



March 2019

---

BUSINESS, TAXATION & INDUSTRY NEWS

---

## The same business test to be replaced by a “similar business” test

Among the first batch of tax legislation the government dealt with in the new year was a bill that contained changes to the “same business” test.

The same business test is relevant in a number of contexts, but most particularly in determining if a company is eligible to claim deductions for past year losses, current year losses and bad debts, and to determine if the existence of unrealised losses may affect future deductions and offsets that may be otherwise available. The need to satisfy the same business test however generally arises if there has been a change in the business’s ownership or control of the company.

The government said in announcing the measure that the same business test, which can also sometimes prevent companies from claiming past year losses as a tax deduction where they have changed their business, will be relaxed and a “similar business test” introduced.

“This more flexible approach to accessing company losses will ensure that companies do not face tax penalties for innovating and risk tasking in an effort to improve their business,” the government announcement said. “Loosening the inflexible rules will encourage investment and growth in our innovative businesses.”

The new relaxed test applies to losses made in income years commencing from 1 July 2015.

The “similar business test” also helps work out whether a debt written off as bad can be deducted in an income year, and whether tax losses of listed widely held trusts can be used.

The government says the similar business test will encourage entrepreneurship by allowing companies to use losses in a wider range of circumstances and will encourage companies to “seek out new opportunities, and hopefully return to profitability”.

However the new test will still be required to meet four factors, including:

- the extent to which the assets (including goodwill) used to generate income were also used formerly
- the extent to which the activities and operations were also the same with the previous business
- the identity of the current business and the identity of the former business, and

-----ACCOUNTING EXCELLENCE SINCE 1952-----  
 ....Benefit from our experience....

### PARTNERS:

Peter Stockdale FCA  
 Paul Lunn FCPA, ICAA  
 Mark Mellor CA  
 Brett Buntain FCPA, ICAA  
 Brad Hope FCA

### LOVE & PARTNERS CHARTERED ACCOUNTANTS

Address: 66 Duporth Avenue (Cnr Wharf St), Maroochydore  
 Postal: P.O Box 299, Maroochydore, QLD 4558, Australia  
 T: (07) 5443 2600 E: [reception@loveandpartners.com](mailto:reception@loveandpartners.com)  
 W: [www.loveandpartners.com](http://www.loveandpartners.com)

- the extent to which any changes to the former business resulted from the development or commercialisation of assets, products, processes, services, or marketing or organisational methods, of the former business.

Note that the new measure is not a free-for-all however. Guidance issued by the ATO indicates that it will not be enough if a business is of a similar “type” to a previous business. It says a business is “similar” where there is an element of continuity, and that it has evolved or organically grown over time without changing its core identity or core source of income. It may not be sufficient that the change in business is a “reasonable” business decision or one that makes commercial sense if there is no continuity of the original business.

While entering a new business or new transaction may not necessarily cause the similar business test to fail (as it has been known to with the previous “same business” test) the new test may be more difficult to satisfy if substantial new business activities and transactions do not evolve from and complement the former business.

## **Removing tax deductibility of ‘non-compliant’ payments**

From 1 July 2019, businesses will only be able to claim deductions for payments that are made to workers (employees or contractors) when the employer has complied with the pay-as-you-go (PAYG) withholding and other tax reporting obligations for that payment.

If the PAYG withholding rules require a business to withhold an amount from a payment that the business makes to a worker, the business must:

- withhold the amount from the payment before it is paid, and
- report the amount to the ATO.

Any payments that are made where the business hasn't withheld or reported the PAYG tax are dubbed by the ATO to be “non-compliant payments”, and for these an employer will not be able to claim a deduction.

Note however that if the employer makes a mistake and withholds or reports an incorrect amount, they will generally not lose their deduction — as long as the ATO is notified and a correction is made.

### **Payments that must comply**

An employer can only claim a deduction for the following payments if they comply with the PAYG withholding rules. This includes payments:

- of salary, wages, commissions, bonuses or allowances to an employee
- of directors' fees
- under a labour hire arrangement, and
- for a supply of services (except from supplies of goods and real property) where the contractor has not provided their ABN.

### **Non-cash benefits**

A non-cash benefit is something that is provided instead of paying cash — for example goods or services. In this case, a business still needs to report to the ATO in order for this to be classified as a compliant payment and therefore allow the employer to claim a deduction.

### **Correcting a mistake**

If a business withholds an incorrect amount by mistake, they shouldn't lose their deduction. To minimise any penalties, and employer can correct their mistake by lodging a voluntary disclosure via the approved form.

If a business withheld the correct amount but made a mistake when reporting it, they also should not lose their deduction. However the ATO advises that they should correct the mistake as soon as possible.

## **Mistaking an employee for a contractor**

There may be a situation where a business honestly believes their employee is acting as a contractor, and so believes they are not obliged to withhold PAYG tax from payments as the “contractor” has provided their ABN.

In this instance, although the business made a mistake and did not withhold PAYG tax from payments made to that worker, the business should generally not lose their deduction for these payments because the employer complied with the withholding obligations for a contractor. Again, a correction will need to be made via the approved form.

Remember also that should PAYG withholding obligations not be met, apart from losing a deduction there is also the prospect of having to face the already existing penalties that apply for both failing to withhold and failing to report such amounts to the ATO.

## **The new “consumer” rules for GST and online purchases**

Australians have been taking full advantage of the offerings on the digital marketplace with gusto for years now, but it has only been relatively recently that the rules for goods and services tax (GST) have caught up.

With the purchase of digital products such as the streaming or downloading of movies, apps, and e-books and much more trending exponentially more popular, it is pertinent to run over the law that applies GST to digital products and services imported by Australian consumers.

Effective 1 July 2017, GST now applies to digital products and other services imported by Australian consumers. Affected supplies that are caught by the new law include not only the streaming or downloading of movies, music, apps, games, e-books, online supplies of software, digital trade journal/magazine subscriptions and other digital products, but also offshore services such as website design, publishing services, consultancy and professional services (for example, legal advice, architectural services and so on).

### **Australian consumer**

The concept of an “Australian consumer” is central to the new law. GST will only apply where the supply is imported by an Australian consumer. This requires that both of the following conditions are met:

- 1) the recipient is an Australian resident for tax purposes, and
- 2) either the recipient is not registered for GST or, if they are registered, the recipient does not acquire the supply for use in their business. Therefore, if the recipient is an Australian resident and makes the acquisition solely or even partly for business purposes, GST will not apply.

### **Safeguards for suppliers**

In many cases, the foreign supplier may have only a limited ability to assess the residency and GST registration status of the recipient (in determining whether they are an Australian consumer). To overcome this, safeguards are built into the legislation that provide that the non-resident supplier can treat the supply as non-taxable where:

- they have taken reasonable steps to obtain information regarding whether the recipient is an Australian consumer, and
- having taken these steps, reasonably believe that the recipient is not an Australian consumer.

These safeguards apply (meaning no GST is required to be charged) even where it is later found that the supply is indeed taxable.

On the other hand, where the non-resident supplier believes the recipient is registered for GST (and is therefore not an Australian *consumer*) then they may treat the supply as GST-free but only where the recipient has provided to them:

- their ABN, and
- a declaration or other information that the recipient is registered for GST (a declaration that can be in any form, including verbal).

## **Simplified registration**

In acknowledgement of the compliance challenges faced under the new law, the ATO has designed a simplified/limited electronic GST registration and payment process for non-resident businesses that make or intend to make sales of imported services or imported digital products to Australian consumers. This fully secure online platform allows businesses to register, lodge and pay the Australian GST online, manage account details, as well as authorising others to access their account. To register and use this platform, non-resident businesses:

- are not required to prove their identity
- use an ATO reference number instead of an ABN
- cannot claim GST credits for acquisitions made in the course of making a taxable supply
- cannot issue tax invoices or adjustment notes
- must lodge GST returns and pay GST quarterly
- can pay electronically via SWIFT bank transfer or credit card.

Alternatively, non-resident businesses can register for GST in the standard way. If this option is adopted these businesses will require an ABN, can claim GST credits, must issue tax invoices (unless the supply is less than \$82.50 [including GST]), and must complete activity statements to report and remit GST to the ATO.

## **Takeaway points**

- Affected non-resident suppliers need to ensure compliance with GST registration requirements and consider whether to apply for simplified or standard registration
- Despite the safeguards built into the new rules, non-resident suppliers face a significant burden in determining whether customers are a “Australian consumers”. This may require them to upgrade their systems
- To avoid GST being charged, GST-registered recipients need provide their ABN and advise of their GST registration status at the time of purchase.

## **Rental travel expenses mostly off the table**

The ATO recently highlighted significant non-compliance with the rules prohibiting taxpayers claiming travel expenses related to residential rental properties.

Late last calendar year, the ATO revealed that it had identified 26,000 taxpayers who had incorrectly claimed deductions for travel to rental properties during tax time 2018, despite recent changes to the law in this area.

New rules, introduced just over a year ago (and therefore perhaps not ingrained in many people’s minds), mean that investors can no longer claim travel expenses relating to inspecting, maintaining or collecting rent for a residential rental property as deductions, unless they are carrying on a rental property business or are an excluded entity.

This measure was introduced to address concerns that some taxpayers were claiming travel deductions without correctly apportioning costs where there was a private component to the travel, or claimed travel costs that were exclusively for private purposes.

The changed rules mean that travel expenditure incurred in gaining or producing assessable income from residential premises is not deductible unless incurred by certain institutional entities or incurred in the course of carrying on a business.

## **Exclusions**

The legislation is primarily targeted at individual landlords who are not in business. Travel deductions can continue to be claimed by the following taxpayers who own residential rental property:

- corporate tax entities (companies, corporate limited partnerships, corporate unit trusts, and public trading trusts)
- superannuation plans that are not an SMSF
- public unit trusts
- managed investment trusts, and
- unit trusts or partnerships where every entity is of the types listed above.

Taxpayers carrying on a commercial business of renting residential properties, such as owners of hotels, motels, boarding houses, are also exempted.

Note that the ATO's view is that it is quite rare that individuals who own standalone residential rental properties are carrying on a business, even where they own multiple standalone properties.

This is in spite of several court case decisions seemingly giving scope to an argument that a taxpayer who owns a portfolio of standalone residential properties could be deemed to be carrying on a business, and therefore should continue to be able to claim travel expenses. However this will depend on individual circumstances, and the number of properties would need to be significant — certainly more than just a couple.

### **Residential investment properties**

The changes apply to “residential properties”, which takes on its ordinary tax law meaning of land or buildings that are occupied as a residence and are capable of being occupied as a residence. This can include a “floating home” and commercial residential premises such as a boarding house.

Whether a property is residential in nature is determined by the property's physical characteristics. It would be expected therefore that the property has characteristics such as kitchen facilities, shower, toilet, laundry, bedrooms and so on. However not all premises that have such facilities are residential premises to be used predominantly for residential accommodation.

If it's apparent from the physical characteristics of a premises that its suitability for living accommodation is merely ancillary to its main function, the premises is not a residential premises for the purposes of the new rules. For example, a multiple-story office block that has open spaces for cubicles and desks, and smaller separate offices, may also contain kitchen and toilet facilities. Despite this, such premises are not residential in nature.

Note that under the new rules, where you are not using the property to derive rental income but are using it for other income-producing purposes (for example, you are using it in a business) travel will continue to remain deductible. This exception accommodates cases where residential premises are converted and used by a professional, such as a doctor or dentist, to operate their business.

Where there is a mix-use of the property, each trip to the property must be considered on its merits, and if necessary the expenses apportioned.

### **Capital gains**

Travel expenditure that is prevented from being deducted by the new rules cannot form part of any element of the cost base or reduced cost base of residential premises for CGT purposes. Consequently, the travel expenses that are no longer recognised on a taxpayer's revenue account are also prevented from being recognised on their capital account.

### **Travel expenses**

The new law is broad in scope and denies deductions for not only travel to the property for the purposes of inspecting, maintaining or collecting rent for example, but also travel undertaken that's *related* to the property but not to the actual property itself.

This includes travel to a body corporate meeting, or to visit the real estate property manager to discuss the property, or travel to buy and install assets used in the rental property. The prohibited deductible travel expenditure under the new rules includes:

- motor vehicle expenses
- taxi, Uber or hire-car costs
- airfares
- public transport costs, and
- meals and accommodation related to the travel.

## **All is not lost**

A question that may be exercising investment property owners is whether travel to see a tax agent is deductible when preparing a tax return in relation to a residential property's income and expenses.

The good news is that the new law does not apply where travel expenses are incurred to visit a tax agent for the purposes of preparing and lodging an income tax return that happens to include rental income and deductions. This is because such expenses relate to the management of your income tax affairs (which is made specifically deductible under the existing rules), and not to the gaining or producing assessable income from the use of residential premises for residential accommodation.

## **Considerations going forward**

Virtually all travel related to earnings from residential rent – provided that it is not as part of a business – is now denied a deduction, and is not claimable under other provisions of the tax rules.

You can still claim a deduction for the cost of employing other parties to carry out tasks on your behalf. This includes enlisting real estate agents to carry out property management services, such as inspections, or hiring tradespeople for repairs and/or maintenance. Indeed, where the travel expenses are significant (and now no longer deductible) it may be a smart option to consider engaging the services of these other parties.

## **When valuations of property are important for tax**

There are times when getting a valuation becomes necessary, especially to estimate the cost of transactions that are not arm's-length or when no actual cash changes hands.

A common example of this is in respect of property, and especially for transactions when a valuation is necessary for tax purposes.

For example, let's say that Humbert transfers his rental property to his daughter Dolores for no consideration. The tax law, specifically the CGT rules, requires that the transfer be made at "market value". If Humbert has held the property for a lengthy period of time and the property has increased significantly in value at the time of transfer, then he could be up for quite a hefty CGT bill, even with the general discount. This is so even though he has not received a single cent by gifting his property.

In order to work out the extent of any capital gain, Humbert will need to obtain an appropriate market valuation of the property that appropriately reflects an arm's length value.

The ATO has issued warnings in the past about penalties that could arise when valuations are not done correctly. A general understanding of how the ATO expects valuations to be done could be necessary so there are no nasty surprises with the annual assessment.

## **What does the ATO consider an appropriate valuation?**

It is recognised by valuation professionals, and has been tested in the courts, that particular valuation methods are more appropriate for some valuations than others based on the information available.

While the ATO admits that the process of valuing an asset can range from being simple to complex, the principles at work remain constant. One of these constants is the concept of market value based on the highest and best use of the asset in question.

The market value should use the most appropriate valuation method. For commodity products, the comparable arm's length sales data is considered the most appropriate method, or for a mature company, discounted cash flow or a multiple of Earnings Before Income Tax (EBIT). Many valuations also use one or more secondary methods to cross-check the value determined from the primary method.

Where a market exists for an asset, that market is widely considered to be the best evidence of market value of the asset (meaning that this is the value that the market is willing to pay).

## **Valuing real property**

In many instances it will be found that the most appropriate method for the valuation of real property is highest and best use.

The concept of “highest and best use” of the property in the market takes into account any potential for a use that is higher than the current use of the property, for example development potential based on council approvals. Factors to consider would be current market transactions, current market trends and condition of the property.

A valuation should be undertaken by a suitably qualified and experienced person in relation to real property valuation, and fully documented to explain how the value was determined.

As with many tax issues, substantiation is extremely important, and the ATO may not accept the market value determination if the document is not “fit for purpose”.

### **Safety grey zone**

The ATO makes it clear however that there is some fallback for people whose intentions are on the right side of the rules.

“The majority of taxpayers who use a qualified valuer or equivalent professional for taxation purposes will generally not be liable for a penalty if they have provided the valuer with accurate information where the valuation ultimately proves to be deficient,” the ATO says.

It uses the example of a real property valuation prepared by a qualified valuer, or an estimate of historical building cost made by a quantity surveyor. These are matters that the ATO says are likely to be outside of the range of professional expertise of a tax agent or the taxpayer. “Relying in good faith on advice of this nature is consistent with the taking of reasonable care,” it says, “even though the advice later proves to be deficient.”

### **Even fallbacks have limits**

But even when using the services of a qualified professional, the ATO says there may still be potential penalties for making a false or misleading statement, or for treating the tax law “in a manner that is not reasonably arguable”.

It says this could be the case if:

- the taxpayer has not given correct information to the valuer to allow them to correctly assess the value of the item for the period required
- the taxpayer or their agent should reasonably have known that the information provided by the value was incorrect
- the methodology or valuation hypothesis used by a qualified valuer may be based on an unsettled interpretation of a tax law provision or unclear facts.

As with all such matters where an element of informed judgement is called for, taxpayers may be well advised to seek out, and document, the wisdom of a tax professional.