Coster Galgut
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TAX UPDATE – JULY 2023

What did I miss?

Finally, simplification of the individual tax residency rules is getting some traction with the release of a new Treasury consultation paper. But don't get too excited, it's only a consultation and we have had extensive consultation previously.

Treasury also released the exposure draft legislation to introduce the small business energy incentive announced in the May 2023 Federal Budget. The incentive provides SBEs with access to a bonus deduction equal to 20% of the cost of eligible assets or improvements to existing assets that support "electrification or more efficient energy use".

Also of interest is the release of a helpful new guide to subdivision projects by the ATO.

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From Government

The proposed ‘bright line’ individual residency tests

Want a step-by-step guide to determining someone’s residency status? Join Michael Carruthers for the Tax Residency for Individuals Web Series, 11 & 18 September 2023. More

Treasury has released a consultation paper on the long-awaited proposed reforms to the individual residency rules. If enacted, the proposal would introduce a simple ‘bright line’ test and would ensure that an individual who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident. Individuals who do not meet this primary test will be subject to secondary tests that apply a bit differently depending on their circumstances and would be based on a combination of physical presence in Australia and some limited measurable and objective criteria.

The primary aim of the reforms is to make it much easier to determine whether an individual is a resident of Australia for tax purposes compared with the current position.

The proposed reforms have been a long time coming - the Board of Taxation commenced work in this area back in 2016. The proposed rules already went through an extensive consultation period before being announced in the 2021-22 Budget. Then silence.

However, there is still no guarantee that the rules will be updated. Treasury has indicated that this process will help the Government determine whether to update the rules and whether the changes should be consistent with the Board of Taxation recommendations and the Budget announcement made in May 2021.

Very briefly, the proposed changes involve two primary tests and a series of secondary test that will be applied when an individual is not already treated as a resident under the primary tests.

The first primary test is the simple 183 day 'bright line' test where a person who is physically present in Australia for 183 days or more in any income year would be an Australian tax resident.

The second primary test, the 'government officials test', effectively replaces the current superannuation test and would operate to ensure government (including federal, state and territory) officials deployed overseas in the service of an Australian government are treated as tax residents throughout their deployment.

The secondary tests are relevant if an individual is not a resident under the primary tests and apply differently depending on whether they were a resident in the previous income year and if so, how long they have been a resident of Australia. A 45 day threshold is used in connection with the secondary tests.

More information
Modernising the individual tax residency rules

The Small Business Energy Incentive

Exposure draft legislation has been released in relation to the Small Business Energy Incentive announced in the May 2023 Federal Budget.

The incentive allows businesses with aggregated annual turnover of less than $50 million to access a bonus deduction equal to 20% of the cost of eligible assets or improvements to existing assets that support electrification or more efficient energy use. The maximum bonus deduction is $20,000 (i.e., up to $100,000 of qualifying expenditure).

To be eligible for the bonus deduction:

- The expenditure must be eligible for a deduction under another provision of the tax law; and
- The asset must be first used or installed ready for use, or the improvement cost incurred, between 1 July 2023 and 30 June 2024.

Some further guidance has been provided on what will qualify as eligible expenditure and this appears to be reasonably broad, if somewhat difficult to quantify. A new depreciating asset is eligible for the bonus deduction if:

- It uses electricity and there is a new reasonably comparable asset that uses a fossil fuel available in the market (e.g., the taxpayer chooses an electric asset over a gas / petrol powered asset); or
- It uses electricity and is more energy efficient than the asset it is replacing or, if it is not a replacement, a new reasonably comparable asset available in the market (e.g., broadly, upgrading to a more energy efficient asset, or picking a more energy efficient new asset); or
- It is an energy storage, demand management or efficiency-improving asset.

Improvements to existing depreciating assets may also be eligible for the bonus deduction if they enable an asset to use electricity instead of fossil fuels, to be more energy efficient, or facilitate energy storage, demand management or monitoring.

There are a range of exclusions from the bonus deduction, including expenditure on assets that can use a fossil fuel, assets which have the sole or predominant purpose of generating electricity, capital works, and motor vehicles.

Financing costs, including interest and borrowing expenses, are also excluded.

More information
Small Business Energy Incentive

Technical amendments to the GST and deduction rules

Treasury has released exposure draft legislation relating to a range of miscellaneous amendments to legislation that falls within the Treasury portfolio. This includes some proposed technical amendments to how GST input tax credits can be claimed if they are not included in the relevant activity statement. Under the proposed new provisions, if an input tax credit that is attributable to a tax period is not taken into account in

a taxpayer's assessment for that period (e.g., not claimed in the relevant BAS), the taxpayer may elect for the input tax credit to instead be attributable to a later specified tax period (i.e., claimed in a later BAS). This is subject to the ordinary 'four year rule' in relation to claiming input tax credits.

The draft legislation also includes a modification to the 'four year rule' in relation to claiming input tax credits in situations where the Commissioner has determined the GST period in which the credit is attributable. The change aligns the end of the period to four years after the period in which the Commissioner determined the credit was claimable.

There is also some clarification on the ability to claim an income tax deduction for GST paid by way of reverse charge. To reflect the fact that GST payable by way of reverse charge is a legitimate cost that a taxpayer can incur in deriving assessable income, the income tax legislation (section 27-15 ITAA 1997) would be amended to confirm that these amounts are deductible, to the extent that the cost cannot otherwise be recouped via an input tax credit under the GST system.

More information

Miscellaneous Amendments to Treasury Portfolio Laws 2023

From the Regulators

Small scale subdivision projects

Want more on advising on the tax and GST treatment of subdivision projects?

Join Michael Carruthers for the Property Subdivision Web Series, 17 & 24 August. More

The ATO has released some fresh guidance on how to determine the tax treatment of property subdivision activities, both from an income tax perspective and GST perspective. The guides make a useful and practical addition to some of the ATO's existing and more technical guidance in this area.

When a taxpayer subdivides land into smaller lots it is necessary to determine how the sale of the subdivided lots will be taxed. The three main possibilities are as follows:

- The sale is treated as the mere realisation of a capital asset and taxed under the CGT rules;
- The sale occurs in the ordinary course of a property development business, in which case the land is held as trading stock; or
- The sale occurs in connection with an isolated profit making undertaking, with the net profit or loss being recognised on revenue account.

The ATO guide looks at each of these categories, with reasonably detailed guidance on the key factors that need to be considered in determining the tax treatment of the project such as:

- The type of entity undertaking the subdivision;
- The types of activities the taxpayer is involved in;
- The costs incurred prior to the sale;
- The complexity and steps undertaken;
- The parties and phases involved in the project;
- The taxpayer's relationship to other parties involved in the subdivision project;
- The taxpayer's purpose in buying the land; and
- The timing and steps undertaken for the sale.

One of the key points for advisers to remember is that a taxpayer's purpose might change throughout the ownership period of the land. For example, land initially acquired and held as a capital asset can potentially start being held on revenue account if it is contributed to a profit making project that goes beyond the mere realisation of a capital asset. The ATO guide includes an example on how to undertake tax calculations in situations like this.

While guidance on the GST position is relatively brief, the ATO confirms that where a property project is taxed on revenue account there are likely to be some GST implications, although this will always depend on the situation.

Separately, the ATO has published a guide containing two examples of relatively common scenarios involving

the acquisition or subdivision of land, where the ultimate sale is considered to be on capital account.

More information

- Subdividing land
- Tax consequences on sales of small-scale land subdivisions
- Examples of tax consequences on sales of land including small-scale land subdivision

Clarifying deductions for digital product expenses

The ATO has released some guidance on the typical treatment of expenses that are incurred by business taxpayers in connection with digital products.

First, the ATO confirms that operating expenses incurred in the everyday running of a business can generally be claimed as a tax deduction in the year in which they are incurred. This would normally cover expenses such as ISP fees, software subscription fees, the ongoing costs of operating a website, file-sharing services, cloud storage and asset lease payments.

When it comes to capital expenses it is necessary to determine whether they relate to a specific depreciating asset, in which case deductions would generally be claimed over a number of years, although immediate deductions can be available in some cases (e.g., under the temporary full expensing rules or small business instant asset write-off rules). Examples include the costs of computers and computer accessories, mobile phones and tablets, POS machines, in-house software, and the cost of acquiring or developing a website.

With respect to software costs, the ATO indicates that software subscription fees and the cost of commercial off-the-shelf software with an effective life of one year or less can be claimed immediately, although the deduction needs to be reduced to take into account any private usage.

Regardless of whether the expenses are normal operating costs or relate to a depreciating asset it is important to identify whether there is an opportunity to take advantage of the small business technology investment boost. The boost provides a bonus deduction of 20% for eligible expenditure incurred by small businesses with aggregated annual turnover of less than $50m between 7:30pm AEDT on 29 March 2022 and 30 June 2023.

More information

Claiming a deduction for digital product expenses

GST and digital currency

The ATO has provided some refined guidance on the GST treatment of digital currency. The GST system contains specific rules dealing with the treatment of digital currency. When someone disposes of digital currency in exchange for money or digital currency they are normally treated as making an input taxed supply, although GST-free treatment can apply if the supply is made to a non-resident.

For GST purposes the term ‘digital currency’ refers to a digital unit of value that:

- Is fully interchangeable with the same digital currency
- Can be provided as payment
- Is available to the public free of any substantial restrictions
- Is either not denominated in any country's currency or denominated in a currency that is not issued by, or under the authority of, an Australian or foreign government
- does not have a value that is derived from or is dependent on anything else
- does not give an entitlement to receive something else unless it is incidental to holding it or using it as payment
- if supplied, would not be an input-taxed financial supply for a reason other than being a supply of a digital currency or money.

Digital currency does not include:

- Non-fungible tokens (NFT’s). The supply of a NFT is taxable unless it is GST-free.
- Stablecoins, which are broadly cryptocurrencies pegged to the value of some other asset (such as a commodity or fiat currency. The supply of a

stablecoin is an input-taxed financial supply unless it is GST-free.

The ATO confirms that receiving or using digital currency to pay for goods and services in a GST-registered enterprise is basically the same as using money for GST purposes. When using digital currency, the GST component of an invoice (either received or paid) needs to be converted into Australian dollars to work out the GST liability or the GST credit that can be claimed.

In situations where the transaction involves a digital currency exchange and where the other party can't be identified, the taxpayer can use the location of the digital currency exchange to treat a supply as GST-free if the exchange is not located in Australia.

While it is not normally possible to claim GST credits for expenses incurred in making input taxed supplies, there are some limited exceptions to this. Firstly, if an entity doesn't exceed the financial acquisitions threshold (FAT) then it can claim GST credits relating to financial supplies. If the entity exceeds the FAT, then it can potentially claim reduced GST credits on specific expenses relating to financial supplies, but this would not normally apply to general expenses like computer hardware, internet, accounting fees etc. When it comes to dealing with cryptocurrency it may be possible to claim reduced GST credits on things like:

- Commission, brokerage costs or arranging services provided by entities that facilitate buying and selling of digital currencies,
- Costs in relation to transaction processing, account maintenance and report generation services.

There is also some guidance for taxpayers who operate a digital currency exchange and are registered for GST. A supply of facilitating trades of crypto assets will be taxable if made to an Australian resident located in Australia, and GST-free if made to a non-resident who is not located in Australia.

More information

- GST and digital currency
- GST and digital currency as payment
- GST and digital currency exchanges
- GST and trading digital currency

Lodging out of time objections

Taxpayers can object to tax assessments and certain other ATO decisions within a specific time limit, which varies between 60 days to 4 years. If the time limit expires the taxpayer can request an extension by including a written request with the objection, explaining why the objection is late.

There is no guarantee that the ATO will grant an extension. ATO's administrative approach to this area is outlined in PS LA 2003/7, which has recently been updated.

Some of the main factors that the ATO will consider in deciding whether to allow a late objection include:

- Whether the objection and the application for an extension of time was lodged by the taxpayer as soon as circumstances permitted
- The taxpayer's explanation for failing to lodge the objection within the time limit
- The duration of the delay
- Whether the taxpayer has an arguable case that the objection should be allowed in full or in part

The ATO indicates to its officers that late objections may be granted where:

- the taxpayer was too ill to lodge an objection
- The taxpayer was overseas, did not return until the time limit had expired, and this was the reason for the delay
- The taxpayer thought that lodging an objection was futile until a court decision, or a change in legislation or a public ruling, was made shortly after the time limit expired which made the objection reasonable
- The taxpayer thought that lodging an objection was futile but then discovered they may have believed this because the ATO gave them incorrect information
- The issue involves an important question of law or practice
- The delay in lodging an objection in time was caused by the ATO's conduct
- The taxpayer's adviser, despite receiving prompt instructions, was negligent and failed to execute those instructions
- An individual or small business with a 2-year time limit has lodged, within 4 years, an objection that

discloses an arguable case for the objection to be allowed in full or in part.

More information

Lodging an objection outside the time limit?

PS LA 2003/7

2023 changes to deduction rules

The ATO has published a reminder of key points to note when completing 2023 tax returns for clients, including:

- The cents per kilometre rate for individuals claiming car expenses increased from 72 to 78 cents per kilometre in the 2023 income year.
- The car limit for depreciation purposes increased to $64,741 for the 2023 income year. The car limit only applies to motor vehicles that are classified as cars and are designed mainly to carry passengers.
- The fixed rate method for home office expenses increased from 52 cents to 67 cents per hour worked from home and no longer requires the taxpayer to have a dedicated home office space. However, it is necessary to maintain more detailed records confirming the hours worked from home. The fixed rate method covers electricity, gas, stationery, computer consumables, internet, and phone usage. Separate deductions can be claimed for expenses not included in the fixed rate, such as depreciation on computers.

More information

Changes to deductions this tax time

ATO flags CGT problem areas

The ATO has provided a warning on key areas of concern when it comes to CGT issues for privately owned and wealthy groups. These are broadly separated into three areas, with the main issues attracting ATO attention summarised below:

Disposal of assets

- Capital gains reported are less than what their estimates are (based on external data sources)
- Companies claiming the CGT discount
- Beneficiaries that fail to gross up the discounted share of capital gains distributed by a trust
- Entities that disposed of high value assets, but report small capital gains or claim unsubstantiated capital losses
- Taxpayers incorrectly applying CGT rollover provisions

Capital Losses

- Losses that appear to be excessive, incorrect or misclassified
- Changes to the company in a year the loss occurred (e.g., potentially meaning the continuity of ownership test or business continuity test might have been failed)
- Capital losses from non-arm's length transactions, where the market value substitution rules are not considered or applied
- Capital losses artificially generated to offset capital gains (e.g., wash sales)
- Reclassifying capital losses as revenue losses to offset taxable income

Small business CGT concessions

- Entities that fail the small business entity tests ($2m turnover tests or $6m maximum net asset value test)
- Where the asset disposed of does not meet the definition of an active asset
- Entities that do not meet the additional conditions where the CGT asset is a share or trust interest
- Restructures for the primary purpose of enabling access to small business CGT concessions, which might not otherwise be available
- Entities that claim the small business rollover, but do not report CGT event J5 at the end of the replacement asset period when they fail to acquire a replacement asset

More information

Capital gains tax

Digital games tax offset

The recently legislated digital games tax offset (Division 378 to the ITAA 1997) provides eligible game developers with a 30% refundable tax offset for qualifying Australian development expenditure from 1 July 2022.

The offset applies to the completion, ongoing development or porting of digital games, subject to meeting the relevant eligibility criteria, which includes certification by the Arts Minister and the company incurring at least $500,000 of qualifying expenditure.

The offset is capped at $20 million per company (or group of companies that are connected or affiliated) per income year. Reaching this cap would require approximately $66.7 million in eligible expenditure.

The offset is available for Australian resident companies with an ABN, and non-resident companies with a permanent establishment in Australia and an ABN.

More information
Digital Games Tax Offset

Working holidays makers taxed as Australian residents

After the High Court decision in the *Addy* case back in November 2021, working holiday makers (individuals holding a subclass 417 or 462 visa) may be taxed on the same basis as a resident Australian national if they are from a country that has a double tax agreement which contains a non-discrimination article (NDA) and they are an Australian resident for tax purposes.

This can include taxpayers from Chile, Finland, Germany (from 2017–18), Israel (from 2020–21), Japan, Norway, Turkey, and the United Kingdom.

The application of this treatment will generally be limited because most working holiday visa holders will be classified as non-residents for tax purposes, although proposed changes to the residency rules could have an impact on this area.

The ATO clarifies that working holiday makers from an NDA country who are treated as Australian residents for tax purposes will have tax withheld by their employer at the 15% rate, but it is possible to lodge a PAYG variation. However, the individual will pay the lower amount of tax that results from being assessed:

- On the same basis as a resident Australian national earning the same income in the same circumstances, or
- As a working holiday maker.

The amount of tax that needs to be paid in Australia will depend on whether the individual only derives Australian sourced income or has a mixture of Australian and foreign sourced income.

The ATO also provides guidance on how to complete the tax return for these individuals and the procedure for amending prior year returns, if necessary.

More information
Taxation of Australian resident WHMs from NDA countries

Cases

GST fraud in the precious metals industry

The ATO has released a decision impact statement concerning a recent case involving GST fraud in the precious metals industry.

The case involved two broad sets of transactions, but the focus of the appeal to the Full Federal Court was the second set of transactions, which involved:

- Manila Exchange acquired gold bullion under a GST-free supply and purportedly adulterated the gold bullion thereby producing scrap gold.
- Manila Exchange sold the scrap gold to GB Traders as a taxable supply in respect of which GST was payable. GB Traders claimed input tax credits for the GST it paid.

- Manila Exchange did not remit the GST it collected on the taxable supplies.
- GB Traders sold the scrap gold to PMMS as a taxable supply.
- PMMS sold the scrap gold to CSS (the taxpayer) as a taxable supply. The taxpayer claimed input tax credits.
- The series of transactions ended with CSS causing the export of the scrap gold to Emirates Gold in Dubai, claiming that GST-free export supplies of scrap gold were made. PMMS negotiated and arranged the export sales of scrap gold on behalf of CSS.

The AAT found that the GST general anti-avoidance rules in Division 165 did not apply to deny input tax credits for the taxpayer as it could not be concluded that any entity had a dominant purpose of securing the taxpayer's entitlement to the input tax credits. Further, the principal effect of the scheme was the non-payment of GST by Manila Exchange and not the taxpayer obtaining input tax credits.

The Commissioner appealed the decision to the Federal Court, focusing on issues relating to the operation of the anti-avoidance rules in the GST legislation and in particular the 'dominant purpose' and 'principal effect' tests.

The Full Federal Court held that the AAT made errors in the way it had applied Division 165. The critical point made by the Court was that the purpose of each entity identified under the scheme needs to be analysed. Different entities may, and often will, have different dominant purposes. Further, the legislation requires that the consideration of each entity's purpose in entering into a specific part of the scheme is based on that part being the entire scheme (i.e., it needs to be considered in isolation).

Similarly, the Court indicated it is not only the principal effect of the scheme as a whole which will engage the operation of Division 165. If the principal effect of any part of the scheme is that the avoider receives a GST benefit from the scheme (directly or indirectly), then Division 165 is engaged. Again, different parts of the scheme may, and often will, have different principal effects, and the principal effect of each part of the scheme needs to be considered in isolation.

While the Court indicated that Division 165 should not apply in circumstances where the taxpayer was not a party to and had no involvement with or knowledge of the fraud perpetuated by another party, this may not be the case if the arranger of the sales (i.e. PMMS) was a party to, had knowledge of, or was willfully blind to that deliberate adulteration and fraud.

On a complete view of the facts and the purpose of each party, it was possible that the AAT may have concluded that PMMS had the requisite dominant purpose of enabling the taxpayer to obtain a GST benefit, and that the principal effect of the part of the scheme in which PMMS was involved was to secure input tax credits for the taxpayer. On this basis, the Full Federal Court allowed the Commissioner's appeal, which means that the Division 165 issues will need to be reconsidered by the AAT.

More information

Decision Impact Statement - Commissioner of Taxation v Complete Success Solutions Pty Ltd ATF Complete Success Solutions Trust

Was a payment for acquisition of a JV interest deductible?

While the facts of this case are extremely complex and the decision was heavily dependent on the interpretation of the specific legal documents involved (joint venture arrangement and farm-out arrangement), the case serves as a valuable reminder of the process that should be followed when considering the tax treatment of expenditure incurred by a client.

Very briefly, the taxpayer in this case paid a significant lump sum to another party in a joint venture arrangement and sought to claim a deduction for the payment, which was disallowed by the ATO. The AAT ultimately agreed with the ATO's view that the payment was on capital account.

When a taxpayer incurs expenses in connection with business or other income producing activities the starting point is to consider whether there is a basis to

claim an immediate deduction on revenue account under the general deduction provisions in section 8-1. This involves determining whether there is a sufficient nexus with producing assessable income and whether the deduction could be denied by the negative limbs of section 8-1, such as the expenditure being capital or private in nature.

If a deduction is not available under section 8-1, it is necessary to consider whether a deduction could be claimed under the specific deduction provisions in Division 25 or another provision in the tax legislation.

If the expenditure is capital in nature and is not deductible under any specific provisions, the next step is considering whether it can be included in the cost of a depreciating asset or the cost base of a CGT asset. This is a step that is sometimes overlooked by advisers and there can sometimes be a tendency to skip straight to the blackhole expenditure rules in section 40-880 which really only apply if no other form of tax relief is available.

In this case, the AAT concluded that the expenditure was capital in nature and while it didn't form part of the cost of a depreciating asset, it did form part of the cost base of a CGT asset (i.e., an interest in the joint venture arrangement). As the expenses were included in the cost base of a CGT asset they could not qualify for a deduction under the blackhole expenditure rules.

More information
Richmond v FCT [2023] AATA 1915

Legislation

Parliament sits between 31 July 2023 and 10 August 2023.

Streamlining fuel and alcohol excise compliance

Amongst other things the Treasury Laws Amendment (Refining and Improving Our Tax System) Bill 2023, introduces the 2022-23 Budget measures to streamline fuel and alcohol excise compliance. The Bill has passed Parliament and received Royal Assent on 28 June 2023.

From 1 July 2023, fuel and alcohol businesses with an annual turnover of less than $50 million will be able to lodge and pay excise and excise equivalent customs duty on a quarterly basis, rather than weekly or monthly. These businesses will lodge returns and pay excise by the 28th day of the month after the end of each quarter (see chapter 4).

And, small-scale repackaging of beer into smaller containers will not be taken to be the manufacture of beer for the purposes of the Excise Act (chapter 5).

The beer must be repackaged into exempt beer containers, which are sealed individual containers with a capacity of no more than 2 litres and are not pressurised (containers commonly known as "growlers"). The retail sale of the beer must occur immediately after the repackaging of the beer.

In addition, only the first 10,000 litres of beer that is repackaged into the exempt beer containers at particular premises in a financial year is not taken to be the manufacture of beer.

If the beer repackaging is not taken to be the manufacture of beer, then a manufacturer licence will not be required (unless the entity is otherwise undertaking excise manufacture or exceeds the 10,000-litre limit in a financial year), and no excise duty is payable on the repackaged beer (up to the yearly limit).

The amendments apply from 1 July 2023 to beer repackaged on or after the commencement date.

Correcting GST errors

A draft legislative instrument has been issued which sets out the ability for taxpayers to correct GST errors from earlier tax periods by including these as an adjustment to the net GST position in a later tax period, rather than making an amendment to the earlier activity statement.

The instrument provides that taxpayers may correct an error made in an earlier tax period if:

- The error relates to an amount of GST, an input tax credit or an adjustment.
- The earlier tax period started on or after 1 July 2012.
- The later activity statement is lodged within the period of review for the assessment of the net GST amount of the earlier tax period.
- At the time of lodging the activity statement for the later tax period, the error does not relate to a matter that is subject to a compliance activity, it was not made in working out the net GST amount for an earlier tax period that is subject to compliance activity and the Commissioner has not notified the taxpayer in writing that the error can be corrected under the instrument.
- The taxpayer has not corrected that error, to any extent, in working out the net GST amount for another tax period.

If the error is a debit error (i.e., an error that resulted in the GST liability being understated), the following further conditions need to be satisfied:

- The error was not a result of recklessness as to the operation of a GST law or intentional disregard of a GST law.
- The error is corrected in a GST return that is lodged within the debit error time limit.
- The net sum of the debit errors is less than the debit error value limit.

More information
LI 2023/D13
Explanatory Statement
Debit Error Time Limit and Value Limit

Digital games tax offset

A legislative instrument connected with the implementation of the digital games tax offset has also been published. The instrument primarily relates to the process of obtaining a certificate to access the offset from the Arts Minister and establishes the Digital Games Tax Offset Advisory Board.

More information
Income Tax Assessment (Digital Games Tax Offset) Rules 2023