client alert | explanatory memorandum

March 2022

CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 18 February 2022.

Keeping you informed about the Federal Budget

We expect to see confirmation from Treasury soon about when the Australian Government will hand down its Federal Budget for 2022–2023. This being an election year, early Budget delivery – perhaps as soon as Tuesday 29 March – is likely.

The Client Alert team will, as usual, work to bring you a special **Budget Extra** edition that outlines the key announcements to assist you in dealing with your clients' queries. You can expect to receive it by the morning after the Budget is handed down.

Work-related COVID-19 tests may be deductible

After the recent furore over the non-existent supply of rapid antigen tests (RATs) and the reduced availability of polymerase chain reaction (PCR) tests at many COVID-19 testing sites, the Federal Government is hoping for some good press with the announcement that it will legislate to make both PCR tests and RATs tax-deductible for individuals who buy them for a work-related purpose.

According to the government's proposal, deductibility of tests will take effect from the beginning of the 2021–2022 tax year (that is, starting 1 July 2021) and will be ongoing. Individuals will also be able to deduct the cost of a test regardless of whether they are required to attend the workplace or have the option to work remotely.

How people will benefit from this proposal depends on their individual tax rate. As a simple example, assuming that there are 249 working days in a year and that each RAT costs $20, if an employee was required to take a RAT every day that they worked, the total cost over the year would be $4,980. If that employee made the minimum wage rate of $20.33 per hour and worked 7.5 hours each day, then their yearly before tax income would be $37,966.

Based on that before-tax income, the individual would usually have to pay around $3,755 in tax. If the deduction for the COVID-19 tests was included, it would reduce the tax paid to $2,809 – a tax saving of $946 to the individual for the year. However, given that the initial test outlay for the entire year could be close to $5,000, the deduction certainly wouldn't have the same monetary effect as to providing free tests to essential and hospitality workers.

For businesses that are able to obtain enough RATs for their workforce, the government has also proposed to make COVID-19 tests provided by employers to employees exempt from FBT, if they are used for work-related purposes. This essentially means that the tests would be excluded from the definition of a fringe benefit, and employers would not have to pay FBT on the costs of tests given to their employees in a work-related context.

With the Federal election fast creeping up, there doesn't seem much time for this proposal to be introduced in Parliament and passed into law, especially given the lack of timeframes provided and the myriad of previous election promises also yet to be legislated. A possible change in government may even mean that this proposal remains just that, or we later see different arrangements altogether. There is uncertainty as to whether a Labor government would champion this specific tax-deductibility measure, in particular due to their election pledge of providing free RATs to all Australians through Medicare.

With all this in the background, the ATO has not provided any detailed advice or guidance on the practical aspects of this proposal. In the interim, it recommends that individuals and/or businesses incurring expenses for COVID-19 tests should keep a record of the expenses (receipts or other documentary evidence of purchase), to make the process straightforward should they become deductible in the future.

Natural love and affection: commercial debt forgiveness

The ATO has recently finalised its stance on the issue of commercial debt forgiveness – in particular, the "natural love and affection" exclusion.

A commercial debt is any debt where interest payable is deductible, or would be deductible if interest were payable, but for certain statutory restrictions. Under this definition, investments that are securities and equity for debt swaps could be included.

Under the commercial debt forgiveness provisions, if a taxpayer's obligation to pay the debt is released, waived, or otherwise extinguished (ie by agreement, parking of debt, repurchase, redemption etc), the amount forgiven will be deducted from the taxpayer's current and future tax deductions. Specifically, the amount forgiven will reduce prior-year revenue losses, prior-year net capital losses, undeducted balances of other expenditure being carried forward for deduction, and the CGT cost base of other assets held, in that order.

Given that commercial debts forgiven may mean a business will have to pay more tax, it can be advantageous if debts the business has forgiven are not captured under the commercial debt forgiveness provisions. The exclusions available include forgiveness of a debt that is effected under an Act relating to bankruptcy or by will, and a natural person's forgiveness of a debt for reasons of natural love and affection for the debtor.

Before 6 February 2019, the natural love and affection exclusion to commercial debt forgiveness didn't require the creditor who forgave a debt to be a "natural person". This meant that a company, through its directors, could forgive the debts of an individual, giving the reason of natural love and affection for the individual, and this would not have been considered a commercial debt forgiveness, meaning a lower tax bill for the company.

Then, the ATO released a draft determination on 6 February 2019 which explicitly stated that the exclusion for debts forgiven for reasons of natural love and affection requires the creditor to be a natural person. This view has been confirmed in the finalised determination, which the ATO recently released.

Delving a little deeper into the final determination: while the ATO states that a debt-forgiving creditor must be a natural person and the object of their love and affection must be one or more other natural persons, where the conditions for the exclusion are otherwise satisfied, there is no requirement that the debtor must also be a natural person. For example, this means that the natural love and affection exclusion can apply in circumstances where the debtor is a company, such as where a parent (a natural person) forgives a debt they are owed by a company that is 100% owned by their child or children.

The natural love and affection exclusion to commercial debt forgiveness may also apply in instances where a natural person forgives a debt owed to a trust or partnership, in their capacity as a trustee of the trust or as a partner in the partnership, respectively. The ATO's determination points out that cases where this could happen would be limited, given limitations that arise under trust and partnership law principles, statute and terms of any trust deed or partnership agreement.

According to the ATO, whether a creditor's decision to forgive a debt is motivated by natural love and affection for a person needs to be determined on a case-by-case basis. In addition, while the ATO will not devote compliance resources in relation to debts forgiven before 6 February 2019, if required to state a view in a private ruling or litigation the Commissioner of Taxation will do so consistently with the views set out in the final determination.

Source: www.ato.gov.au/law/view/document?docid=TXD/TD20221/NAT/ATO/00001

Last chance to claim the loss carry-back

Businesses that need a little more financial help will have one last opportunity to claim the loss carry-back in their 2021–2022 income tax returns. Businesses that have an early balancer substituted account period (SAP) for the 2021-22 income year are eligible to claim the loss carry-back offset before 1 July 2022.

To recap, the loss carry-back is a refundable offset that effectively represents the tax that the business would save if it had been able to deduct the loss in an earlier year using the loss year tax rate. It may result in a cash refund, a reduced tax liability, or reduction of a debt owing to the ATO. Eligible businesses include companies, corporate limited partnerships and public trading trusts.

A company, corporate limited partnership or public trading trust may be eligible if it made a tax loss in 2021, carried on a business with an aggregated turnover of less than $5 billion, had an income tax liability in 2019 or 2020, and has met all of its lodgment obligations for the five prior income years.

Loss carry-back can either be claimed by businesses through their standard business reporting enabled software, where it has the additional loss carry-back labels required, or by using the paper copy of the

company tax return 2021 and attaching a schedule of additional information to report the extra aggregated turnover and loss carry-back labels required (because these are not included in the company tax return 2021 itself).

For example, if a business is carrying back a tax loss from the 2021–2022 income year, the additional information needed includes the income year the business is choosing to carry the loss back to, the tax losses incurred, net exempt income, the income tax liability for the prior year, and the aggregated turnover range of the business.

Since there are so many additional labels which may need to be completed, the ATO has developed a loss carry-back tax offset tool which will assist businesses that are claiming the loss carry-back before 1 July 2022 to determine which labels are relevant in their unique situations. Once all of the relevant information is provided, the tool will first determine whether the business is eligible to claim the loss carry-back tax offset, then calculate the maximum amount of tax offset available. It will also provide a printable report of the labels which will need to be completed.

However, to use the tool, businesses will need to have the following information handy:

- income tax lodgment history;
- for the 2019–2020 and later income years, details of the loss that was made, including the amount of tax losses, the tax rate and the aggregated turnover for that year and the prior year;
- for the 2018–2019 and later income years, details of the tax liability, including the amount, and any net exempt income; and
- opening and closing balances of the franking account for the income year that is being lodged (ie 2021–2022).

If your clients' businesses have been battered by the latest COVID-19 wave, they may be able to take advantage of this refundable offset one last time. Remember, the offset effectively represents the tax that the business would save if it had been able to deduct the loss in an earlier year using the loss year tax rate. Because the offset is refundable, it may result in a cash refund, a reduced tax liability, or reduction of a debt owing to the ATO, all of which should help with cash flow.

Source: www.ato.gov.au/business/loss-carry-back-tax-offset/
www.ato.gov.au/Calculators-and-tools/Loss-carry-back-tax-offset-tool/

Tax debts may affect business credit scores

The ongoing COVID-19 pandemic has caused uncertainty in many parts of the economic and has led to what many experts term a "two-speed economy": while some businesses are recovering well, others continue to suffer from the effects. If your clients' businesses have had issues paying debts, or have prioritised trade debts ahead of tax debts, remember that these actions may lead to penalties and have a lasting impact on the business.

The best option is to engage with the ATO to manage business debts. Failure to get in touch with the ATO to come to an arrangement will not only affect the potential penalties imposed, but may also affect a business's credit score.

Laws were passed in 2019 which allow the ATO to disclose information about overdue business tax debts to credit reporting agencies including Equifax, Experian and Illion. The laws were originally promoted as a way to support businesses in making more informed decisions about dealings with various parties by making overdue tax debts more visible. The flow-on effects from that include reducing unfair financial advantages obtained by businesses that do not pay their tax on time, and encouraging businesses to engage with the ATO to manage their tax debts to avoid having those debts disclosed.

To protect taxpayers, the laws passed contained some safeguards. Not all tax debts can be disclosed by the ATO. The following criteria must be met for a business's debt to qualify for disclosure:

- the business has an ABN and is not an excluded entity (excluded entities include deductible gift recipients, complying super funds or self managed super funds, registered charities and government entities);
- the business has one or more tax debts, of which at least $100,000 is overdue by more than 90 days;
- the business operators have not engaged with the ATO to manage the debt; and
- there is no active complaint with the Inspector-General of Taxation and Tax Ombudsman regarding the ATO's intent to report tax debt information.

Even if a business debt satisfies these criteria, where exceptional circumstances apply to the situation the ATO may still have the discretion to not report the debt information to credit reporting agencies. "Exceptional

circumstances" may include, but are not limited to, family tragedy, serious illness and the impact of natural disasters. The ATO will assess claims of exceptional circumstances on a case-by-case basis.

It should be noted that the ATO does not consider cash flow issues nor financial hardship to be exceptional circumstances, although it still recommends that taxpayers who are experiencing these issues initiate ATO contact as soon as possible to discuss debt management options. For example, where a business has been affected by COVID-19, the ATO has committed to additional administrative support in the areas of lodgment and payment.

Before any debt is disclosed to credit reporting agencies, the ATO is required to send the business a written notice confirming its intent to report the debt information, and setting out the criteria that the business has met and the debt information that will be disclosed. The letter will also outline the steps which the business can take to avoid having the tax debt reported – and these need to be taken within 28 days of receiving the notice. Business owners who believe that the ATO has made a mistake or who disagree with a disclosure decision are advised to contact the ATO immediately upon receiving a notice.

Source: www.ato.gov.au/General/Paying-the-ATO/If-you-don-t-pay/Disclosure-of-business-tax-debts/ https://moneysmart.gov.au/managing-debt/credit-scores-and-credit-reports

Contributions into SMSFs: minimum standards

There are many compliance obligations for trustees of self managed superannuation funds (SMSFs). One of the simplest but most important is ensuring that contributions from members can be accepted into the fund. This involves reporting the tax file numbers (TFNs) of members to the ATO, ensuring non-mandated contributions are not accepted for members over a certain age, and observing certain restrictions on *in specie* (asset) contributions. If an SMSF inadvertently accepts a non-allowable contribution in error, it must generally be returned within 30 days of the fund becoming aware, otherwise breaches of the contribution rules may occur.

Broadly, whether a contribution to an SMSF can be accepted depends on the type of contribution, the age of the member making the contribution, certain caps, and whether the fund has the TFN of the member.

When a member joins an SMSF, they need to provide their TFN, which then needs to be passed on to the ATO through the registration process. It should be noted that members are not legally required to provide their TFNs. However, if a TFN is not provided, the fund cannot accept certain member contributions, including personal contributions, eligible spouse contributions and super co-contributions. Employer contributions, including salary sacrifice contributions and other assessable contributions, may also be liable for additional income tax of 32% on top of the 15% tax already paid.

As a trustee, you must ensure that any TFNs reported to the ATO for members are correct. If you do not know a member's TFN, you cannot report an exemption code such as 444 444 444. According to the ATO, exemption codes like this are intended for use by banks/investment bodies for an exemption from withholding tax on interest and other investment income, and are not for use when an SMSF member has not provided a valid TFN to the trustee.

In circumstances where an SMSF mistakenly accepts a contribution it should not have, the fund must return it within 30 days of becoming aware of the error. The 30-day limit is a grace period allowing the fund to remove the contributions from the super system without breaching the payment or contribution rules. Failure of the SMSF to comply with the time limit does not affect the fund's legal obligation to return contributions.

Even if a member has provided their TFN, the type of a contribution combined with the age of the member can affect what is acceptable. For example, mandated employer contributions such as super guarantee contributions from a member's employer can generally be accepted at any time, regardless of the member's age or the number of hours they work. Non-mandated contributions largely cannot be accepted if a member is aged 75 years or older.

Non-mandated contributions include the following:

- contributions made by employers over and above super guarantee or award obligations (that is, salary sacrifice contributions); and
- member contributions, including personal contributions, downsizer contributions, super co-contributions, eligible spouse contributions and contributions made by a third party such as an insurer.

Lastly, there are restrictions on when an SMSF can accept an asset as a contribution from a member. These are referred to as "*in specie* contributions", which just means contributions to the fund in the form of a non-monetary asset. Generally, an SMSF must not intentionally acquire assets (including *in specie* contributions) from related parties to the fund; however, there are exceptions for listed shares and other securities, as well as business real property.

Source: www.ato.gov.au/Super/Self-managed-super-funds/Contributions-and-rollovers/Contributions-you-can-accept/

SMSFs investing in crypto-assets: be informed and keep records

According to the Australian Securities and Investments Commission (ASIC), there has recently been a surge of promoters encouraging individuals to set up self managed superannuation funds (SMSFs) in order to invest in crypto-assets. ASIC warns people to be aware that while crypto-asset investments are allowed for SMSFs, they are high risk and speculative, as well as being an attractive area for scammers targeting uninformed investors.

Seek reliable information

Current record low deposit rates and volatility in stock markets around the world have motivated many retirees to seek alternative asset classes to either protect their investments or get higher returns. In conjunction, there has been a noticeable increase in spruikers encouraging individuals to invest in crypto-assets through SMSFs, with many promotions recommending switching from retail or industry super funds in order to do so.

For example, late last year ASIC moved to shut down an unlicensed financial services business based on the Gold Coast that promised annual investment returns of over 20% by investing in crypto-assets through SMSFs. The money obtained was not invested, but instead allegedly used by the directors of the business for their own personal benefit, including acquiring real property and luxury vehicles in their personal names.

Professional advice should always be sought before deciding on whether an SMSF is appropriate for your circumstances, as there are risks involved in being the trustee of an SMSF, and any SMSF established must meet the “sole-purpose” test. Remember, SMSF trustees bear all the responsibility for the fund and its investment decisions complying with the law, and breaches may lead to administrative or civil and criminal penalties. This is the case even if you (as the trustee) rely on the advice of other people, licensed or otherwise.

SMSFs are not generally prohibited from investing in crypto-assets – if you do decide, after receiving appropriate advice, that investing in crypto-assets through an SMSF is right for your situation, you can do so. Careful consideration must also be given to the following factors:

- *the fund’s governing rules:* trustees need to ensure that any investments in crypto-assets are allowed under the particular SMSF’s deed;
- *investment strategy:* there should be documentation of how the SMSF’s investments will meet retirement goals, taking into account diversification, liquidity and the ability of the fund to discharge its liabilities; and trustees need to consider the level of risk for the proposed crypto-asset investments, including reviewing/updating the fund’s investment strategy to ensure they are permitted;
- *ownership and separation of assets*: crypto-assets must be held and managed separately from any personal or business investments of trustees and members – the SMSF must maintain and be able to provide evidence of a separate crypto-asset “wallet”; and
- *valuation*: SMSFs must obtain fair market valuations for their crypto-assets for the purposes of calculating member balances.

Other considerations include restrictions on related-party transactions (that is, if you currently own crypto-assets and want to transfer them to the SMSF for various purposes, you will be unable to do so), and potential CGT consequences when an *in specie* lump sum payment of crypto-assets occurs upon a condition of release.

Keep your records in order

If you do decide to invest in crypto-assets, whether through an SMSF or as an individual investor, it’s also important to keep accurate records and ensure you report any related income to the ATO.

Each time you transact in crypto, the ATO requires you to keep a record of:

- the date and value of the cryptocurrency (or digital asset) in Australian dollars at the time of the transaction;
- what the transaction was for; and
- who the other party was (a cryptocurrency address is sufficient).

You must keep these records for at least five years after lodging the relevant return or form.

The ATO started its first crypto data-matching program in April 2019, comparing taxpayer self-reported income to cryptocurrency transaction data for the 2015–2020 financial years. This program was expanded mid-last year to cover the 2021–2023 financial years, and the ATO will no doubt continue to gather and compare data into the future under subsequent programs. Records relating to between 400,000 and 600,000 individuals will be obtained each financial year under the current program.

The ATO sources its data from designated service providers (DSPs) or entities providing a designated service under Australia's anti-money laundering/counterterrorism legislation. It may also obtain data from other sources.

A designated service is any service that exchanges, issues, transacts or deals in digital currency. This includes centralised cryptocurrency exchanges, exchanges that convert fiat currency to cryptocurrency (or vice versa) or other designated or regulated entities.

The ATO's legal power to gather information is extensive and includes the power to physically enter any place and inspect any document, good or other property – this extends to a physical cryptocurrency wallet. The ATO is also permitted by law to amend a taxpayer's tax return for an unlimited period where it considers that fraud or evasion has occurred – and deliberate non-reporting of gains made from disposals of crypto-assets would meet this description. Possible penalties and interest are also a consideration.

Source: https://asic.gov.au/about-asic/news-centre/articles/warning-self-managed-super-funds-and-crypto-investments/
https://moneysmart.gov.au/investment-warnings/cryptocurrencies
www.ato.gov.au/super/self-managed-super-funds/in-detail/smsf-investing/smsf-investing-in-cryptocurrencies/
www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/