enterprises' refers to taxpayers (including SMSFs) with an annual turnover of less than \$2 million. The key priorities that the Tax Office are focusing on include:

- ***assisting small businesses to stay on track with their tax obligations*** – the Tax Office has stated that its support and verification compliance activities will be structured around the business life cycle of a small business. It will be improving its assistance program to support micro enterprises at critical points in their business life cycle, with a particular emphasis on helping businesses get started and get back on track with their tax obligations, which includes meeting obligations in relation to cash transaction, and tax and superannuation debt.
- ***employer obligations, including superannuation guarantee*** — the Tax Office is increasing its audit coverage of employers. In particular, the Tax Office will focus on: businesses that are expected to have high tax liabilities (based on their history or third-party information); businesses that fail to lodge on time or only meet part of their lodgment obligations; and business operators with child support obligations.
- ***cash economy*** — the Tax Office is expanding its coverage with a more focused cash economy strategy that includes regional activities, business-to-consumer transactions and micro enterprises with conspicuous consumption or multiple obligations. Further, the Tax Office has said it will continue to use data-matching to detect unreported income and will also check for inconsistencies between household and personal assets and reported levels of income.
- ***international dealings*** — the Tax Office will focus on offshore income including dividends and interest, royalties and rental income. The Tax Office plans to match data on dividends, interest and royalties supplied by overseas revenue agencies with income tax return and AUSTRAC information to identify unreported foreign income.
- ***capital gains on sales of assets and investments*** — the Tax Office will focus on capital gains arising from the sale of real property and shares, the accuracy of capital losses reported and the correct application of the small business CGT concessions. It will also focus on ensuring that any capital gains tax is correctly reported when a business operator is exiting a business. Further, it will continue to ensure that any capital gains arising from an in-specie contribution to a superannuation fund, or where proceeds from the sale of assets have been transferred into the fund are reported.
- ***tax debt management*** — the Tax Office will use risk profiling to detect problems much earlier so it can identify the problem and offer assistance at an earlier stage.
- ***refund fraud*** — unusual and high value GST and income tax refund claims will become a focus for the Tax Office who has stated that it will undertake pre and post-issue verification checks by either telephone, visiting the business or by contacting third parties.
- ***small business owners and superannuation funds*** — the Tax Office is developing new tools for trustees and auditors to help them achieve high levels of compliance with superannuation and tax laws.

- **partnership and trust distributions** — the Tax Office said it is reviewing distributions from partnerships and trusts and beneficiary returns to check that the distributions have been correctly disclosed: see **Compliance Matters** on page 7.
- **GST and property transaction** — the GST treatment of property transactions remains a significant compliance issue. The Tax Office said it will continue to work with builders and developers through industry consultative forums to improve its understanding of the industry, consider the impact of current economic conditions and keep them informed of law changes in a timely manner.
- **fuel tax credits measures** — the Tax Office will embark on an education program to inform taxpayers of the expanded fuel tax credits measures which applied from 1 July 2008. This will be accompanied by work to build its own understanding of the industries and businesses new to fuel tax credit entitlements, so it can identify those that are outside of industry norms for claiming credits. The Tax Office has warned that firm action will be taken if deliberate non-compliance is identified.

Small to medium enterprises

Small to medium enterprises businesses refer to taxpayers with an annual turnover of between \$2 million and \$250 million, including highly wealthy people who with their associates, effectively control \$30 million or more in net wealth. The key priorities that the Tax Office are focusing on include:

- **loans to business owners** — the Tax Office said its focus in 2008/09 will be on identifying and dealing with cases where businesses did not take advantage of the option to self-correct past loan or payment breaches (i.e. Division 7A). The Tax Office will also continue to monitor compliance with shareholder and associate loans and payments.
- **highly wealthy individuals** — the Tax Office will increase its focus on highly wealthy individuals and follow up where necessary by reviews and audits. The Tax Office reported that it had 400 reviews of wealthy people in progress as at 30 June 2008 compared with 38 at 1 July 2006. The Tax Office also expects to have at least 110 audits underway in 2008/09. In addition to undertaking more reviews and audits, the taskforce is developing a more sophisticated risk-assessment approach.
- **tax planning around business exits** — the Tax Office will be undertaking more targeted compliance activity by examining business restructures where the primary objective is to receive a tax advantage through the use of demergers, consolidation or trust cloning rather than for preparing a business for sale.
- **international transactions** — the Tax Office will examine transactions between related Australian and offshore entities that shift profits from Australia to other countries. It will also examine whether Australian residents are declaring capital gains from overseas assets and reporting their foreign income. The Tax Office has said that it will undertake reviews and audits in high-risk cases.
- **trusts issues** — the Tax Office will seek judicial clarification of a number of trust issues including the effectiveness of clauses in trust deeds that seek to equate trust income with trust taxable income. It said some clarification might also be provided by the outcome of the appeal to the Federal Court from the recent Tribunal decision in *AAT Case [2008] AATA 322, Re Bamford & Ors and FCT*. While awaiting clarification, the Tax Office said it does not propose conducting active compliance activities specifically in relation to these issues. The Tax Office will seek to identify cases of trust cloning involving the permanent deferral of tax, such as where there is a claimed increase in the cost base of the transferred asset.
- **fuel tax credits measures** — the compliance activities to be undertaken are similar to that of micro enterprises.

Superannuation

The Commissioner has highlighted several superannuation-related compliance priorities for 2008/09. The Tax Office will this year focus on supporting the implementation of the introduction of the new First Home Saver Accounts (FHSAs) from 1 October 2008. Key priorities include:

- **employee superannuation** — the Tax Office said it received around 20,000 complaints in 2007/08 from employees in relation to their employers not paying the correct superannuation guarantee contributions or not offering a choice of superannuation fund. Tax Office analysis suggests that employers in

hairdressing and beauty, engineering design and consulting, and building and industrial cleaning are at a higher risk of not meeting their superannuation obligations. The Tax Office said it plans to make available by the end of 2008/09 an online tool for employees to allow them to check whether they are eligible for a superannuation guarantee and if they have received the correct contribution for each quarter. Where contributions are not correct, employees can lodge a complaint online.

- *over-claiming deductions for superannuation contributions and excess contributions* — the Tax Office will use its data matching processes to ensure the annual contribution caps have not been exceeded.
- *lost members* — the Tax Office will review a further 200,000 lost accounts and follow up with the account owners by telephone.
- *early access to superannuation* — the Tax Office will work closely with industry regulators to investigate superannuation funds that are accessed without authority.
- *First Home Saver Accounts (FHSAs)* — the Tax Office said it will manage the introduction of FHSAs from 1 October 2008. Its focus will be on ensuring that people have the information and advice required to understand the eligibility requirements and consequences of saving with the product.
- *self-managed superannuation funds (SMSFs)* — the Tax Office will continue to focus on regulatory issues associated with protecting retirement investments, such as loans, in-house assets, borrowings and non-arm's length transactions, as well as ensuring funds are meeting income tax compliance obligations. Active compliance activities will cover at least 10% of all new funds. The Tax Office will also monitor approved auditors to ensure they are fulfilling their roles.

Bonuses and Superannuation Guarantee

In a recent AAT case, the Tribunal affirmed the Commissioner's decision that bonus payments by a corporate taxpayer to its employees are considered ordinary time earnings (OTE). Accordingly, the Tribunal held that the payments must be taken into account when calculating the prescribed level of superannuation guarantee contributions and/or the superannuation guarantee charge (SGC) for each employee: *AAT Case [2008] AATA 762, Re Prushka Fast Debt Recovery Pty Ltd and FCT* (AAT, Ref Nos VT200600274 and VT200600275, Fice M, 28 August 2008).

The taxpayer had established a profit-share bonus scheme whereby they retained the discretion to make the payments. Following a superannuation guarantee audit by the Tax Office, the Commissioner determined that the taxpayer had not provided the minimum level of superannuation guarantee for its employees for the years ended 30 June 2000 and 30 June 2001. Therefore, the Commissioner held that the taxpayer was liable for the SGC. The taxpayer objected to the Commissioner's assessment, however the objection was disallowed. The issue in dispute was whether the bonus payments were considered OTE of the employees. The Tribunal said that the taxpayer's discretion to make the payments did not convert these payments into *ex gratia* payments. In determining the true nature of the payments, the Tribunal said that it must look at the **substance of the payments and not the label that had been ascribed** [emphasis added]. The Tribunal found that the bonuses paid by the taxpayer were paid in an employment context and by reference to the specific performance of its employees as a group. Further, the Tribunal also found that the payments could be properly regarded as over-award payments. Therefore, the Tribunal was satisfied that the payments were OTE and should be taken into consideration when calculating the SGC.

Superannuation guarantee

The superannuation guarantee legislation requires employers to provide a minimum level of superannuation support for their employees. Currently, the prescribed level of support is 9% of an employee's notional earnings base. However, where an employee's salary or wages exceed the maximum contribution base, which is currently \$38,180 per quarter, the excess above the threshold is not included in the calculation of the superannuation guarantee.

Since 1 July 2008, an employee's notional earnings base is the employee's ordinary time earnings (OTE). Broadly, OTE are the total of earnings in respect of ordinary hours of work and earnings consisting of over award payments, shift loading or commissions. However, OTE do not include unused annual leave payments, unused long service leave payments made on termination of employment, or payments in lieu of

unused sick leave made on termination of employment. Further, payments that are specifically excluded from salary or wages are not included in OTE.

The article ‘Super Update’, which was published in the June issue, contained two tables detailing whether an earning is included or excluded from OTE.

It is important to note that salary or wages are used in calculating an employee’s individual shortfall component for the purpose of the superannuation guarantee charge if an employer has failed to make the minimum level of superannuation contributions for the employee by the quarterly due date. While certain payments that form part of ‘OTE’ are also included in ‘salary or wages’, payments specifically excluded from OTE will not necessarily be excluded from the definition of salary or wages.

In Superannuation Guarantee Ruling SGR 94/5, the Commissioner gives his view on the meaning and scope of ‘salary or wages’. The table below, which is adapted from the Ruling, states whether a payment is considered to be ‘salary or wages’ or ‘OTE’:

Payment	Salary or wages	OTE
Expense allowance paid with expectation that it will be fully expended in producing income (eg car allowance paid to real estate agents)	No	No
Allowances paid (other than a reimbursement of expenses)* *Note that the allowance must be paid in respect of ordinary hours. An overtime meal allowance for example, would not be paid for work done during ordinary hours (subject to the exceptions related to overtime).	Yes	Yes
Reimbursement of expenses (e.g. travel costs)	No	No
Bonuses that do not relate to specific performance criteria (e.g. Christmas bonuses)	Yes	No
Other bonuses	Yes	Yes
Commission	Yes	Yes
Overaward payments	Yes	Yes
Shift loading	Yes	Yes
Overtime	Yes	No
Casual loading	Yes	Yes
Benefits subject to FBT	No	No
Workers compensation payments, including top-up payments, where no work is performed	No	No
Workers compensation payments, including top-up payments, paid by the employer, where work is performed	Yes	Yes
Top-up payments (e.g. when serving on jury duty or with reserve forces)	Yes	No
Payments when on maternity or paternity leave	Yes	No
Pay for annual holiday leave taken	Yes	Yes
Government subsidies	Yes	Yes
Annual leave loading	Yes	No
Pay for sick leave taken	Yes	Yes
Pay for long service leave taken	Yes	Yes
Accrued annual leave, long service leave and sick leave paid as a lump sum on termination	Yes	No
Payments in lieu of notice	Yes	No

Payment	Salary or wages	OTE
Redundancy payments	Yes	No
Other payments made by an employer on termination of employment	Yes	No
Director's fees	Yes	Yes
Payments for performance in, or provision of services relating to, entertainment, sport, promotions, films, discs, tapes, TV or radio	Yes	Yes
The labour portion of payments to contractors who are employees for super guarantee purposes	Yes	Yes
Dividends	No	No
Partnership and trust distributions	No	No
Payments for entering into a restraint of trade agreement	No	No
Payments for domestic or private work under 30 hours per week	No	No

SMSF and the Sole Purpose Test

In a media release issued by ASIC, it stated that a trustee of a self-managed superannuation fund (SMSF) has pleaded guilty in relation to a criminal charge under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). According to the media release, this is the first case to be laid against a trustee of an SMSF under this Act.

The trustee was charged with dishonestly failing to ensure that an SMSF was maintained in accordance with the sole purpose test as required by section 62 of the SIS Act while the trustee of the fund. ASIC alleged that the preserved superannuation benefits of 192 superannuants totalling \$4,055,043 were deposited into the bank accounts of the SMSF. These funds were rolled over from 56 complying superannuation funds. ASIC alleged that the trustee used the SMSF to obtain early access to fund benefits by withdrawing and distributing the funds to the superannuants and agents engaged by him to assist in an early release scheme. ASIC also alleged that the trustee retained over \$600,000 for himself by way of a commission.

The sole purpose test was discussed in the September issue.

Early access to superannuation

The Tax Office has announced that there are some promoters of illegal early superannuation release schemes trying to entice individuals to roll their superannuation into an SMSF as a means of accessing their superannuation benefits early.

The Tax Office reminded investors that they need to be aware that if they become an SMSF trustee that they must operate the fund in accordance with the law. Failing to meet this obligation may result in prosecution and taxation consequences. The Tax Office has said that investors need to know that it is illegal to access their superannuation early unless an individual has satisfied a condition of release or an exception applies.

(Note that early access to superannuation is a focus area in the Tax Office's Compliance Program 2008/09.)

Off-the-shelf Accounting Software

In Practice Statement Law Administration PS LA 2008/14 — Software system documentation for record keeping purposes, the Tax Office provides guidance to its tax officers on what are sufficient electronic records to be retained for the purposes of ITAA 1936 and ITAA 1997 if taxpayers use commercial off-the-shelf software packages.

For the purpose of the Practice Statement, the Tax Office defines a commercial off-the-shelf software package that typically has at least three of the following attributes:

1. the software is designed to be routinely operable by individuals with limited information technology training. In many cases, maintenance is carried out by individuals with vendor based product training only;
2. the software costs less than \$2,000;
3. the software is not designed for a specific business but rather is for general business use or use by particular industries or types of business; and
4. the starting point for the contractual relationship is the first use of the software whereby the licensee agrees to specific conditions in relation to the use of the software.

While the Practice Statement notes that taxpayers using commercial off-the-shelf software packages are generally not able to satisfy the computer system documentation as set out in paragraphs eight and nine of Taxation Ruling TR 2005/9, it states that tax officers can accept that taxpayers using such software packages are maintaining electronic records in accordance with the record keeping requirements in sections 262A(1), (3) and (4) of ITAA 1936 if:

- the software name and version is recorded;
- a record is made of the components of the software package that have been installed and the date of installation;
- a chronological record is kept of all system changes or upgrades;
- a record is made of the options that have been enabled or disabled; and
- any manuals or instructions provided with the software package are kept.

The Practice Statement is effective from 28 August 2008.

Record keeping requirements

Section 262A(1) of ITAA 1936 requires a taxpayer who is carrying on a business to maintain records and explain all transactions for income tax purposes. The records must be kept in written English or readily accessible and convertible into written English: section 262A(3). Further, the records must be kept for the statutory period of five years.

In TR 2005/9, the Tax Office states that to ensure electronic records are maintained in accordance with the relevant sections, a taxpayer should have an understanding of his or her computer system. In addition, the taxpayer should retain any system documents to enable the Tax Office to ascertain whether the system is doing what it is claimed to do. If a system has changed over time, the Ruling states that records should be kept to allow the original data to be reconstructed to satisfy the requirements of section 262A.

With the increasing number of taxpayers using commercially available accounting software, it is paramount that the taxpayers adhere to the guidance set out in the Practice Statement and the Ruling.

Compliance Matters

Data matching — security industry

The Tax Office has announced that it will request and collect names, addresses, business and licence details of entities within the security industry from the following sources:

- Victorian Police Licensing Services Division;
- NSW Police Security Industry Registry;
- NT Office of Racing, Gaming and Licensing;
- ACT Department of Fair Trading;
- Tasmanian Office of Consumer Affairs;
- Qld Department of Fair Trading;
- WA Police Commercial Agents;

- SA Office of Consumer and Business Affairs; and
- the Australian Crime Commission.

Records relating to approximately 38,000 registered entities (businesses and individuals) will be matched. According to the Tax Office, the data-matching program will focus on security firms and then their sub-contractors. It is anticipated that the matching program will occur in the period from September 2008 to June 2009. Further, the Tax Office intends to obtain the information for the period from 1 July 2007 to 30 June 2008.

The Tax Office says the details will be electronically matched with certain sections of its data holdings to identify non-compliance with lodgment and payment obligations under taxation law. Taxpayers identified as being non-compliant with regards to their tax obligations may be referred to the relevant field area of the Tax Office for appropriate follow-up action.

Partnership and trust distributions

The Tax Office has advised that distributions from partnerships and trusts to the respective partner and beneficiary returns for the years ended 30 June 2004 to 30 June 2007 are being reviewed to ensure that distributions have been correctly disclosed.

The Tax Office says tax agents may have already received a letter listing clients whose partnership or trust income distributions may have either not been disclosed or have been understated in income tax returns. The Tax Office asks tax agents to review the returns and confirm whether the distributions have been correctly declared.

The Tax Office says that if an error or mistake has been made, tax agents should make a voluntary disclosure on behalf of their client by lodging an amendment through the ELS or the Tax Agent Portal. The Tax Office said this will result in a reduction or waiving of the penalty provided the amendment is lodged within 28 days of the date of the letter.

The Tax Office warns that if it does not receive a response to the letter within 28 days, an audit may commence for the income tax returns listed in the letter. The letter notifying of this action will be sent to the postal address of the client. The Tax Office says that, if the audit determines distributions have been omitted or not fully declared, penalties will be imposed.

Social security payments

Schooling conditions on welfare payments

The Government has introduced the *Social Security and Veterans' Entitlements Legislation Amendment (Schooling Requirements) Bill 2008* into the House of Representatives on 27 August 2008.

The Bill will amend the *Social Security (Administration) Act 1999*, the *A New Tax System (Family Assistance) Act 1999*, the *Student Assistance Act 1973* and the *Veterans' Entitlement Act 1986* to give effect to measures announced in the 2008/09 Federal Budget which related to parental responsibilities in relation to the school enrolment and attendance of their children.

Amendments to the *Social Security (Administration) Act 1999* include the addition of Part 3C to provide for implementation of the 2008/09 Budget measure — Improving School Enrolment and Attendance through Welfare Reform (SEAM). SEAM introduces conditions on the receipt of income support payments whereby parents are obliged to ensure their children of compulsory school age are enrolled in school as well as to take reasonable action to ensure children attend school regularly.

Part 3C outlines requirements for parents in receipt of income support in relation to the enrolment and attendance of their compulsory school age children. For enrolment, the amendments allow for the provision of notices to affected parents requiring them to provide information to Centrelink about the status of their child's enrolment at school. Parents who do not comply with the notice without a reasonable excuse or other special circumstance will have their income support payments suspended.

The amendments will take effect from the date that the Bill receives royal assent.

Increase in Pensions and Income Support

From 20 September 2008, the following pensions and other income support payments and allowances will increase in line with the CPI:

- age pensions;
- wife pension;
- carer payment;
- special benefit;
- disability support pension;
- veterans service pension;
- newstart allowance;
- parenting payment (partnered and single);
- sickness allowance;
- mature age allowance;
- widow allowance;
- maternity immunisation allowance;
- rent assistance;
- pension bonus scheme; and
- concessional allowances such as utilities allowance and senior concessional allowance.

The indexation with the CPI will deliver an increase of \$15.30 a fortnight in the maximum single pension and \$12.70 in the maximum partnered rate for each member of a pensioner couple.

The increase in the pensions and income support payments and allowances will be accompanied by an increase in the income and assets cut-off amounts for these entitlements:

Family situation	From 20 Sep 2008	Previous amount	Increase
	(\$)	(\$)	(\$)
Pensions			
<i>Pensions disqualifying income limits — per fortnight¹</i>			
Single	1,557.75	1,519.50	38.25
Single + 1 child	1,582.35	1,544.10	38.25
Couple (combined)	2,602.00	2,538.50	63.50
For each additional child add	24.60	24.60	0.00
Couple separated due to illness (combined)	3,079.50	3,079.50	76.50
<i>Pensions disqualifying assets limit - per fortnight¹</i>			
Single, homeowner	550,500	540,250	10,250
Single, non-homeowner	675,000	664,750	10,250
Partnered, homeowner (combined)	873,500	856,500	17,000
Partnered, non-homeowner (combined)	998,000	981,000	17,000
One partnered eligible, homeowner	873,500	856,500	17,000
One partnered eligible, non-homeowner	998,000	981,000	17,000

Family situation	From 20 Sep 2008	Previous amount	Increase
	(\$)	(\$)	(\$)
Couple separated due to illness, homeowner	1,001,000	980,500	20,500
Couple separated due to illness, non-homeowner	1,125,500	1,105,000	20,500
Payments and allowances			
<i>Income test cut-offs for NSA, WA, PA SA and MAA - per fortnight</i>			
Single, 21 or over, no children	842.17	821.8	20.33
Single, 21 or over, with children	903.34	881.34	22.00
Single, 60 or over, after 9 months (PhA)	913.00	891.00	22.00
Partnered, each	69.00	750.67	18.33
Single, principle carer of child, exempt from activity test	1,030.17	1,004.67	25.50
<i>Income test for parenting payment — per fortnight</i>			
Partner's free area	769.00	751.00	18.00
<i>Average weekly income for Health Care Card purposes</i>			
Single	446.00	435.00	11.00
Couple (combined)	743.00	725.00	18.00
Single, or couple combined, one child	777.00	759.00	18.00
<i>CDEP Participation Supplement (CPS) income test</i>			
Single	1,025.00	1,000.00	25.00
Couple	942.00	919.00	23.00
Total income of both partners must be under	1,884.00	1,838.00	46.00

1. Disqualifying limit includes consideration for pharmaceutical allowance.

Source: Minister for Families, Housing, Community Services and Indigenous Affairs Media Release, 2 September 2008

Tax Update

Donations to Political Parties

The Government has introduced *Tax Laws Amendment (Political Contributions and Gifts) Bill 2008* into the House of Representatives, which seeks to abolish the tax deductibility for contributions and gifts to political parties, independent members and independent candidates. Further, the Bill also seeks to ensure that political parties, independent members and independent candidates will not lose access to certain GST concessions that they may be entitled to as a consequence of the amendment.

Note that the amendments were previously introduced as part of *Tax Laws Amendment (2008 Measures No 1) Bill 2008* but were rejected by the Senate.

Proposed amendment — income tax

The amendments will remove the ability for taxpayers (including corporate taxpayers) to claim tax deductions for contributions and gifts to political parties, independent members and independent candidates. In addition, the amendments will preclude any contributions and gifts from forming part of the cost base or reduced cost base of any CGT asset.

However, if the contribution is related to an individual's employment, the individual should be able to claim a deduction provided the general deduction requirements of section 8-1 of ITAA 1997 are met. The following example is from the Explanatory Memorandum accompanying the Bill:

'A member of Parliament pays a compulsory levy to retain their party membership. This would generally be deductible under section 8-1'.

Proposed amendment — GST

As a consequence of the proposed amendments, political parties, independent members and independent candidates will no longer meet the definition of a "gift-deductible entity" in section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). Therefore, a new term "concessional entity" will be introduced into the GST Act to ensure political parties, independent members and independent candidates still have access to certain GST concessions which are available to gift-deductible entities.

The GST concessions that are available include:

- accounting for GST on a cash basis, regardless of turnover;
- making GST-free supplies for nominal consideration in certain circumstances; and
- treating certain fund-raising events as input-taxed.

Date of effect

It is proposed that the amendments apply to contributions and gifts made on or after 1 July 2008.

Current law

Currently, political donations of \$2 or more to political parties, independent candidates or membership subscriptions paid to registered political parties which satisfy the relevant rules in Subdivision 30-DA of ITAA 1997 are deductible under section 30-242.

Section 30-243 provides that the maximum amount deductible in an income year is \$1,500. The \$1,500 threshold applies separately to political parties (including membership subscriptions) and independent candidates (i.e. a taxpayer may, in the one income year, separately donate up to \$1,500 to political parties and independent candidates respectively).

Taxpayer Alert

The Tax Office has released a Taxpayer Alert warning taxpayers that it intends to closely scrutinise GST refund requests that could result in windfall gains not intended by the law.

The Tax Office said the Commissioner is concerned about situations where a taxpayer seeks to obtain a GST refund four years after the end of a tax period on the basis that they had originally incorrectly classified the supply of goods or services as taxable, and now contend it should have been GST-free. However, after four years, the Commissioner may be unable to recover previously claimed GST input tax credits the Tax Office has paid out on that same supply. The Tax Office said this could lead to a windfall gain if a refund was paid.

The Alert applies to arrangements that have the following features:

1. a taxpayer has paid GST on a supply that they considered at the time was a taxable supply but they now contend that the supply is in fact, not a taxable supply;
2. the taxpayer at the time of making the supply issued tax invoices to the recipient who was registered for GST or required to be registered;
3. the taxpayer's notification is now seeking a refund of the GST purportedly overpaid in an earlier tax period where more than four years has elapsed since the end of that tax period;
4. depending on whether or not the taxpayer reimburses the refund of the overpaid GST to the registered entity who was the recipient of the supply, there may be an unintended windfall gain to either the taxpayer who made the supply or to the recipient of the supply; and
5. in some cases, there are arrangements in place for the supplier and recipient of the supply to share a percentage of the refund sought from the Commissioner.

Features that concern the Tax Office

The Tax Office considers that the situations outlined above gives rise to taxation issues that include whether in the particular circumstances:

- the supply has in fact incorrectly been treated as a taxable supply;
- the Commissioner in the particular circumstances is required under section 105–65 of Schedule 1 of the *Tax Administration Act, 1953* (TAA) to pay the refund;
- it is appropriate in any particular case for the Commissioner to exercise his discretion contained in section 105–65 where a supply, as between two registered entities or entities that are required to be registered, has been incorrectly treated as a taxable supply;
- the time limits on refunds or credits contained in section 105–55 of Schedule 1 to TAA should apply to any of the tax periods in which a refund has been sought or are to be sought;
- the Commissioner is precluded by the time limits contained in section 105–50 from recovering from the recipient of the supply input tax credits previously claimed on the transactions that it is now contended gave rise to GST free supplies; and
- a windfall gain not intended by the law will arise because of: (i) the retention of the refund by the supplier, or (ii) the reimbursement by the supplier of the GST to the recipient.

The Tax Office said it is examining these arrangements and would not exercise discretion in such circumstances where the taxpayer did not bear the economic burden of the GST.

The Tax Office noted that section 105–65 provides that the Commissioner need not give a refund to a taxpayer in certain situations. Under this section, the Tax Office said the Commissioner may deny a taxpayer a refund where one of the following applies: (i) the Commissioner is not satisfied that the taxpayer seeking the refund has reimbursed a corresponding amount to the recipient of the supply; (ii) the recipient is registered or required to be registered.

The Tax Office also noted that the recent Federal Court decision *KAP Motors Pty Ltd v FCT* (2008) 68 ATR 927 does not apply in these situations because this Alert deals with cases where there is supply. The *KAP Motors* case dealt with a situation in which there was no supply.

Legal status of Alert

A Taxpayer Alert is only intended to be an ‘early warning’ for tax planning arrangements that the Tax Office have under risk assessment. However, it is to be expected that the Tax Office will follow up the release of any Alert with a public ruling or determination.

Taxpayers who have entered into, or are contemplating entering into an arrangement similar to that described in an Alert can seek a formal determination of the Tax Office’s position through a Private Ruling.

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