LANTERI
PARTNERS GROUP
WEALTH MANAGEMENT

Here for the future...

December 2020

A run-down of the new loss carry back measure

The last Federal Budget carried with it a number of tax changes that were designed to assist the Australian economy recover from the impact of the COVID-19 pandemic.

Among the changes announced was the temporary re-introduction of the loss carry back rules for corporate tax entities (it was previously briefly in force for 2012-13). The ability to carry a loss backwards simply means that a loss incurred in one year can be, effectively, claimed as a tax deduction in a prior year when tax was paid.

The outcome is that the entity carrying the loss back will obtain a refund of tax in relation to the year when tax was paid. Some jurisdictions in the world, other than Australia, have the ability to carry losses backwards as a permanent feature of their tax system. At present, the

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About this newsletter

We are very proud to announce our monthly Newsletter!! It is intended for you, our clients, as well as future clients of Lanteri Partners Group. You will be informed on the latest news and announcements regarding changes to legislation mainly within financial planning and wealth management industry. Each issue will have significant contributors including our Managing Director, Michael Lanteri and other key individuals who are specialists in their areas of expertise. We hope you find this newsletter of great value. Thank you.

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A run-down of the new loss carry back measure *cont*

changes set out below will only be in existence for a couple of years.

The explanatory memorandum to the enacting legislation states that under the temporary loss carry back refundable tax offset rules, a corporate tax entity with an aggregated turnover of less than $5 billion can choose to carry back a tax loss for the 2019-20, 2020-21 or 2021-22 income years and apply it against tax paid in a previous income year as far back as the 2018-19 income year.

The choice to claim a loss carry back tax offset is an alternative to carrying tax losses forward as a deduction for future income years. But note that only tax losses can be carried back — capital losses cannot be carried back because the capital gains tax regime operates on a "realisation" basis.

A STRATEGY OPENS

The Federal Government has introduced the ability for most entities (not only companies) to be able to fully expense an eligible depreciating asset (under various conditions) if it is held for the first time after Budget night on 6 October 2020 and before 1 July 2022.

The ability to fully expense, for tax purposes, the cost of a depreciating asset opens up the opportunity, for otherwise profitable companies, to be in a tax loss due to the purchase of a significant asset. If this occurs, the company may then be able to carry back the loss created from the purchase of the asset to a prior year where tax has been paid — the result of which could be a refund of tax.

No doubt there will be many incorporated business owners or boards of directors of companies that will be contemplating this strategy. It is way to save tax and receive a refund of tax without any fear of the general anti-avoidance rule of income tax applying.

THE MECHANISM

The benefit of being able to carry back a tax loss is delivered to the relevant entity by way of a refundable tax offset. In order to claim the tax offset, the taxpayer must be a "corporate tax entity" throughout the relevant income year and in the period between the loss year and the profit year that the loss is carried back to.

The corporate tax entity must have an aggregated turnover of less than $5 billion. The concept of "aggregated turnover" broadly takes in the turnover of connected and affiliated entities and adds this to the turnover of the particular corporate tax entity.

The choice to carry back losses must be made "in the approved form". It is expected that this will be part of the tax returns for the years ending 30 June 2021 or 30 June 2022, depending on the circumstances. Accordingly, the tax offsets that will flow from the carrying back of losses will only be received following the lodgement of the tax returns for those years.

Carrying back tax losses is optional, and so it follows that if losses are made in one year and are carried back, there is no compulsion to carry back losses from a following year.

The new loss carry back rules contain an "integrity rule" (an anti-avoidance provision). There is some detail in these rules, however broadly the rules try to ensure that some continuity of ownership can be satisfied — that is, that the entity that incurred the loss should also be the one that has access to any benefits from these losses. An entity cannot carry back losses that have been transferred between companies. Also amounts of tax offsets to which a corporate tax entity is entitled, and which may in some circumstances be converted into an amount of a tax loss, cannot be carried back.

The aim of such integrity rules is to try to hold off what could be called egregious behaviour. In a very basic form, an example of the egregious behaviour at which the integrity rule is aimed can be as follows:

- Shares in a company are sold to another party who will gain control of the company.
- This occurs between the beginning of the gain year to which losses are to be carried back and the end of the loss year.
- Then an entity, other than the company, obtains a financial benefit that is calculated by reference to a loss carry back offset to which the company is entitled.
- A not incidental purpose of the share sale is to enable the company to obtain a loss carry back tax offset. ■

Calling time out on your business? Some essentials you'll need to know

When you first went into business, either buying an established enterprise or starting from scratch, probably the last thing on your mind was the day you would close the door for the last time.

In a way, a business ending is inevitable, whether through the outcomes of COVID-19, retirement, health or, in another scenario, pursuing another career. But it's important for you to know what's involved when you come to the time when you close your business, as this can go a long way to smoothing the transition.

For starters, it's important that all your tax issues are finalised before you cancel your Australian business number (ABN), which ceases that business. This allows the ATO to finalise your business's account and issue any refunds that may be owing.

STEP 1: LODGEMENT AND PAYMENT

Make sure all lodgement and payment obligations are met, including:

- outstanding activity statements
- outstanding instalment notices
- final fringe benefits tax returns
- final income tax returns.

STEP 2: REFUNDS

Request any refunds for accounts with a final tax position in credit.

STEP 3: CANCEL PAY-AS-YOU-GO (PAYG) WITHHOLDING REGISTRATIONS

You can do this by phoning the ATO's business line (13 28 66) and speak to a customer service representative, or complete an *Application to cancel registration form* (ask for "NAT 2955"). Or we can do this for you.

STEP 4: CANCEL THE ABN

This step must be completed after the first three steps, and will stop any problems with refunds being delayed and the need for the ATO to contact you (or this office on your behalf). The ABN needs to be cancelled within 28 days of your ceasing business through the Australian Business Register.

Cancelling the ABN will:

- cancel registrations for goods and services tax (GST), luxury car tax, wine equalisation tax, fuel tax credits
- cancel AUSkeys linked to the ABN
- end all authorisations for the business in Relationship Authorisation Manager, preventing access to the online services using myGovID.

After cancelling the ABN, it will pay to keep in mind that you may have a PAYG instalment obligation through to the date of ceasing business, and may still receive instalment activity statements. You are able to vary your PAYG instalment amount if the amount or rate the ATO calculated doesn't reflect your circumstances.

STEP 5: RECORD KEEPING

You need to keep business records for five years from when they were prepared or obtained, or from when the transactions or acts those records relate to were completed, whichever is later. ■

Small business CGT concessions: Goal posts moved on vacant land and active assets

Businesses wanting to claim CGT concessions for active assets may find hope in a recent Full Federal Court decision on a long-contested vacant land case.

In 2007, the Administrative Appeals Tribunal (AAT) ruled that vacant land on which two shipping containers had been placed for storing business records did not qualify as an “active asset” for the purposes of the CGT small business concessions.

The AAT said that it could not accept that “the allowance of passively storing old records in two containers placed on the property can be regarded as using the land in the course of carrying on a business”, (that is, as an “active asset”, which is one of the conditions required to access the concession). However, following a recent decision of the Full Federal Court, the same conclusion may not be reached today.

In the recent case, the taxpayer sold adjacent land next to his home, which he used for storing work tools, work vehicles, equipment and materials for his building, bricklaying and paving business. The land also contained two large sheds, had a two-metre high brick wall and was gated. In addition, the taxpayer visited the land several times a day in between jobs to collect tools or other items to use in jobs.

In overturning the earlier decision to not allow the small business CGT concession to apply to the situation outlined above, the Full Federal Court unanimously held that the land was an “active asset” on the basis of a plain meaning of the legislation – namely, whether the asset was “used in the course of the carrying on of the identified business”.

In doing so, it also emphasised the CGT small business concessions “should be construed beneficially rather than restrictively in order to promote the purpose of the concessions” and that the relevant legislation does not require the use of the asset to take place within the day-to-day or normal course of the carrying on of a business.

Accordingly, the Full Federal Court found that the judge in the first instance had erred in finding that the use of the asset must have “a direct functional relevance to the carrying on of the normal day-to-day activities of the business”.

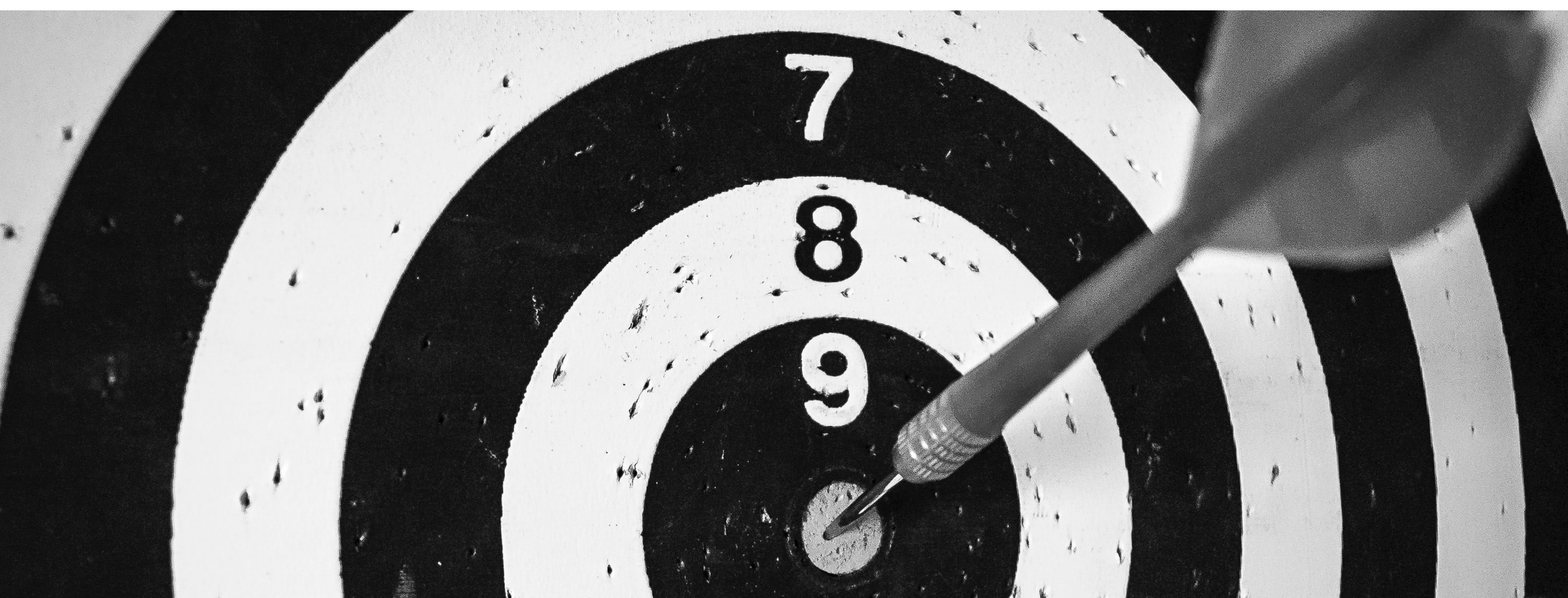
The decision of the Full Federal Court now raises the strong prospect (if it did not already exist) that a business that purchases any form of real property (for example, vacant land or strata-titled space) to store and access business records would qualify for the concessions.

One could also readily imagine that, given the coronavirus-induced downturn in business, that an enterprise that, say, usually uses equipment on a day-to-day basis may acquire a vacant block of land to temporarily store the machinery that is not currently in use and also qualify for the concession.

Finally, consider the following scenario. A transport company that is currently operating at less than full capacity acquires vacant tracts of cheap land to park its trucks until the crisis subsides (and which it, say, visits regularly to ensure that the vehicles remain in some operational condition). Under the principles established by this decision, it would seem that this land would qualify as an active asset.

Of course it is recommended that advice be sought, as the small business CGT concessions are neither simple nor straightforward (and it can be seen that even the courts have come to varying conclusions). ■

ATO takes aim at ‘you-scratch-my-back’ auditing arrangements



It has long been an accepted standard that the auditor of an SMSF needs to be independent of that fund, and be a third party entity to the SMSF.

This requirement is written into the relevant legislation. There have of course been breaches of this requirement, and instances where auditors and/or fund trustees have suffered administrative penalties or even disqualification for non-compliance in this area.

The more blatant breaches of the requirement to use a third party auditor involve someone auditing their own SMSF, or the fund of close family members. But another concern for the ATO relates to auditors who enter into arrangements that reflect that old idiom “you scratch my back, I’ll scratch yours”. The ATO has labelled these as reciprocal auditing arrangements, and has issued a warning about them.

It says that such arrangements arise where two or more auditors, each with their own SMSFs, agree to audit the other’s fund. The ATO likens the situation to the scenario of a two-partner practice where one partner takes on the work of auditing an SMSF of which the other partner is trustee.

In the view of both the ATO and ASIC, there is no realistic safeguard available for these very cosy arrangements, and no other way to view them than being non-independent.

But the ATO has identified another form of a reciprocal arrangement that it is taking active steps to closely scrutinise. This is where there can be two accounting practitioners who are also SMSF auditors. They each offer services and prepare the accounts for a number of SMSF clients, and come to an understanding that each will audit the funds that are on the other one’s books.

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Claiming interest expenses for rental properties

Interest is a common deduction claimed by taxpayers. Generally, interest is seen as being inherently deductible where it is incurred in gaining or producing assessable income.

An established factor from court cases is that the deductibility of interest depends on the purpose of and use of borrowing the principal. Interest expenses will not be deductible where money is used for a purpose that does not produce income, even if the money is borrowed by being secured over rent-producing property.

For rental properties, if you take out a loan to purchase a rental property, you can claim the interest charged on that loan, or a portion of the interest, as a deduction. However, the property must be rented, or genuinely available for rent, in the income year for which you claim a deduction.

If you have a loan you used to purchase a rental property and also for another purpose, such as to buy a car, you cannot repay only the portion of the loan related to the personal purchase. Any repayments of the loan are apportioned across both purposes.

What can you claim?

You can claim the interest charged on the loan you used to:

- purchase a rental property
- purchase a depreciating asset for the rental property (for example to purchase a new air conditioner for the rental property)
- make repairs to the rental property (for example roof repairs due to storm damage)
- finance renovations on the rental property
- you can also claim interest you have pre-paid for up to 12 months in advance.

What can't you claim?

You cannot claim interest:

- for the period you used the property for private purposes, even if it's for a short period of time
- on the portion of the loan you use for private purposes when you originally took out the loan, or if you refinanced
- on a loan you used to buy a new home if you do not use the new home to produce income, even if you use your rental property as security for the loan
- on the portion of the loan you redraw for private purposes, even if you are ahead in your repayments.

Rental property owners should remember three simple steps when preparing their return:

1. Include all the income you receive

This includes income from short term rental arrangements (eg a holiday home), sharing part of your home, and other rental-related income such as insurance payouts and rental bond money you retain.

2. Get your expenses right

- Eligibility – claim only for expenses incurred for the period your property was rented or when you were actively trying to rent the property on commercial terms.
- Timing – some expenses must be claimed over a number of years.
- Apportionment – Apportion your claim where your property was rented out for part of the year or only part of your property was rented out, where you used the property yourself or rented it below market rates. You must also apportion in line with your ownership interest.

3. Keep records to prove it all

You should keep records of both income and expenses relating to your rental property, as well as purchase and sale records.

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Claiming interest expenses for rental properties *cont*

Examples

Claiming part of the interest incurred

Kosta and Jenny take out an investment loan for $350,000 to purchase an apartment they hold as joint tenants. They rent out the property for the whole year from 1 July. They incur interest of $30,000 for the year. Kosta and Jenny can each make an interest claim of $15,000 on their respective tax returns for the first year of the property.

Interest incurred on a mortgage for a new home

Zac and Lucy take out a $400,000 loan secured against their existing home to purchase a new home. Rather than sell their existing home they decide to rent it out. They have a mortgage of $25,000 remaining on their existing home which is added to the $400,000 loan under a loan facility with sub-accounts; that is, the two loans are managed separately but are secured by the one property.

Zac and Lucy can claim an interest deduction against the $25,000 loan for their original home, as it is now rented out. They cannot claim an interest deduction against the $400,000 loan used to purchase their new home as it is not being used to produce income even though the loan is secured against their rental property.

Interest incurred on funds redrawn from the loan halfway through the year

Tyler has an investment loan for his rental property with a redraw facility. He is ahead on his repayments by $9,500, which he can redraw. Halfway through the year, Tyler decides to redraw the available amount of $9,500 and buys himself a new TV and a lounge suite.

The outstanding balance of the loan at that time is $365,000 and total interest expense incurred until then is $9,300. The total interest for the year is $19,000. Tyler can only claim the interest expense on the portion of the loan relating to the rental property using the following calculation:
Total loan balance – redraw amount = rental property loan portion:
That is: $365,000 – $9,500 = $355,500
To work out how much interest he can claim, he does the following calculation in respect of the period following the redraw:
Total interest expenses x (rental property loan portion ÷ loan balance at the time of the redraw) = deductible interest
That is: $9,700 x ($355,500 ÷ $365,000) = $9,448
Tyler can claim interest of $18,748, being $9,300 plus $9,448. ■

ATO takes aim at 'you-scratch-my-back' auditing arrangements *cont*

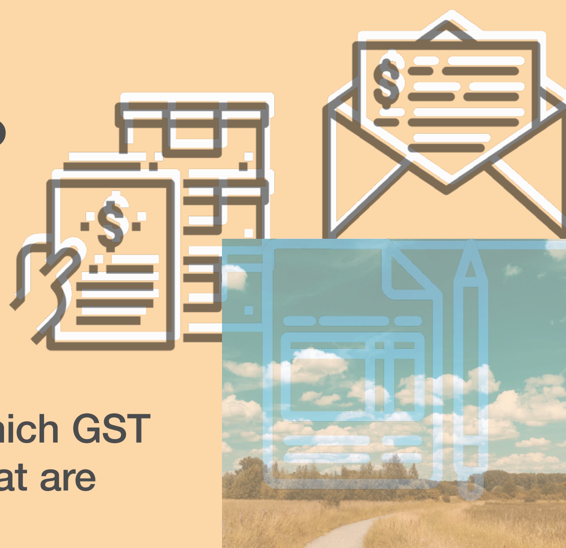
The concern the ATO has (and ASIC agrees with it) is the threat to independence from these reciprocal arrangements. The ATO says the problems that can arise include:

- self-interest – an SMSF auditor may be influenced to vary their audit opinion or not report a contravention if they perceive this will influence the outcome of the audit on their own fund or if they fear a potential loss of business as a result
- familiarity – an SMSF auditor having a close relationship with, or a high regard for, the other auditor may be influenced to ignore certain issues or to undertake a cursory and inadequate SMSF audit
- intimidation – the other auditor's knowledge or their industry contacts may influence the auditor to not report certain issues and to apply less scrutiny to the audit.

The ATO has indicated that approved SMSF auditors who continue to engage in reciprocal auditing arrangements will be subject to increased scrutiny. It warns that referral to ASIC may result if it considers SMSF auditors have failed to meet independence requirements. ■

This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs.

What is a recipient created tax invoice?



Tax invoices are an essential element of Australia's taxation system, and serve both to collect taxation revenue related to the goods and services on which GST is levied as well as record the credits that are claimable by eligible businesses.

A business registered for GST will generally be required to hold a tax invoice for any transaction in order for an input tax credit to be claimed. The tax invoice can usually only be issued by the entity that made the taxable supply, however there are circumstances where, in order to secure access to input credit claims, the receiver of the services or goods can generate such an invoice. This is known as a recipient-created tax invoice (RCTI).

Note however that an RCTI can only be issued in circumstances that are ATO approved. The circumstances are typically those where for commercial or practical reasons it is appropriate for the recipient of a supply to calculate and/or issue an invoice. Government grants and trade-in contracts are typical RTCI examples.

You can issue an RCTI if:

- you and the supplier are both registered for GST
- you and the supplier agree in writing that you may issue an RCTI and they will not issue a tax invoice
- the agreement is current and effective when you issue the RCTI
- the goods or services being sold under the agreement are of the type that the ATO has determined can be invoiced using an RCTI.

Your written agreement can either be a separate document specifying the supplies, or you can embed this information or specific terms in the tax invoice.

To be valid, an RCTI must contain sufficient information to clearly determine the requirements of tax invoices (ask us what these are) and show the document is intended to be a recipient-created tax invoice, not a standard tax invoice.

In addition it must detail the purchaser's identity or ABN. If GST is payable, it must also show that it's payable by the supplier.

As the recipient, you must:

- issue the original or a copy of your RCTI to the supplier within 28 days of one of the following dates
  - the date of the sale
  - the date the value of the sale is determined
- retain the original or a copy of the RCTI
- comply with your obligations under the tax laws.

You will need to stop issuing RCTIs once any of the requirements for issuing RCTIs are no longer met.

The ATO has supplied a template that you can use to generate an RCTI. See www.ato.gov.au/Forms/Recipient-created-tax-invoices, or ask us for a copy. ■