# client alert | explanatory memorandum

August 2022

**CURRENCY:**

This issue of **Client Alert** takes into account developments up to and including 22 July 2022.

## Keeping you informed about the Federal Budget

We expect to see confirmation from Treasury soon about when the new Australian Government will hand down its Federal Budget for 2022–2023. Late October is likely for this Labor Budget.

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.

## ATO reminder to small businesses this tax time

Small businesses are again in the ATO's sights this tax time, with a focus on stamping out deductions not related to business income, overclaiming of expenses, omission of business income and insufficient records to substantiate claims. The ATO reminds small business taxpayers that it receives external data from a variety of sources, including the taxable payments reporting system for certain industries. This data can be used to data-match information included in tax returns to ensure completeness and accuracy.

Regarding deductions, the ATO reminds businesses that they can only claim what they are entitled to, and the claiming method may differ depending on the type of structure used (ie sole trader, partnership, trust, or company). For example, sole traders need to claim deductions in their individual tax return in the "Business and professional items" schedule, while partnerships, trusts, and companies need to claim deductions in their respective tax returns.

If a small business has purchased equipment or capital items in the 2021–2022 financial year, it may be able to claim an immediate deduction for the cost of those assets, subject to meeting eligibility criteria. However, only the business portion of the cost of the asset is eligible for immediate deduction. For example, if the business purchased a printer for $500, but it is used for both business and private purposes on an 80/20 basis, then the business can only claim a $400 deduction (80% of the purchase price, to match the 80% business usage proportion).

Because of COVID-19, many small businesses may have downsized their operations and relocated their offices to their homes. The ATO notes that a deduction can be claimed for the portion of expenses that relate to running the business. This includes occupancy expenses (ie mortgage interest or rent, council rates, land taxes, and home insurance premiums), running expenses (ie electricity, phone, decline in value of plant and equipment, furniture and furnishing repairs, and cleaning), and expenses of business motor vehicle travel between home and other locations.

However, small business owners should be aware that if they decide to claim a deduction for the portion of expenses in relation to running their business from home, they may be subject to capital gains tax (CGT) on that portion of their home if they later sell it, even if the home was their main residence.

On the other side of the coin, the ATO will also be focusing on the income of small businesses; the focus will not only be on cash, EFTPOS, and credit or debit card transactions, but also on coupons, online transactions, and income from platforms such as PayPal, WeChat or Alipay. According to the ATO, almost half of Australia's 1.9 million sole traders have non-business income such as salary and wages, or income from investments which can be data-matched.

In addition, those small businesses (including sole traders) in the building and construction, courier, cleaning, information technology, road freight, security, and investigation or surveillance industries will have their payment information provided to the ATO through the taxable payments reporting system, which will ultimately flow to data-matching. Therefore, completeness and accuracy are important this year.

*Source: www.ato.gov.au/Media-centre/Media-releases/Tax-time-for-small-business--how-to-nail-your-tax-return/ www.ato.gov.au/Tax-professionals/TP/Tax-Time-Toolkit---Small-business/*

## ATO warns against asset wash sales

With COVID-19 lockdowns and restrictions in the rear-view mirrors of most of the country, the ATO is also beginning to resume ordinary compliance activity levels. One of the many areas it will be paying close attention to this tax time is "asset wash sales", which may artificially increase tax losses and reduce gains or expected gains.

The ATO considers asset wash sales to be transactions which involve a person or business disposing of assets just before the end of the financial year. After a short period of time, they then reacquire the same or substantially similar assets. Other arrangements that achieve similar economic and tax effects using similar techniques may also be considered wash sales. These include situations where:

- a taxpayer enters into an arrangement to acquire the same asset, or one that is substantially the same, at a future point in time at a price that is substantially the same as the sale proceeds received for the original asset, either shortly before, after or at the time of disposing the asset;
- an asset is transferred from one wholly owned company to another, or between two trusts with the same trustee and class of beneficiaries; and
- a taxpayer disposes of an asset to family members and an arrangement or understanding exists between the parties to the effect that the asset will later be reacquired by the taxpayer.

These transactions are often used to create a loss to offset a gain that would be taxable, and the ATO views them as a form of tax avoidance. In the context of wash sales, a reacquired asset is considered "substantially the same" as a recently sold asset where it is economically equivalent to, or fungible with, the original asset, or if there are immaterial differences between the two assets such that, in substance, the assets are economically equivalent.

According to the ATO, the assets involved in these wash sales are not necessarily traditional assets such as shares. Taxpayers could also be disposing of crypto-assets and reacquiring them later as a part of a wash sale. With the price of many crypto-assets at a low ebb, taxpayers looking to rid themselves of these assets need to be careful they do not inadvertently attract the attention of the ATO.

Although there may be legitimate reasons for taxpayers to be selling and then reacquiring the same or substantially similar assets, the ATO notes that a wash sale is different from normal buying and selling as it is usually undertaken for the artificial purpose of generating a tax benefit – such as a capital loss – in the current financial year.

To stamp out this behaviour this tax time, the ATO will be using data analytics to identify wash sales through data from various share registries and crypto-asset exchanges. Where the system identifies a wash sale, the capital loss claimed by the taxpayer in their tax returns will be rejected. The Commissioner of Taxation may then make a determination, known as a compensating adjustment, to adjust the taxation situation of the taxpayer. In addition, compliance action and additional tax, interest and penalties may be applied at the discretion of the ATO.

*Source: www.ato.gov.au/Media-centre/Media-releases/Wash-sales--The-ATO-is-cleaning-up-dirty-laundry/*

## ATO protocol for legal professional privilege

As a part of the ATO's extensive information-gathering powers, it can compel taxpayers to furnish or produce certain documents. However, information and documents where the underlying communication is privileged do not have to be provided. Legal professional privilege (LPP) operates as an immunity from any obligation to disclose documents created by these powers.

Recently, the ATO released a protocol which contains its recommended approach for identifying communications covered by LPP and making LPP claims. While it is voluntary for taxpayers to follow the steps outlined in the protocol, it's more likely that the ATO will accept LPP claims without further enquiries if the protocol is followed.

While the purpose of the protocol document is ostensibly to assist the ATO in deciding whether to accept, review or challenge an LPP claim in an interaction with the taxpayer, it also provides taxpayers with clarity about making LPP claims when responding to formal information-gathering notices from the ATO. The protocol applies to both legal practitioners and non-legal practitioners and all LPP claims, regardless of the firm or business structure within which the service or engagement is provided.

Where an LPP claim is made, the most challenging part of the ATO's role is to make an informed decision about the communication and the basis on which LPP is claimed. Although the approach contained in the protocol is only voluntary and not intended to replace legal advice, the ATO notes that where the protocol is followed, it will usually have a sufficient level of information to be able to decide next steps. In many cases, it's likely that the ATO will accept the claim for LPP without further enquiries.

The protocol itself contains three steps for taxpayers who receive an information-gathering notice and wish to make an LPP claim: assessing the situation and the communications involved; explaining the basis of the LPP claim; and advising the ATO how the LPP claim was approached.

### Assessing the engagement and each communication

This step requires the taxpayer to identify each service or engagement that gave rise to the communication. For example, this might include separately assessing service engagements involving the following: legal practitioners; more junior non-legal persons acting under close supervision and direction of legal practitioners (eg paralegals, clerks, law graduates, executive assistants etc); in-house counsel; those involving non-legal persons or by legal practitioners not acting in capacity of legal practitioners; third-party advice other than from a legal practitioner.

For each of these engagements, taxpayers will need to review each specific communication separately (eg each email within an email chain, its attachments, forwarded copy of email and its attachments), evaluate the overarching relationship, and determine the capacity in which the communication was made.

Taxpayers are also encouraged to check for communications which are usually not privileged but may potentially be eligible for a claim of LPP. This might include internal reports and memoranda, file notes and minutes of meeting with third parties, and original documents which constitute or evidence transactions.

### Explaining the LPP claim

It's the ATO's view that taxpayers should explain LPP claims on or before the due date specified within the formal notice that the ATO sends seeking information/documents, although a staged approach to accepting information may be adopted in some instances. For documents and files, details are required such as the names of privilege holders, the identity and role of each person between whom the document passed or communication was made, and the dominant purpose for which the communication was made.

For in-house counsels, details expected from the ATO include their name, whether they have been admitted to practice (and jurisdiction of admission), the functions/positions/roles/responsibilities at the time of communication, and the capacity in which the legal advisor was acting in making the communication.

For specific engagements, taxpayers need to provide an evaluation of the service, engagement or relationship; purpose of the communications; role of non-legal practitioners; and for each person involved in the preparation of communications, their name, position, capacity and whether they hold a current practising certificate.

### Advising the ATO of the approach

Finally, it is recommended that taxpayers advise the ATO of the process they have used for making their LPP claim, framed around the following key elements: whether the first step was followed, whether any computer-assisted processes were used, and whether any assumptions or pre-determined judgements around the context of the communications guided the LPP assessment.

*Source: www.ato.gov.au/Media-centre/Media-releases/ATO-provides-certainty-on-Legal-Professional-Privilege-claims/ www.ato.gov.au/Business/Business-bulletins-newsroom/Law,-rulings-and-policy/Final-legal-professional-privilege-protocol-and-compendium-released/*

## Is this the end for stamp duty in New South Wales?

In the NSW Budget handed down on 21 June 2022, the State Government announced plans to make some transfer duty optional from January 2023. This is consistent with its policy for the abolition of stamp duty introduced in its 2020 Consultation Paper.

However, the scope of the proposal is quite limited at this stage. Although these changes could be the beginning of the most significant reform to stamp duty law in NSW in over 150 years, media reports about the imminent abolition of stamp duty in favour of a broad-based property tax are exaggerated. In reality, a complex web of duty traps remains to ensnare the unwary for the foreseeable future.

### Evolution of NSW stamp duty

Stamp duty was first imposed in NSW in 1865. Since that time there have been some significant reforms, including the rewrite of the legislation with the *Duties Act 1997*, which removed the "stamp" from stamp duty and converted stamp duty from a duty on documents to a duty on transactions. Do you remember the short-lived frolic with vendor duty which was abolished in 2005? That's right – it was duty imposed on vendors of land.

Following the introduction of GST in 2000 (revenue from which flows to the states), many of the heads of duty have been abolished including hire of goods duty, lease duty, mortgage duty in different stages, duty on unlisted marketable securities (ie shares and units), as well as most recently duty on statutory licensing, gaming and machine entitlements and transfers of business assets except land. Not much left to worry about then, you might be thinking. Well think again!

Despite the significant reductions in the scope of duty over the last two decades, duty on transfers of land and interests in land have provided a foundation for the state's revenue, duty revenue yielding over $12.2 billion in the 10 months to April 2022. This is largely attributable to "bracket creep", with the progressive rates at which duty is calculated only indexed to consumer price index (CPI) annually since 1 July 2019.

## Policy for abolition

NSW Treasury's 2020 Consultation Paper and 2021 Progress Paper proposed the introduction of a widespread option to either choose paying duty on land acquisitions or an annual property tax with varying rates depending on the nature and use of the land. Reportedly, high value properties were to be excluded from the option to protect the loss of revenue. Critically, under the original proposal, once the property tax option had been elected, future buyers would have no option but to be bound by the annual property tax. In this way, over a period of decades, gradually the stamp duty would be phased out and a broad-based annual property tax introduced. A similar system has been in place in the ACT for a decade.

## Measures as announced in the 2022–2023 NSW Budget

The June NSW State Budget announcements for the First Home Buyer Choice scheme were a long way from the policy as proposed during the consultation phase. The key features are as follows.

- The option as announced is only open to eligible first home buyers who enter into a purchase contract on or after 16 January 2023.
- There will be a higher rate of annual property tax for investors ($1,500 plus 1.1% of land value) than for owner occupiers ($400 plus 0.3%). These rates will be indexed annually to wage growth.
- The tax will be based on a financial year unlike land tax which is based on a calendar year.
- The property value must not exceed $1,500,000.
- The existing First Home Buyers Assistance Scheme duty concessions for properties valued up to $800,000 will remain. Under the scheme, duty is exempt up to $650,000 and the concession phases out up to $800,000. Buyers above $650,000 will have the option to pay the concessional duty or choose to be subject to the annual property tax.
- Guidance from the NSW Government suggests that upon sale by those who elected the property tax option, the purchaser would be subject to normal duty unless they too are an eligible first home buyer or buyers.

Of course, legislation must first be enacted and the details remain to be seen, including the transitional provisions that will apply.

As seen by the ACT example, even a widespread introduction would be expected to take up to 20 years before transfer duty would be completely replaced by an annual property tax. So, with antipathy from the opposition, a looming NSW state election soon after the proposed introduction, and the reported need for interim Federal Government revenue shortfall support, the full introduction of optional duty seems a long way off.

## Duty issues and complexity remain

Meanwhile, despite various changes to stamp duty over recent decades, complexity remains in the area of duty arising from various exemptions and concessions for first home buyers, deceased estates, and marital transfers and breakdowns, the availability of which is closely regulated by Revenue NSW.

Ask yourself this simple question: are goods subject to duty? Goods are generally not liable for duty, but sometimes they can be, unless they are certain types of goods which are always excluded!

The concept of land is also so much broader than the simple freehold title definition which people often assume. For example, duty also applies on the transfer of leases and the payment of lease premiums.

Take care that adequate measures have been taken before changing the trustee of trusts which hold dutiable property such as land, lest the new trustee receives an invoice from Revenue NSW as though it had just purchased all the land in the trust fund.

Landholder duty (an anti-avoidance provision) is notoriously complex and can unexpectedly result in significant duty on a change in shareholding in a company or unitholding in a trust.

Recent years have seen the introduction of foreign person surcharge duty which also adds a further layer of complexity to duty law including landholder duty. Foreign person surcharge duty can result in duty payable on a residential property valued at $3 million or more calculated at a total rate of duty (including the surcharge) of 15% of the purchase price of the property. That is, duty of $450,000 on a $3 million dollar purchase price. While the rate of surcharge duty was not increased in the State Budget, the land tax surcharge is set to be increased from 2% to 4%.

More complexity in the area of duty law was introduced prior to the Budget with amendments to the Duties Act which came into effect on 19 May 2022. These changes impose duty on a change in beneficial interest in dutiable property. This has resulted in the introduction of duty on call options among other duty exposures.

The Budget announcements introduce another regime into the mix and merely add to the existing complexity. If the announcements become law, by next January we will have the existing transfer duty regime, the existing land tax regime and new annual property tax all running in parallel.

Duty also remains on declarations of trust, creating a life interest, foreclosing a mortgage over NSW property, insurance premiums and transfers of motor vehicles.

So, is duty dying in NSW? Despite the proposed optional stamp duty changes under First Home Buyer Choice, the complex world of NSW Duty Law remains alive and well, ready to be imposed by an enhanced Revenue NSW compliance team, bolstered by further funding also announced in the fine print of the Budget Papers.

*Source: www.revenue.nsw.gov.au/help-centre/resources-library/budget/budget-202206*
*www.nsw.gov.au/initiative/first-home-buyer-choice*

## Current compliance issues in the SMSF space

The self managed superannuation fund (SMSF) space has always been a complex area for trustees, beneficiaries and advisers. In the past few years, the ATO has made many concessions and has put compliance action on hold because of COVID-19 and its after-effects. However, for the 2022–2023 year and beyond it's looking to scale up its compliance program as a reaction to indicators of heightened risk in the sector. One specific area the ATO will be targeting is those failing to lodge annual fund returns, which has been identified as a red flag associated with illegal early release.

In a recent presentation, the Director of ATO's superannuation and employer obligations area, Paul Delahunty, shared some key compliance issues that the ATO is currently prioritising in the SMSF space, some identifiable compliance trends to emerge from audit contravention reports and some key statistics on the overall SMSF population and details on asset classes.

Recent statistics indicate that there are around 600,000 SMSFs, with over 1.1 million members holding an estimated total asset value of $876 billion. By far the most popular investment class by dollar value is listed shares ($241 billion invested by SMSFs), which is almost double the amount invested in the second asset class of cash and term deposits ($147 billion). These investments are followed in descending monetary value by unlisted trusts ($115 billion), non-residential property ($91 billion), and residential property ($49 billion).

During COVID-19 and until recently, the ATO had put compliance action in the sector on hold and provided various forms of relief, including the in-house asset rules for rental relief provided to related party tenants. However, in the 2022–2023 financial year the ATO is looking to scale up its compliance program as a reaction to indicators of heightened risk.

While the ATO's main compliance focus will always be on any activity that puts retirement savings at risk or inappropriately takes advantage of the concessional tax environment, in the near-term it will be dedicating its focus specifically to illegal early release of super in all forms. This is when individuals access their retirement savings before a condition of release has been met. This type of activity, according to the ATO, is currently on the rise.

The three main routes for illegal access, according to the ATO, are as follows:

- new registrants entering the SMSF space purely for the purpose of illegal access;
- existing trustees of SMSFs no longer lodging SMSF returns after illegal access; and
- existing trustees that continue to lodge but have illegally accessed some of their super.

One of the big red flags that the ATO looks out for is when individuals establish their SMSF and initiate a rollover but then fail to lodge a corresponding first annual return. It notes that this is a good predictor that an illegal early release has occurred, either as a result of deliberate behaviour or participation in a scheme.

Data obtained from lodgment of 2020 annual returns showed a significant growth in the number of SMSFs failing to lodge their first annual return – these accounted for 26% of all expected lodgments. Even more concerning for the ATO, early data from the 2021 year seems to indicate that the percentage of outstanding returns for new registrants has increased yet again. For context, the percentage of new registrants failing to lodge their first return was only 3% in 2013.

New registrants that ignore the extensive ATO communications campaigns about lodging will now be targeted with a "three strikes and you're out" compliance campaign. This campaign consists of the ATO firstly issuing a "blue letter" that encourages trustees to take immediate action to lodge and provides a pathway for those who need support. If no response is received from the "blue letter", the ATO will follow up by issuing an "amber letter" warning trustees of the consequences of failing to lodge their return.

Finally, if no response is received from the "amber letter", a final warning or "red letter" will be issued advising trustees that the ATO has commenced the disqualification process and will consider other enforcement action. The ATO issued its first and second batches of "red letters" to funds in early April and June 2022, with presumably more to follow.

*Source: www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/Speeches-and-presentations/Current-compliance-issues-and-SMSF-industry-trends---31-May-2022/*
*www.ato.gov.au/Super/Self-managed-super-funds/Administering-and-reporting/How-we-help-and-regulate-SMSFs/How-we-deal-with-non-compliance/*

## SMSF TBAR to be streamlined

In good news for trustees of self managed superannuation funds (SMSFs) and after much community consultation, transfer balance account event-based reporting (TBAR) will soon be streamlined for convenience. The current event based reporting framework for SMSFs commenced from 1 July 2018 and facilitated the administration of the transfer balance cap by the ATO. SMSFs were generally required to start reporting when their first member commenced a retirement phase income stream. To simplify the process, from 1 July 2023 all SMSFs will be required to report certain events 28 days after the end of the quarter.

The TBAR allows the ATO to record and track an individual's balance for both their transfer balance cap and total superannuation balance. That information is not extracted from the SMSF annual return, or any information shared through a rollover. Under the existing framework, an SMSF must report common events that affect a member's transfer balance account when they happen; including:

- details of when a member commences a retirement phase income stream, and death benefit income streams;
- details of commutations of retirement phase income streams, and commutations of a pension that occurs before it is rolled over to another fund;
- details of limited recourse borrowing arrangement payments;
- compliance with a commutation authority issued by the ATO; and
- details of personal injury (structured settlement) contributions.

For SMSFs with members with a total super balance of $1 million or more on 30 June the year before the first member starts their first retirement phase income stream, events must be reported within 28 days after the end of the quarter in which the event occurs. In instances where all members of an SMSF have a total super balance of less than $1 million, the SMSF can report events at the same time as when the annual return is due.

An SMSF may be required to report earlier if a member has exceeded their personal transfer balance cap. For individuals who start their first retirement phase income stream on or after 1 July 2021, their personal transfer balance cap will be $1.7 million. If no reportable events occurs, the SMSF is not required to report. Some non-reportable events include:

- pension payments;
- investment earnings and losses;
- when an income stream ceases because the interest has been exhausted;
- death of a member;
- information that individuals have to report directly to the ATO (ie family law payment split; debit event from fraud, dishonesty, or bankruptcy; structured settlement contributions made before 1 July 2007); and
- information other funds will, report including a member's interest in an APRA fund.

From 1 July 2023, the TBAR will be streamlined by removing the total super balance threshold and requiring all SMSFs to report 28 days after the end of the quarter in which a reportable event has occurred (ie 28 Jan, 28 April, 28 July, 28 October). However, the obligation to report earlier will continue in cases where a commutation of an income stream occurs in response to an excess transfer balance determination. This will still be required to be reported 10 business days after the end of the month in which the commutation occurred.

Similarly, the obligation to report earlier will also continue for responses to a commutation authority, which must be reported by the legislated due date as specified in the notice. Under the new streamlined framework, trustees of SMSFs will still be allowed to report transfer account balance events more frequently if they wish. This may be beneficial in instances where members are close to their personal transfer balance cap, and will avoid excess transfer balance determinations.

*Source: www.ato.gov.au/Super/Sup/Streamlined-TBAR-for-SMSFs/*

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