Coster Galgut
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TAX UPDATE – AUGUST 2023

What did I miss?

The case of the taxpayer who was paid too late! What a difference the timing of employment payments can make to tax outcomes. In this case, the impact of the late payment of a performance bonus paid once the taxpayer became a resident of Australia. We look under the hood of Tawfik v FC of T [2023] AATA 2541.

A win for a taxpayer over the treatment of a taxi industry compensation payment.

And, what the final luxury car tax determination tells us about the importance of the purpose of the vehicle.

Regards,
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INSIDE

From Government

Stronger penalties for tax adviser misconduct

In response to the recent scandal involving tax advisers leaking confidential information to their clients, the Government has announced that it will be taking a series of steps to improve the integrity of the tax system.

The package of reforms cover three primary areas:

- Strengthening the integrity of the tax system;
- Increasing the powers of regulators, including the ATO and Tax Practitioners Board; and
- Strengthening regulatory arrangements.

When it comes to strengthening the integrity of the tax system the Government has announced that it will:

- Significantly increase the maximum penalties for advisers and firms who promote tax exploitation schemes from $7.8 million to over $780 million;
- Expand the promoter penalty laws so that they are easier for the ATO to apply; and
- Extending the time limit for the ATO to bring Federal Court proceedings on promoter penalties from four years to six years after the conduct occurred.

Treasury will be co-ordinating the Government's response in this area, with the expectation that options for reform will be delivered to the Government progressively over the next two years. Consultation is expected to commence in the coming months.

More information

Media Release - Government taking decisive action in response to PwC tax leaks scandal

From the Regulators

Online services for foreign investors

Non-residents who invest into Australia will now be able to authorise representatives to access ATO online services on their behalf by using their myGovID.

The process that needs to be followed in order to authorise a representative to access online services depends on whether the foreign investor holds an ABN or not. Before starting the registration process it is important to review the ATO guides and gather all of the information that needs to be provided before the registration can be completed.

More information
Authorise a representative
Access to Online services for foreign investors for entities with an ABN

Client bank account details on returns

The ATO has reminded tax agents to ensure the correct financial institution details are included on all tax returns and other lodgements. These need to be manually input on new returns when using Online services for agents. If the details are missing, the ATO removes the information from the client's account and any future refunds due to the client will be issued by cheque, increasing processing time.

More information
Are you including FID on every return?

Rulings, Determinations & Guidance

LCT and determining the principal purpose of a vehicle

The ATO has issued a final determination dealing with the luxury car tax (LCT) system that explains how to determine the principal purpose of a vehicle.

LCT can apply to the sale or importation of a car if its LCT value exceeds the relevant LCT threshold. For the purpose of the LCT rules a motor vehicle is treated as a car if it is designed to carry a load of less than 2 tonnes and fewer than 9 passengers or it is a limousine.

However, LCT does not apply if the vehicle:

- Is a commercial vehicle, and
- Is designed for the principal purpose of carrying passengers.

Whether a car is a 'commercial vehicle' or is designed for the principal purpose of carrying passengers is determined objectively based on the car's design, rather than how a particular operator intends to use the car in practice.

The ATO indicates that the following factors should be considered in determining the principal purpose of a vehicle, although this is not an exhaustive list:

- The appearance and presentation of the vehicle;
- Any relevant promotional literature;
- The emphasis evident in marketing;
- The vehicle's specifications;
- The Australian Design Rules (ADRs) applicable to the vehicle, according to Vehicle Standard (Australian Design Rule - Definitions and Vehicle Categories) 2005 (ADR) vehicle category classification;
- The load carrying capacity; and
- The passenger carrying capacity.

When assessing a vehicle's principal purpose it is necessary to consider the original design of the vehicle

and any modifications to the vehicle which are incapable of being readily reversed. The ATO provides a series of examples looking at vehicles that have been subject to modifications and whether those modifications would lead to the conclusion that the principal purpose of the vehicle is not to carry passengers.

The determination also explains how the ATO will apply compliance resources in this area. In broad terms, the ATO expects that commercial vehicles are unlikely to have the following body types:

- Station wagons;
- Off-road passenger wagons;
- Passenger sedans;
- People movers;
- Sports utility vehicles.

If vehicles with these body types are supplied for an amount above the LCT threshold but without LCT being paid then the ATO would regard the arrangement as high-risk.

On the other hand, the supply of trucks and cargo or delivery vans without LCT would be treated as low-risk arrangements.

When it comes to utility vehicles (including single cab, dual cab and extra can utility vehicles) the ATO won't apply compliance resources if the passenger carrying capacity is less than 50% of the load carrying capacity. The passenger carrying capacity is determined by multiplying the number of seating positions by 68kg.

While the determination makes brief reference to the fact that this concept is used in other statutory contexts (e.g., in the FBT rules for exempt motor vehicles), the ATO doesn't specifically comment on whether the approach taken in LCTD 2023/1 will be applied in the context of the FBT rules, depreciation rules or GST rules.

More information
LCTD 2023/1

Cases

Timing of employment income

The AAT has confirmed that employment income will normally be derived for tax purposes at the time the payment is received, regardless of when the work was performed or when the entitlement to the payment arose.

This case involved an individual taxpayer who was working overseas as a non-resident when they became entitled to receive a 'performance bonus' from their employer. The employer was not in a position to pay the bonus to the taxpayer at that time. The amount was subsequently paid in instalments, after the taxpayer had returned to Australia and had become an Australian resident for tax purposes.

The dispute between the taxpayer and the ATO focused on when the bonus was derived. Had the bonus been derived while the taxpayer was still a non-resident then it would not have been taxed in Australia. This is because non-residents are normally only taxed in Australia on Australian sourced income. Employment income is typically sourced in the place where the work is performed (although there can be exceptions to this).

The AAT referred to the High Court decision in Carden's case, which established that in determining the appropriate basis on which to recognise the derivation of income, it is appropriate to consider whether the method gives a substantially correct reflex of the taxpayer's true income, and to discover whether income or gains have come home to the taxpayer in a realised or immediately realisable form.

Application of these principles has led to employee remuneration generally being treated as having been derived upon receipt. TR 98/1 provides guidance in this area and indicates that salary, wages or other employment remuneration are assessable on receipt even though they relate to a past or future income period.

As the taxpayer received the bonus payments when they were an Australian resident they were taxed on

their worldwide income. The fact that the income related to work performed overseas while the taxpayer was a non-resident didn't prevent the bonus from being taxed in Australia.

More information
Tawfik v FC of T [2023] AATA 2541

Taxi industry compensation payments

We have seen a significant upheaval in the taxi industry in recent years. Some State and Territory governments have been paying compensation to taxi licence holders in recognition of the adverse impact of these changes. In this case the AAT held that a compensation payment made to a taxpayer who held three taxi licences was not income according to ordinary concepts.

The taxpayer received a payment from the Victorian Taxi Reform Fairness Fund in recognition of significant financial hardship suffered as a result of reforms in the Victorian tax industry, including the reduction in value of taxi licenses and reduced income due to increased competition.

In determining the tax treatment of the payment the ATO focused on the fact that the payment was partly made in connection with reduced income. Compensation payments are normally taxed on revenue account if they are designed to replace lost income or profits.

However, the AAT considered that the payment was a one-off discretionary payment that was paid as a matter of public policy for the relief of unfair financial hardship. The payment was not a product of the taxpayer's remaining taxi business or a substitute for, or estimate of, income forgone. The payments were not made to encourage recipients to remain in business or subsidise the cost of doing business.

While AAT concluded that the payment should not be classified as ordinary income, unfortunately there was no consideration of how the payment should be dealt with for tax purposes. For example, the AAT didn't look at possible CGT implications associated with receiving the payment or whether the payment could potentially fall within the scope of the CGT exemption in section 118-37 which deals with compensation payments that meet certain conditions.

It is important for practitioners to remember that this case dealt with payments made under a specific Victorian scheme. Payments made in other jurisdictions or under different schemes may have different tax implications. For example, there is specific guidance on the New South Wales Point to Point Financial Assistance Scheme which indicates that those payments trigger CGT event C2 and a capital gain or loss can potentially arise – see the link here.

More information
Bains v FC of T [2023] AATA 2477

Interest expenses relating to a scam

The AAT concluded that a taxpayer could not claim deductions for interest incurred on funds borrowed from friends and business associates because there was not a sufficient connection with the taxpayer's income producing activities.

The taxpayer claimed that the funds borrowed from friends and associates were intended to be used in connection with a casino junket operation. The taxpayer claimed that he expected to derive assessable income from this activity and initially it appeared that the business was operating successfully. However, the casino junket operation was subsequently revealed to be a scam.

While the taxpayer ceased physically paying interest on the loans, he continued to claim interest deductions arguing that the expenses were incurred and that there was a sufficient connection with producing assessable income. While the taxpayer acknowledged that some of the funds were used for private purposes, he produced a report suggesting that this was only minor.

The Commissioner disallowed the deductions on the basis that:

- Some of the interest expenses were not actually incurred;
- There wasn't a strong enough connection with producing assessable income;
- Some of the borrowed funds were used to meet personal expenses.

The AAT decided in favour of the Commissioner and disallowed the interest deductions. The AAT also held that the taxpayer's actions constituted fraud or evasion.

The Tribunal found that even if the taxpayer genuinely believed that there was a genuine casino junket business that would generate profits, there were no formal agreements in place with the casinos or gamblers. There was never any possibility of the taxpayer gaining or producing assessable income from this activity.

Even if there was a sufficient connection with producing assessable income, the AAT wasn't convinced that only a small portion of the funds were used for private purposes. The taxpayer's records were poor and it was difficult to reconstruct their affairs with any confidence.

More information
Automotive Invest Pty Limited v Commissioner of Taxation [2023] FCAFC 129

More information
TKYY v FC of T [2023] AATA 2497

LCT and GST for cars displayed in a museum

The Full Federal Court has found that the owner and operator of a car museum was not holding the cars solely as trading stock even though the cars were held for sale in the ordinary course of business. This meant that the taxpayer could not escape LCT on the cars and could not avoid the application of the GST credit limit for luxury cars.

The taxpayer owned and operated a car museum, which was marketed to the public as a tourist attraction. The museum charged admission fees and hosted other events. The controller of the taxpayer was a licensed car dealer and gave evidence that the museum was a marketing strategy to increase car sales. The cars in the museum were classified as trading stock in the taxpayer's accounting and tax records. The taxpayer was registered for LCT and quoted when acquiring and importing cars, which meant that LCT was not payable.

The key issue in this case was whether the cars were acquired for the purpose of holding them as trading stock (other than holding them for hire or lease) and for no other purpose. The Commissioner wasn't disputing whether the cars were held as trading stock, but was arguing that the cars were also held for another purpose or use.

The Full Federal Court was split in its decision but the majority (Wheelahan and Hespe JJ) agreed with the Commissioner (and the primary judge) that the cars were not used only for the purpose of holding them as trading stock. The Court adopted a strict approach and held that the use of the cars as trading stock must be exclusive. The Court focused on the extensive promotion of the museum and the commerciality of the museum operations in finding that the manner in which the cars were displayed went much further than simply displaying the cars for sale in a showroom in a novel way.

Non-arm's length income (NALI) of an SMSF

Despite the AAT finding that the parties were *not* dealing on arm's length terms, the NALI provisions were not engaged. As a result, the income was not taxable at penalty rates.

The SMSF was the ultimate beneficiary / unit holder and derived interest income from a loan arrangement where funds were advanced through several associated entities (a unit trust where the SMSF was the unitholder, and two companies) before being loaned to unrelated parties.

The key factor in the decision was that although the related parties (the unit trust and companies) were not dealing with each other at arm's length, the income which was derived by the SMSF as a result of the arrangement *was not* more than the amount that the SMSF might have been expected to derive if those parties had been dealing with each other at arm's length.

The support of expert witnesses from the private lending space, indicating that the arrangement as structured was typical in commercial arrangements, was important on this point. The Commissioner's expert witness, on the other hand, was considered less knowledgeable in the relevant area, having experience mainly in the context of banks and larger lenders.

More information
BPFN v FC of T [2023] AATA 2330

Legislation

Parliament sat between 31 July 2023 and 10 August 2023. There was no new tax related legislation introduced and no significant developments in terms of legislation that was previously before Parliament. The next sitting is between 4 and 14 September 2023.

Treasury Laws Amendment (2023 Measures No. 1) Bill 2023

In front of the Senate since March, this Bill contains two major changes:

- Aligning the tax treatment of off-market share buy-backs undertaken by listed public companies with the tax treatment of on-market share buy-backs by amending the legislation so that no portion of the buy-back price will be treated as a dividend for tax purposes.
- Introducing an integrity measure to prevent certain dividends paid by companies from being franked where they are funded by capital raising.

Treasury Laws Amendment (2023 Measures No. 3) Bill 2023

Currently before the Senate, this Bill includes the changes to the recently introduced 'education and training standards' that financial advisers will need to meet, and amendments to the first home super saver (FHSS) scheme to allow individuals to amend or revoke their applications.

Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023

Also before the Senate, this Bill includes the major amendments to the thin capitalisation provisions, as well as the new rules requiring public companies to disclose information about subsidiaries in their annual financial reports.

Reporting exemptions for digital platform operators

Two draft legislative instruments were released dealing with the new reporting obligations of operators of digital platforms (e.g., such as Uber or Airbnb) and providing exemptions from reporting for certain transactions. The exemptions broadly apply for small operators (reportable transactions of less than $1m) with respect to accommodation or taxi travel, situations where another entity has a reporting obligation for the same transaction, and for transactions involving the supply of accommodation or taxi travel overseas.

More information
LI 2023/D15
LI 2023/D16