Coster Galgut
Chartered Accountants

T AX UPDATE – APRIL 2024

What did I miss?

This month, self-education deductions denied by the AAT for a dental technician studying to be a registered dentist and the ATO's warning around common Division 7A mistakes.

The ATO has been ramping up its efforts to educate practitioners and taxpayers on some of the key aspects of Division 7A. The ATO seems to be concerned that too many mistakes are being made in this area and that fundamental aspects of the rules are being overlooked or misunderstood.

We also look at an AAT decision where a dental technician was denied deductions for self-education costs to become a registered dentist.

Plus, significant changes to the thin capitalisation rules have now received royal assent.

Regards,
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INSIDE

From Government

Income tax concessions for the build-to-rent sector

In the context of a trend towards more Australians renting and declining rates of home ownership, Treasury has released draft legislation and explanatory materials for consultation on proposed income tax concessions designed to encourage investment and construction in the build-to-rent sector. These measures were first announced in the 2023-24 Federal Budget.

For eligible build-to-rent projects where construction commenced after 7:30pm AEST on 9 May 2023, the measures propose to:

- Increase the capital works deduction rate from 2.5% to 4% per year; and
- Reduce the final withholding tax rate on payments of rental income made to foreign residents from managed investment trusts from 30% to 15%.

To qualify for these concessions, the draft legislation requires the development to meet the following conditions:

- The development consists of 50 or more residential dwellings made available for rent to the general public;
- All dwellings in the development must continue to be owned together by a single entity for at least 15 years, although the development could be sold to another single entity during this period and continue to qualify;
- Dwellings in the development must be offered for lease terms of at least three years, but the rules allow tenants to request a shorter period; and
- At least 10% of the dwellings are available as affordable tenancies. The concept of affordable tenancies requires the dwellings to be rented or made available for rent at 74.9% or less of the market rate to certain eligible tenants.

More information

- Build-to-rent tax concessions

Ensuring low-income earners are not subject to higher Medicare levy when receiving backpay

Following an announcement in the 2023-24 Federal Budget, Treasury has released draft legislation and explanatory materials for consultation which are targeted at ensuring low-income earners who receive eligible lump sum payments are not subject to a higher amount of the Medicare Levy.

This can become relevant in situations where individuals receive lump sum compensation for underpaid wages. Subject to meeting certain conditions, the proposed changes are designed to ensure low-income taxpayers are not denied concessional Medicare levy treatment (e.g., as a result of not exceeding the Medicare levy threshold) that they would have otherwise received had they been paid correctly.

To qualify for relief, the proposed measures require the taxpayer to:

- Be eligible for a reduction in the Medicare levy in the two most recent years to which the lump sum accrues; and
- Satisfy the eligibility requirements of the existing lump sum payment in arrears tax offset. This includes that the lump sum accounts for at least 10% of the taxpayer's income in the year of receipt.

The changes are intended to apply from 1 July 2024 onwards.

More information

- Exempting lump sums payments in arrears from the Medicare levy

From the Regulators

ATO's warning on common Division 7A mistakes

The ATO is warning that a series of common mistakes are being made in relation to Division 7A, which can apply when shareholders or their associates access money and assets from a private company.

Division 7A is a focus area of the ATO. If taxpayers fail to identify and deal with Division 7A issues appropriately, this can lead to harsh tax outcomes resulting in a deemed unfranked dividend in the hands of the shareholder or their associate.

While Division 7A contains some complex and highly technical provisions, the ATO has indicated that often the mistakes that are being identified relate to fundamental aspects of the rules.

One of common way of preventing a loan from a private company to a shareholder or their associate being treated as a deemed unfranked dividend in the year the loan is made is to ensure the loan is placed under complying loan terms by the relevant deadline. However, the ATO has been identifying situations where loan arrangements don't meet the strict requirements contained in Division 7A.

In order for a loan to be subject to complying Division 7A terms there needs to be a written agreement which meets the following requirements:

- A minimum interest rate at least equal to the Division 7A benchmark rate; and
- A maximum term of 7 years (or in some cases 25 years if the loan is secured by a mortgage over real property).

Placing a loan under a complying Division 7A loan agreement will normally prevent the full loan balance from being treated as a deemed dividend. However, if the borrower doesn't make the minimum annual loan repayments in a subsequent income year then this can trigger a deemed dividend for the shortfall in the repayments for that year. The ATO has identified that it is relatively common for errors to be made when making minimum repayments.

It is also important to remember that the use of private company assets by a shareholder or their associate can sometimes be treated as a payment for Division 7A purposes, which can trigger a deemed dividend if the shareholder or associate doesn't pay market rates for the use of the asset. The ATO is finding that taxpayers often don't realise that the use of private company assets can trigger Division 7A or they aren't taking appropriate steps to prevent a deemed dividend from arising.

The low level of compliance with Division 7A has prompted the ATO to launch a series of webinars and articles to help educate practitioners and taxpayers on key aspects of the rules. However, this doesn't mean that the ATO won't continue to undertake reviews and audits looking for situations where Division 7A has been triggered. This is clearly an ATO focus area at the moment and practitioners should ensure that appropriate steps are being taken to identify potential Division 7A problems and that these are managed carefully.

More information

- Accessing private company money or assets?

Changes to trust and beneficiary returns

The ATO is introducing changes to the trust and beneficiary tax returns as part of the Modernisation of Trust Administration Systems project announced in the March 2022 Federal Budget.

As these changes apply from 1 July 2024, this will impact on lodgments for the 2023-24 income year onwards.

A brief summary of the changes is set out below.

First, the ATO is adding four CGT labels in the statement of distribution in the trust tax return. The intention is that this will assist in notifying beneficiaries of their trust entitlements and support the CGT calculation in their own tax return.

Second, the ATO is introducing a new trust income schedule that all beneficiaries receiving trust distributions will be required to lodge. The schedule is designed to align with the statement of distribution in the trust's tax return. This is why the ATO recommends that beneficiaries obtain a copy of the trust's statement of distribution relating to their own trust distributions.

Last, the ATO has also supplemented this with data validation controls in the practitioner lodgement service to ensure accurate reporting. This means practitioners won't be able to lodge trust and beneficiary returns without completing the required information.

More information

- Modernising trust administration systems

Passive investor guide for Top 500 private groups

The ATO engages with and reviews some of the largest private groups through its Top 500 program.

Recognising that private groups operate in different industries, the ATO has now provided a simplified pathway towards achieved justified trust for taxpayers in the Top 500 group whose income is mainly derived from passive investment activity. Achieving justified trust broadly normally results in a reduced level of ATO engagement.

One of the ATO's focus areas in the Top 500 program is tax governance. To that end, the ATO has released illustrative examples of well-designed tax governance procedures for recognising tax issues and risks for the following three classes of passive investment activities:

- Income from shares in listed companies;
- Income from leasing of real property; and
- Interest income.

Although not intended to be exhaustive, the guides highlight a list of tax issues that can potentially arise in these areas and the types of typical processes and procedures that can be put in place to show effective tax governance in relation to these issues.

While the guides are targeted at the Top 500 private groups, they can be relevant to other passive investors deriving income from listed shares, properties and/or interest income. It would be prudent for practitioners with clients deriving material amounts of passive income to review the guide to determine what might be considered good practice in terms of procedures and processes to put in place.

More information

- Passive investor guide for the Top 500 private groups

ATO warning signs of a tax scheme

The ATO is warning clients to not get caught up in tax schemes that might be too good to be true.

A tax scheme may involve complex transactions, distort the way funds are used to avoid tax or incorrectly claim rebates and refunds and typically involve the deliberate exploitation of the tax system (rather than acting within the intent of the law).

While tax schemes may vary in how they are structured, the ATO sets out the following warning signs of advisers who:

- Offer zero-risk guarantees for their product;
- Ask to maintain secrecy to protect the arrangement from rival firms;
- Charge a fee or commission based on the amount of tax that is saved;
- Discourage obtaining independent advice;
- Do not have a product disclosure statement or prospectus for the product; and
- Offer advice about phoenixing or liquidation of key companies.

Entering into an unlawful tax scheme can end up costing clients not only back taxes but also interest and penalties. The ATO recommends taxpayers to double check the arrangement is legitimate before committing.

More information

- Before you commit, check it is legit

Private public partnerships and social infrastructure

The ATO has updated its guidance on social infrastructure public private partnerships.

This broadly involves a consortium agreeing with the government to construct, operate and maintain some form of public infrastructure. Examples of infrastructure projects include schools, hospitals, prisons, roads and public utilities.

The ATO's updated guidance covers the income tax and GST implications of social infrastructure projects using a securitised licence model, as well as the tax implications to investors (including on exit). The ATO's guidance also discusses where it will focus its attention when it comes to compliance activities.

It is important to be aware that the tax issues in this area can end up being quite complex. It would be prudent for practitioners with clients involved in a social infrastructure public private partnership to review the ATO's guidance and ensure that they are across the key tax issues.

More information

- Private public partnerships and social infrastructure

Changes to fuel tax credit rates

With fuel tax credit rates having changed from 5 February, the ATO has issued a timely reminder that taxpayers normally need to use the latest rates for the dates the fuel was acquired.

To help with the calculation, the ATO reminds clients that they can use the ATO's 'Fuel tax credit calculator' which already takes into account any fuel tax credit rate changes.

The ATO is also reminding clients of the simplified methods that could potentially be used to help simplify record keeping and calculate fuel tax credit claims. One of these simplified methods allows eligible clients to calculate their fuel tax credit claim based on the rate that applies at the end of the period (rather than requiring clients to split fuel purchases during the period using two different rates).

More information

- Getting your fuel tax credit rates right

Claiming reduced GST credits on complex outsourced IT agreements

The ATO has issued a document which set out its expectations when clients claim reduced GST credits on complex information technology outsourcing arrangements.

It isn't normally possible to claim GST credits for acquisitions that relate to making input taxed supplies. Financial supplies are normally treated as input taxed supplies. However, in some cases a taxpayer will be able to claim reduced GST credits for certain acquisitions that relate to making input taxed financial supplies.

The focus of this document is on whether acquisitions relating to IT outsourcing arrangements qualify for reduced GST claims as "processing services" in relation to account information under table item 2 of subsection 70-5.02(1) of the GST Regulations (item 2).

Some of the areas which the ATO might focus on when reviewing this area include the following:

- Understanding the IT outsourcing agreement, specifically whether the taxpayer retains responsibility and control over the processing function. If so, they might not qualify for reduced GST credits under item 2;
- Determining which parts of the outsourcing agreement are directed towards a specific processing outcome in relation to account information;
- Looking at services or applications that perform operational functions, as well as those that are supportive of the general IT environment; *and*
- Where an acquisition only qualifies partly as a reduced GST credit, checking whether a reasonable apportionment approach has been adopted.

More information

- ATO expectations on how you support your reduced input tax credit claims on complex information technology outsourcing agreements

R&D tax offset claimed denied

The ATO has issued a decision impact statement in response to the AAT decision in *GQHC and Commissioner of Taxation [2024] AATA 409*.

In brief, the case dealt with a taxpayer which conducted poultry farming operations and claimed the R&D tax offset in its 2013 tax return. The taxpayer claimed the R&D offset in relation to research and development expenditure associated with improvements to poultry incubation and hatchery processes, new water treatment processes, techniques to improve laying shed cleaning efficiency and the development of methods to improve broiler performance and yield.

The AAT considered the following issues.

First, the AAT decided on a jurisdictional issue. While the ATO is normally bound by findings made by Innovation and Science Australia, the AAT confirmed that the ATO has the power to make decisions around the eligibility of the entity's registered R&D activities where no such findings have been made by Innovation and Science Australia.

Second, the AAT concluded that the taxpayer's activities were not eligible R&D activities. The AAT confirmed that there needs to be sufficient evidence of scientific observation and evaluation being undertaken to qualify for the R&D offset, as well as a baseline threshold for quality with the work based on the principles of established science.

Last, the AAT considered the feedstock adjustment rules, which can cause an amount to be included in the taxpayer's assessable income. In broad terms, the intent of these rules is to ensure a 'claw back' of the R&D tax offset where goods and materials are transformed during R&D activities to produce a valuable tangible product.

The ATO has issued a number of taxpayer alerts relating to the R&D tax incentive over the years and this decision should serve as another warning that taxpayers and practitioners need to approach this area of the tax system very carefully.

It is also important to remember that even if a taxpayer meets all the conditions to qualify for the R&D tax offset, the position still needs to be monitored in future years. This is because adjustments can potentially arise under the feedstock rules and other 'claw back' provisions which can sometimes lead to the benefit of the tax offset being unwound to some extent.

More information

- GQHC and Commissioner of Taxation

Rulings, Determinations & Guidance

Liability of executor to deceased's tax obligations

The ATO has updated PCG 2018/4 which is intended to provide certainty to the legal personal representative (LPR) of a deceased individual on their personal liability for any outstanding tax obligations of the deceased individual.

The LPR is generally responsible for ensuring that any outstanding tax obligations and liabilities of the deceased are dealt with as part of the administration of the estate. In general terms, the LPR's liability to pay outstanding tax liabilities of a deceased person is limited to the value of the deceased's assets which form part of the estate. However, in some cases the LPR may have to meet liabilities personally if they distribute the assets of the estate with notice of a claim or potential claim by the ATO.

The guideline sets out the situations where the ATO will treat the LPR as having notice of a claim and when they will not be regarded as having such notice. However, the guideline only applies if the deceased individual's estate is considered "less complex".

Originally, one of the conditions to be regarded as a "less complex" estate was that the total market value of the assets of the deceased estate at the date of the death was less than $5 million. This threshold has now been lifted to $10 million.

The ATO has also included additional examples and commentary to provide greater certainty to LPRs seeking to rely on the guideline.

More information

- PCG 2018/4

Cases

Self-education deductions denied for a dental technician studying to be dentist

The AAT in *Ionita and Commissioner of Taxation [2024] AATA 808* held that the self-education costs of a dental technician in relation to undertaking exams to become a registered dentist were not deductible. This outcome was reached even though the taxpayer was already working in the dental industry.

The taxpayer originally qualified as a dentist in Romania before moving to Australia to work as a dental technician in or around 2013. In order to become a registered dentist in Australia, the taxpayer undertook an initial assessment and subsequent written and practical exams over a number of years which were facilitated by the Australian Dental Council of Australia.

The taxpayer sought to claim deductions for the costs of the various exams and assessments, as well as travel and accommodation costs that were incurred to undertake these exams and assessments.

The key issue considered by the AAT was whether the self-education activities undertaken by the taxpayer had a sufficient connection with her current income earning activities as a dental technician.

The taxpayer predominantly tried to argue that the duties and skills of a dental technician and dentist are similar. The taxpayer's argument was that studying to become a registered dentist helped the taxpayer perform her current role as a dental technician more effectively.

To lend support to this argument, the taxpayer produced a letter from her employer stating that her skills and knowledge improved rapidly during her period of employment leading to pay increases well above inflation.

The AAT disagreed with the taxpayer. In particular, the AAT considered that the studies to become a registered dentist were not necessary to her role as a dental technician, did not improve her skills and knowledge in performing that role and otherwise also did not lead to an increase in her income as a dental technician.

The AAT reached this conclusion having regard to the following:

- The self-education was not required to maintain her skills as a dental technician as her employment contract and professional body did not require this study;
- Studying to become a registered dentist was not linked to an improvement in performing her role as dental technician because the job of a dentist and dental technician are fundamentally different. While a dentist's duties involve patient treatment and care, a dental technician's role involves working in a lab to create plaster and stone models, impression trays, refine and repair dentures, etc; *and*
- The taxpayer's studies did not lead to increase to her income as a dental technician. While the AAT noted that her employer's letter stated that the taxpayer's salary had increased over the years, this could be due to other factors including the skills and experienced she gained while working over this period. In particular, the AAT did not find a link between completing the various assessments and exams to the timing of her pay increases.

The AAT ultimately considered that the taxpayer's self-education was undertaken to obtain registration as a dentist. Since the taxpayer was not yet employed as a dentist and therefore the self-education was designed to put the taxpayer in a future position to earn income as a dentist, the AAT concluded that the exams costs were incurred 'too soon' to be deductible.

Practitioners should be aware that just because a client has commenced working in the general industry of study, this doesn't necessarily mean that the self-education costs relating to the industry are deductible. This is especially if the self-education is being undertaken in order to commence a new role with different duties, responsibilities, etc.

While the ATO in TR 2024/3 states that it is relevant to consider whether the self-education activities are likely to lead to a promotion, it is also necessary to consider whether the promotion leads to a position that is materially different from the taxpayer's current position. The ATO has also notes that the cost of initial qualifications to gain entry into a profession that do not increase the taxpayer's ability to perform their current job may not be deductible because they are simply incurred 'too soon'.

More information

- Ionita and Commissioner of Taxation (Taxation) [2024] AATA 808

Timing of superannuation contributions and the ATO's discretion

In *Mackie and Commissioner of Taxation [2024] AATA 619*, the AAT held that the ATO exercised its discretion correctly by not reallocating the taxpayer's superannuation contributions in the 2019 and 2020 financial years to other financial years for contribution cap purposes.

In this case, the taxpayer electronically transferred amounts to his superannuation fund on the 30 June 2018 and the 30 June 2019. Both days were on a weekend.

The issue was that the contributions were received by the superannuation fund on 4 July 2018 and 11 July 2019 and therefore applied to the concessional contribution caps of the 2019 and 2020 financial years respectively.

The taxpayer subsequently requested that the ATO exercise its discretion in section 291-465 ITAA 1997 to reallocate the contributions such that they applied to the concessional contribution cap in the financial year that he originally initiated the transactions.

While the ATO has the ability to exercise discretion in certain cases involving special circumstances, the AAT concluded that this was not a situation where such special circumstances arose. Even though one of the contributions took 11 days to reach the taxpayer's superannuation fund, the AAT took into account the fact that even if it had been transferred on the following working day it would still have occurred in the following financial year.

As we approach the end of the financial year, this case is a timely reminder that employers and individuals need to allow for delays in processing superannuation contributions. For contribution cap purposes, a superannuation contribution is not considered to be made until it has been received by the member's super fund. The timing is also important when considering superannuation guarantee deadlines.

More information

- Mackie and Commissioner of Taxation [2024] AATA 619

Legislation

While the last sitting of Parliament before the Federal Budget concluded last month, a number of Bills received Royal Assent this month.

Treasury Laws Amendment (Foreign Investment) Bill 2024

Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2024

Originally announced by the Government in its Mid-Year Economic and Fiscal Outlook on 13 December 2023, legislation has now received royal assent that results in the following:

- A tripling of the foreign investment fees that apply to foreign investors on the purchase of established dwellings;
- A six-fold increase in vacancy fees on foreign investors for future purchases of established dwellings after 8 April 2024;
- A doubling of vacancy fees on foreign investors for established dwellings already purchased on or after 7.30pm on 9 May 2017; and
- A doubling of vacancy fees on foreign investors for new dwellings purchased on or after 7:30pm on 9 May 2017.

The legislation also introduces measures to ensure that Australian taxes (other than income tax and FBT) continue to apply in the case of any inconsistency with a Double Tax Agreement. This ensures that foreign investment fees and some state and territory property taxes are not subject to the Non-Discrimination Articles of certain Double Tax Agreements.

More information

- Treasury Laws Amendment (Foreign Investment) Bill 2024
- Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2024

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

Legislation has now received Royal Assent in relation to some significant changes to Australia's thin capitalisation provisions. These measures were originally announced in the 2022-23 Federal Budget.

In very broad terms, the main changes involve:

- Removing the current classifications of 'inward investor' and 'outward investor' with a single category relevant for all entities other than financial entities and ADI's (i.e., banks);
- A replacement of the applicable debt tests. The current methods of establishing whether debt deductions are allowable (the safe harbour debt test, worldwide gearing ratio test, and arm's length debt test) is replaced for most entities by a fixed ratio test, a group ratio test, and an external third-party debt test.
- Introducing new provisions that disallow debt deductions to the extent they relate to debt creation schemes.

In broad terms, the new tests involve a change from an asset-based approach to using earnings-based tests.

Importantly, the $2m de minimis threshold, which is an existing exclusion to the rules, is retained under the new rules.

The changes apply to income years commencing on or after 1 July 2023, with the exception of the measures relating to debt creation schemes which apply to income years commencing on or after 1 July 2024.

The legislation also introduces measures requiring Australian public companies to provide further disclosures around entities within their consolidated group as part of their annual financial reporting obligations under Chapter 2M of the Corporations Act 2001. This measure applies to financial years commencing on or after 1 July 2023.

More information

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