

IN THIS ISSUE

- Borrowing from your business?
- Is your business car available for private use?
- Do you import goods and services?
- 4 ways to avoid simple mistakes with GST reporting
- Do you hold vacant land?
- Travel deductions for residential rental property
- New tax reporting requirements for couriers and cleaners
- Key tax dates

Borrowing from your business?

Are you a shareholder or associate of a private company?

Does your company have a distributable surplus at the end of the income year?

Do you borrow or use business assets for your personal use and enjoyment?

If you answered yes to any of these questions, then the legislative provisions of Division 7A of the *Income Tax Assessment Act 1936* could potentially affect you.

What is Division 7A?

Division 7A is essentially designed to prevent shareholders and their associates from using private company profits without paying tax at their marginal tax rates.

With the highest individual marginal rate sitting at 45%, it is tempting to structure your tax affairs to access the lower company tax rate of either 30% or 27.5%. However, the anti-avoidance provisions of Division 7A operate to prevent this kind of activity.

Division 7A rules determine what kinds of benefits to shareholders and their associates are treated like unfranked dividends and therefore subject to

personal income tax without any credit for company tax paid.

Does Division 7A apply to me?

You may potentially be affected by Division 7A if you are a:

- private company
- non-resident private company
- closely-held corporate limited partnership
- trust
- interposed entity
- shareholder or associates of a shareholder.

Note! The term 'associate' in this case extends to a shareholder's spouse, child, relative or trustee of a trust under which the shareholder benefits.

What transactions does Division 7A apply to?

Division 7A can apply to a broad range of transactions, including:

- loans
- payments
- debt forgiveness
- payments or loans where a trust has an unpaid present entitlement (UPE)
- payments and loans through interposed entities
- private use of company assets
- transfer of company assets
- gifts
- guarantees.

Note! An unpaid present entitlement (UPE) is a payment or distribution that you are entitled to but have not been paid.

When does Division 7A not apply?

Division 7A does not apply to:

- payments to a shareholder or associate in his or her capacity as an employee. In such situations, fringe benefits tax (FBT) may apply rather than Division 7A.

- amounts that are assessable to the shareholder or their associate under other parts of the income tax law, such as normal dividends or director's fees.
- a payment or benefit that is potentially subject to Division 7A if it is repaid or converted into a Division 7A complying loan by the company's lodgment day for the income year in which the payment or benefit occurs.

What is a complying loan?

A loan is a complying loan if the loan has satisfied the minimum interest charge and maximum term requirement and is made or put under a written agreement before the private company's lodgment day (currently 7 or 25 years depending on the terms).

Complying loans will have tax implications for the company and shareholder (e.g. the taxation of interest will need to be considered).

When is Division 7A triggered?

Division 7A can be triggered if:

- a private company provides a payment or benefit to a shareholder or associate; or
- a trust has allocated income to a private company but has not actually paid it, and the trust has provided a payment or benefit to the company's shareholder or their associate.

Note!

- A payment or benefit provided by a private company to a shareholder or their associate can be treated as a dividend under Division 7A even if the participants treat it as some other form of transaction such as a loan, advance, gift or writing off a debt.
- Division 7A can also apply when a private company provides a payment or benefit to a shareholder or associate through another entity, or if a trust has allocated income to a private company but has not actually paid it, and the trust has provided a payment or benefit to the company's shareholder or their associate.

What is considered a payment by a private company?

A payment may include:

- the provision of an asset for use by a shareholder or their associate (other than a transfer of property)

- when a company asset is available for use by a shareholder or their associate to the exclusion of the company, but not where there is a general entitlement to use the company's assets
- a right to use assets under a licence or lease, but which does not involve a transfer of property. It does not matter when the right to use the asset is granted.

When is a payment treated as a dividend?

A private company may be taken to pay a dividend to an entity at the end of the company's income year if it pays an amount to the entity during the year:

- when the entity is a shareholder or an associate of a shareholder of the company; or
- a reasonable person would conclude that the payment was made because the entity was a shareholder or an associate of a shareholder at some time.

Note!

- However, the total of all dividends a private company is taken to pay under Division 7A is limited to its distributable surplus for that income year.

What is considered a loan by a private company?

A loan may include:

- an advance of money
- a provision of credit or any other form of financial accommodation
- a payment for a shareholder or their associate, on their account, on their behalf, or at their request if they have an obligation to repay the amount
- a transaction (whatever its terms or form) that is the same as a loan of money.

When is a loan treated as a dividend?

A private company may be taken to pay a dividend to an entity at the end of the company's income year, if it loans an amount to an entity during the year:

- when the entity is a shareholder or an associate of a shareholder of the company; or

- a reasonable person would conclude that the payment was made because the entity was a shareholder or an associate of a shareholder at some time.

Transactions that will create deemed dividends

Certain transactions between a private company and shareholder or associate are deemed to create an unfranked dividend assessable to the shareholder or associate.

Note!

- The shareholder or associate need not be a shareholder or associate at the time the transaction occurred, as long as a reasonable person would conclude that the transaction occurred because the person was a shareholder or associate at some time.

Payments treated as deemed dividends

These include:

- an amount paid or credited to the shareholder or associate
- an amount paid or credited on behalf of, or for the benefit of, the shareholder or associate
- a transfer of property to the shareholder or associate.

Case study 1

Matt owns shares in a private company, ABC Pty Ltd. On 30 June 2017, ABC Pty Ltd makes a payment of \$5,000 to Matt's mother, Norma. Norma is not an employee of ABC Pty Ltd and she is not an associate of an employee of the company. However, she is an associate of Matt.

The payment will be taken to be an unfranked dividend paid to Norma and she must include the \$5,000 as assessable income on her 2016-17 tax return.

Loans treated as deemed dividends

These include:

- loans made to a shareholder or an associate of a shareholder
- loans that are not fully repaid before the private company's lodgment day for the year when the loan is made. A private company's lodgment day is the earlier of the due date for lodgment, or the actual date of lodgment of the

private company's income tax return for the income year

- loans that are not excluded specifically by other sections of Division 7A.

Case study 2

Charlotte is a shareholder in a private company, XYZ Pty Ltd. Charlotte's credit card bills, totalling \$10,000, are paid with company cheques throughout the income year and debited to her loan account. Interest is not payable on the balance of the loan account.

If Charlotte repays the \$10,000 to XYZ Pty Ltd by the end of the company's income year, no amount should be treated as a deemed dividend under Division 7A. If she does not repay all of the \$10,000, an unfranked dividend may arise.

Consequences of triggering Division 7A

Generally, if Division 7A has been triggered, the shareholder would be deemed to have received a dividend equal to the amount of the payment, loan or benefit received.

What if I borrow an asset from my company for personal use?

Case study 3

Bruce is a shareholder of a private company that owns a luxury yacht. Bruce does not have a formal agreement with the company in relation to the yacht, however, he borrows the yacht and takes it out every second weekend. Bruce keeps the yacht at the company's business premises, but takes the key home. Bruce stores his personal items on the yacht.

Bruce's fortnightly use of the yacht is effectively treated like a payment under Division 7A. The availability of the yacht for Bruce's use is also subject to Division 7A because the yacht is not readily available for use by the company.

The company would need to arrange with Bruce to get the key and for the removal of his personal items before using the yacht. The asset is available for Bruce's use to the exclusion of the company.

Case study 4

Nicole is a shareholder of a private company that owns a city apartment. The apartment is generally available for rent. However, Nicole asks the

company not to rent the apartment out for a week so that she and her family can borrow it over a long weekend. Nicole's use of the apartment may be a payment for the purposes of Division 7A.

What if my company provides a loan to a shareholder?

Case study 5

Conway Pty Ltd loans \$20,000 to Angie, a shareholder of Conway Pty Ltd. The money is loaned to Angie on the basis that she pays it back when she can. The \$20,000 is a loan from Conway Pty Ltd to Angie because it is an advance of money. Consequently, Division 7A may apply.

Case study 6

Wayne Pty Ltd provides \$10,000 to Bob, a shareholder of Wayne Pty Ltd, by way of a promissory note. The note places no obligation on Bob to repay the amount. The \$10,000 is a loan from Wayne Pty Ltd to Bob because it is a form of financial accommodation. Consequently, Division 7A may apply.

What if my company provides a car for use by a shareholder?

Case study 7

Carla is a shareholder of a private company that owns five cars for company use. Shareholders and their associates have general permission to use the cars on weekends if they are not being used for company business. Carla regularly takes one of the cars home.

Carla's use of the car that she takes home will be subject to Division 7A. This will include driving the car (actual use) and the availability of the car for her use to the exclusion of the company, such as when it is parked at home, or at a restaurant that Carla is visiting.

Although Carla may have general permission to use all five of the cars, she does not use all of them for the purposes of Division 7A. The four cars that Carla leaves at the company premises are available for the company to loan to another shareholder, employee, customer, or other party. That is, these cars are not available to Carla to the exclusion of the company.

Note! Providing cars or other residual benefits (e.g. a holiday house) to shareholders may be treated under FBT instead of Division 7A.

Government's proposed changes to Division 7A

The proposed changes to the legislation are intended to apply from 1 July 2019 and may impact you if you are a company owner, a shareholder of a private company or an associate of a shareholder.

What do the changes mean?

The proposed changes are intended to make it easier for businesses to comply with Division 7A. The amendments will comprise:

- a self-correction mechanism to assist taxpayers to promptly rectify breaches of Division 7A;
- clarification that unpaid present entitlements (UPEs) come within the scope of Division 7A;
- simplified loan rules. Complying loans are not treated as dividends under Div 7A. Under the current law, there are 2 types of complying loans (7-yrs for an unsecured loan or 25-yrs for a secured loan). Under the proposed changes, there will be one single 10-yr model.

Is your business car available for private use?

A car fringe benefit occurs when your business owns or leases a car and makes it available for your employees' private travel. Directors might also be employees.

Note! Generally, travel to and from work is private use of a vehicle.

For FBT purposes, a car is any of the following:

- a sedan or station wagon
- any other goods-carrying vehicle with a carrying capacity of less than one tonne – eg a panel van or utility (including four-wheel drive vehicles)
- any other passenger-carrying vehicle designed to carry fewer than nine passengers.

If the vehicle provided does not meet the definition of a car, and your employee has private use of the vehicle, the right to use the vehicle may be a residual fringe benefit.

Providing car fringe benefits

Some examples of providing a car fringe benefit include:

- employees using the car for private travel, such as travel between work and home;
- garaging the car at or near your employees' home, which makes it available for private use – even if it is not used privately.

Note!

- If a car is garaged at or near your employee's home, even if only for security reasons, it is taken to be available for their private use regardless of whether or not they have permission to use the car privately.
- Similarly, where the place of employment and residence are the same, the car is taken to be available for the private use of the employee.

Working out the taxable value of a car fringe benefit

To calculate a car fringe benefit, as an employer, you must work out the taxable value of the benefit using either:

- the statutory formula method (based on the car's cost price)
- the operating cost method (based on the costs of operating the car).

You can choose whichever method yields the lowest taxable value, regardless of which method you used in a previous year.

Note! If you have not kept the required documentation for the operating cost method (eg log books), you must use the statutory formula method.

Do you import goods and services?

GST applies to most imports over \$1,000. GST is 10% of the value of the goods you have imported. You generally need to pay this to the Department of Home Affairs before you can receive the goods.

There is a scheme where you can pay your GST later. This is called the deferred GST scheme (DGST), and there are eligibility requirements.

If you are registered for the deferred GST scheme, you don't need to pay GST until after the goods are imported and you lodge your next activity statement.

If you're registered for GST, you may be able to claim a credit for any GST paid on goods you import for your business.

What is the deferred GST scheme?

If you import goods and services, the deferred GST (DGST) scheme allows you to defer payment of GST on all taxable importations into Australia.

Note!

- You need approval from the ATO to participate in the DGST scheme.

Am I eligible to participate in the deferred GST scheme?

To be eligible to participate in the deferred GST scheme, you must:

- have an ABN
- be registered for GST (you can register for GST and apply for an ABN on the one form if you don't already have an ABN)
- lodge your activity statements online
- lodge your activity statements monthly (if you are lodging quarterly, you can elect to lodge monthly)
- make your activity statement payments electronically.

When am I *not* eligible?

- if you are not up to date with your tax returns or payments
- if you or anyone relevant to the application has, in the past three years, been convicted or penalised by a court for specific offences.

4 ways to avoid simple mistakes with GST reporting

Businesses can make simple mistakes reporting their GST. To avoid errors, keep an eye out for the following common errors.

1. Transposition and calculation errors

Transposition errors can occur when an amount is manually input. These errors can be easily eliminated by double checking all figures and calculations before submitting your BAS.

2. No tax invoices

You need to keep tax invoices to claim GST credits you have claimed on business related purchases.

3. Transaction classification

Make sure you check that GST is applicable. Transactions involving food may be GST free.

4. Accounting systems

Check your systems as one coding error can classify several transactions incorrectly.

If you find you've made a mistake on a previous return, you can:

- correct the error on a later activity statement – if you meet certain requirements; or
- lodge an amendment.

Do you hold vacant land? Your expenses may no longer be deductible

Are you a property owner sitting on vacant land? The Government has recently released draft legislation to deny deductions for certain expenses associated with holding vacant land.

The current law

The current law allows you to claim the costs of holding vacant land if it is held for the purpose of gaining or producing assessable income or carrying on a business for the purpose of gaining such income.

The proposed law

From 1 July 2019, the proposed law will limit deductions for expenses associated with holding vacant land.

The proposed rules do not apply to expenses associated with holding vacant land that is used by the owner or a related entity to carry on a business. For example, the measure will not apply to a business of primary production or to a property developer that is carrying on a business and is holding land for the purpose of that business.

The proposed rules also do not apply to corporate tax entities, managed investment trusts, public unit trusts and unit trusts.

What is vacant land?

Land is vacant if there is no building or other structure on the land that is substantial and permanent in nature and in use or ready for use.

In this context, land does not have to refer to the whole of the land on a property title but could refer to part of the land on a property title. For example, if a property title includes two areas of land, one containing a factory and the other undeveloped, the part of the property title containing the factory has ceased to be vacant land, while the undeveloped area remains vacant land.

What does 'substantive' in nature mean?

To be substantive, a building or structure needs to be:

- substantial in size; and
- have an independent purpose or function (not ancillary in nature to other structures or proposed structures on the land such as is the case for retaining walls or fences).

Case study

Deborah owns a block of land. She intends to eventually build a rental property on the land. However, while the block of land is fenced and has a large retaining wall, it currently does not contain any substantial or permanent building or other structure.

As the property does not have a substantial permanent building or structure on it, it is vacant land and Deborah cannot deduct any holding costs she may incur in relation to the land.

What if land does not have a substantive permanent building or structure?

There are many genuine commercial reasons land may not have a substantive permanent building or structure (eg holding yards for goods that are awaiting transport or customs clearance, parking areas for trucks/buses for a logistics company) as not all business operations require structures and buildings.

If the owner of land used for these purposes is a private trust or individual who does not have the requisite connection to the business being carried on, all deductions will be denied even though the “vacant land” is an essential part of the business activities.

Did you incorrectly claim deductions for travel to your residential rental property?

This tax time, the ATO has identified 26,000 taxpayers who have incorrectly claimed deductions for travel to their residential rental properties, despite recent changes to tax laws.

From 1 July 2017, you are no longer able to claim travel expenses relating to inspecting, maintaining or collecting rent for a residential rental property as deductions unless you are carrying on a business of letting rental properties or are an excluded entity.

As with prior years, the travel expenditure cannot be included in the cost base for calculating your capital gain or capital loss when you sell the property.

Note! The new changes only apply to residential rental property. You may still be able to claim deductions in relation to your commercial property.

‘In the business of letting rental properties’

Generally, owning one or several rental properties will not be considered being in the business of letting rental properties.

The receipt of income by an individual from the letting of property to a tenant, or multiple tenants, will not typically amount to the carrying on of a business of letting rental properties.

This means that as their activities are generally considered a form of investment rather than a business, deductions for travel expenses are not allowed.

Excluded entities

An excluded entity is a:

- corporate tax entity

- superannuation plan that is not a self-managed superannuation fund (SMSF)
- public unit trust
- managed investment trust
- unit trust or a partnership, all of the members of which are entities of a type listed above.

Case study

Tara's Tyres Pty Ltd incurred travel expenses in 2017-18 when the property manager was tasked with inspecting a residential property investment that is currently tenanted. Tara's Tyres Pty Ltd is a corporate tax entity and can claim a deduction for rental travel expenses.

ATO and data analytics

The ATO has announced that it will be using sophisticated data analytics to assess a range of other deductions and work-related expenses.

Remember that when making a claim, you must follow the 4 golden rules:

1. You must have spent the money; and
2. The expenditure must not have been reimbursed to you either directly or indirectly; and
3. The expense must be directly related to earning your income; and
4. You must have some sort of record to prove that the expense was incurred (which can be produced if asked).

Made a mistake?

Rental property investors: you should check if you fall into one of these exceptions before you lodge and claim for rental travel.

If you have already lodged and made a mistake, you can lodge an amendment.

New tax reporting requirements for couriers and cleaners

If you own a business that provides cleaning or courier services (even if it's only part of the services provided), you now need to lodge a taxable payments annual report (TPAR) each year to tell the ATO about your payments to contractors.

What is a TPAR?

The TPAR tells the ATO about payments that are made to contractors for providing services.

Contractors can include subcontractors, consultants and independent contractors.

The details you need to report about each contractor are generally found on the invoice you should have received from them. This includes:

- their Australian business number (ABN)
- their name and address
- gross amount you paid to them for the financial year (including any GST).

What are courier services?

Courier services include:

- activities where items or goods are collected from, and/or delivered to, any place in Australia using a variety of methods including by car, truck, station wagon, van, ute, motorcycle, motorised scooter, drones, bicycle or other non-powered means of transport, or on foot;
- door-to-door services that are often used for specialty deliveries or for small parcels or packages. Goods commonly transported using courier services include parcels, packages, letters and food.

Note! If you sell goods and you provide the option of a delivery service, you are supplying a courier service unless the customer doesn't have the option to obtain the goods from you any other way.

Courier services does not include:

- delivery of goods your business provides where delivery is the only method your clients or customers have of receiving the goods
- passenger transport services – for example, buses and taxis
- freight transport – the transportation of bulk or large quantities of items, goods or commodities via rail, sea, air, or road (usually heavy vehicle trucks or larger vehicles) from one location to another.

What are cleaning services?

Cleaning services include (but are not limited to) any of the following activities undertaken on a building, residence, structure, place, surface, transport/vehicle, industrial machinery or equipment and for events:

- interior cleaning
- exterior cleaning (except sandblasting)
- carpet cleaning
- chimney cleaning
- gutter cleaning
- road sweeping and street cleaning
- swimming pool cleaning
- park and park facilities cleaning.

Note! If your business provides mixed services, not just courier or cleaning services, you may need to lodge a TPAR if the payments you receive for either courier or cleaning services make up 10% or more of your total GST turnover.

When do you need to lodge a TPAR?

You will need to lodge by 28 August 2019 for payments made to contractors between 1 July 2018 and 30 June 2019.

Key tax dates

| Date | Obligation |
|-------------|---|
| 21 Nov 2018 | Oct monthly BAS due |
| 28 Nov 2018 | Sep quarter SG charge statement due |
| 21 Jan 2019 | Dec monthly BAS due |
| 28 Jan 2019 | Dec quarter SG due |
| 4 Feb 2019 | Feb fuel tax credit rates change |
| 21 Feb 2019 | Jan monthly BAS due |
| 28 Feb 2019 | - Dec quarterly BAS due - Dec quarter SGC statement due - Dec quarter PAYG instalment due |

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