NEWS BULLETIN

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January 2017 – Happy New Year!

BUSINESS, TAXATION & INDUSTRY NEWS

When are donations deductible?

A charitable donation is only tax deductible if it meets the requirements in the relevant legislation. In brief, the rules allow a taxpayer to claim a deduction for a “gift” or for a “contribution” which satisfies certain conditions. While the deductibility criteria do vary, the common requirement across all types is that the recipient must be a “deductible gift recipient” (DGR).

A DGR is a non-profit entity that is legally entitled to receive tax-deductible donations. A DGR must be explicitly registered (or legislated) as such.

Common donations

Common examples of methods of giving include donating cash, being involved in fund raising events, taking part in a workplace giving program, donating goods or taking part in a “wishing tree” appeal, volunteering or offering professional services for free.

As noted, different conditions apply depending on the donation type – for example, some gifts must be over $2 in value, in other cases, there is a need to obtain a valuation (if goods are provided).

Consider these examples:

Example 1: Donating cash

Stephen’s son attends the local school. The school has launched a Christmas appeal for donations to fund a renovation. The school as a whole is not a DGR.

Stephen donates $500 in cash to the school’s building fund. However the building fund itself is endorsed as a DGR, so Stephen can deduct his gift of $500.

Stephen also donates $50 to his son’s school cricket team for new equipment. The cricket team is not a DGR (and neither is the school), so Stephen cannot deduct his gift of $50.

Example 2. Donating goods

Rosanna buys a new washing machine at the Boxing Day sales. Rosanna decides to donate her old washing machine, which she purchased four years ago, to a large charity (a DGR).

From online listings of similar second-hand washing machines for sale, she estimates that her old machine is worth approximately $300.

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Rosanna cannot deduct the $300 market value of the gift. It does not meet any of the alternative deductibility conditions, which are that:

- it is a gift of cash, or
- it was purchased within the last 12 months, or
- Rosanna can obtain an ATO valuation of more than $5,000.

Example 3. Volunteering

Marcus takes a week off work for Christmas and New Year. During that week, he spends each morning volunteering at a soup kitchen operated by a DGR. He drives to and from the soup kitchen. He pays for petrol for the week and for parking each morning.

Marcus cannot deduct his expenditures on petrol and parking. The payments are not gifts of cash or property that is actually gifted to the DGR, even though the expenditures enable him to fulfil his volunteer duties.

Marcus observes that the kitchen has insufficient cooking pots. He purchases a new boxed set of pots for $200 and donates it to the DGR’s representative at the soup kitchen the next day. The market value of each individual piece is more than $2.

Marcus can deduct $200 for his gift of boxed cooking pots that he makes to the DGR. It was purchased within the last 12 months and the value is not less than $2 (whether considered as a set or as individual items).

Example 4. Offering professional services for free

Owen is an IT contractor operating as a sole trader. He hears about a local charity (a DGR) that is replacing its outdated computer systems.

Owen helps the charity with its project during his Christmas break, using his IT expertise. He does not charge the charity any fees for his services. His contracting business receives no advertising, recognition or other benefit from his volunteer work.

Owen uses the same specialised skills and knowledge in his paid contract work. He estimates that his donated services would have earned him about $2,000 in contract income had he undertaken an equivalent project for a paying client.

However Owen cannot deduct the notional foregone income of $2,000 as a gift under tax legislation. The $2,000 is neither cash nor property that Owen gives to the DGR.

As a sole trader, Owen wonders whether he can claim the $2,000 as a business deduction, since it represents the market value of his professional skills that he uses in his ordinary business activities. However he cannot make such a deduction as the $2,000 is a notional loss only; it is not expenditure that Owen actually incurred.

Even if Owen did incur expenditures in his volunteer work (such as purchasing consumables), he would still be unable to claim the amounts. There is no connection between the expenditures and either the derivation of his assessable income or the carrying on of his business.

Home office deductions: What substantiation will the ATO accept?

Home office expense claims are subject to the same general substantiation requirements as other deductions – that is, it is a requirement that records should be kept for at least five years.

But in practice, full compliance with the substantiation rules may be difficult. It may be simple to keep a receipt for a printer purchased for a home business, but not so easy to prove the deductible proportion of a specific utilities bill. So the ATO has provided some administrative guidelines to ease this burden.

Proving business use proportion

The ATO will generally accept these three methods of calculating the business use proportion for a particular expense (in order of preference):

1. Explicit evidence of business use – such as an itemised phone bill.
2. Records of representative periods of use – such as a diary record spanning a four-week period (see below for details).
3. A "reasonable estimate" – the ATO does not define this term, but the taxpayer must be able to demonstrate that such a component was "reasonably likely" under the circumstances.

More about the four-week representative records

Claims exceeding $50
The ATO requires a taxpayer to keep records for a four-week representative period in each income year in order to claim a deduction of more than $50. The taxpayer can choose to keep records for longer than four weeks or to base their deduction on itemised bills (see above) for the entire year for a more accurate deduction.

The four-week record is merely the minimum amount of record-keeping that the ATO will accept. It is not a legal requirement to produce a time-limited representative record like the 12 week log book for car expense deductions. Remember to adjust the deduction for periods of leave taken.

According to an ATO fact sheet, the ATO will look favourably upon evidence that the employer expects the taxpayer to work at home or make work-related calls. But be aware that employer expectation is not a legal requirement. Under legislation and taking into account common law covering work-related expenses, it is enough that the expenditure is incurred in the course of producing assessable income and is not private, domestic or capital in nature.

Claims of $50 or less
Claims of $50 or less are not generally subject to substantiation checks by the ATO (although it is not explicitly stated). This however only affects the substantiation of the amount, and does not change the fact that the amount still has to be deductible under law.

Therefore it would be prudent for the taxpayer to be able to show that they had a reasonable basis for making the claim (for example, to keep evidence that some work was done at home during the year).

Shared expenses

According to the ATO, an invoice in the name of one person is acceptable as evidence of incurred expenditure for more than one person. This may be relevant where spouses or rental accommodation housemates each do home-based work, using shared utilities.

SMSFs need to prepare for the new transfer balance cap

Legislation introducing changes to the superannuation regime were recently passed by Parliament.

Among them will be a requirement for fund members to establish a transfer balance account for each retirement phase recipient. In other words, individuals receiving superannuation income stream benefits will be required to have a transfer balance account. Those following the Government's proposal might have seen it referred to as the $1.6 m cap.

The use of "accounts" for tax law purposes is not new. The best example, and a useful analogy, is the franking account that each company has. The franking account is used to track income tax paid by the company so that the company can pass to its shareholders the benefit of franking credits when a distribution is made. The "franking account" does not actually record anything for accounting purposes, but merely tracks an income tax attribute (which is why it does not appear on any financial statements).

Each individual receiving superannuation income stream benefits will have a transfer balance account, which in general will be created when they start an account-based pension with all or part of their accumulated superannuation balance. But an important additional rule is that there is to be a cap placed on the amount that can be held in these accounts, which for 2017-18 is set at $1.6 million (it will be indexed for later years). The start date for the new measure is July 1, 2017.

The ultimate purpose of introducing the transfer balance account is to limit the total amount of an individual's superannuation interests that receive an earnings tax exemption. Those who are in retirement phase will typically not pay tax on pension income from their super fund.

While the transfer balance account mostly tracks how much superannuation savings an individual transferred into the retirement phase, it does not limit total transfers to the retirement phase. The transfer balance cap is used for this purpose.

However the cap applies towards net transfers to the retirement phase and is not affected by earnings, losses or drawdowns that occur within the retirement phase. Note also that indexation of an individual's transfer balance cap is done on a proportional basis – only the unused portion of the transfer balance cap is indexed.

In cases where there are excess funds above the cap (for that year) held in the account, the amount in excess will be required to be removed. Failure to do so will see the funds concerned deemed to be not in retirement phase, and therefore lose the earnings tax exemption. This will also be deemed to take effect from the start of the financial year in which the excess occurred, and all later financial years.

Not only this, but notional earnings made on this amount will be taxed — at a rate of 15% for the first instance of a breach of the cap, but at 30% for subsequent breaches. Moreover, notional earnings are to be taxable regardless of whether the individual has rectified their breach and removed the notional earnings amount from the retirement phase.

Shopping for a "luxury car"? Beware of the luxury car tax

You can judge whether a car is luxury or not, according to the government, if it costs more than $64,132 for 2016-17.

It's not an over-the-top price tag if you're considering true luxury, but it's enough to cop an extra tax.

So what do I need to know about the luxury car tax?

The luxury car tax (LCT) kicks in after that threshold is reached, and has been set at 33%, and applies to the amount that exceeds the threshold (ie. $64,132).

From a typical car buyer's point of view, where the tax is payable it will already be factored into the price quoted by a dealership or car yard.

Before the goods and services tax era (July 1, 2000) luxury cars were slugged with a 45% wholesale sales tax. The luxury car tax that replaced it was set at 25%, but has been 33% since July 1, 2008.

The tax is in addition to GST, and that price threshold includes GST but not charges such as stamp duty or compulsory insurance. And the amount of tax is calculated only on the vehicle's value over the threshold, not the GST portion of it (that is, there's no tax on top of a tax).

It also applies only to those registered for GST, so private sales are generally not covered (although it can still apply if you import a luxury car). Businesses acquiring a luxury car will be restricted in their claim for GST credits to the luxury car threshold, so if the car costs more than $57,581 (which is the figure used for luxury car depreciation purposes), GST credits are not available in respect of the excess. In other words, the maximum credit you could claim will be $5,235.

Any exclusions?

Yes there are. Generally speaking, vehicles not included are emergency vehicles, trucks or vans that carry more than two tonnes, and passenger carrying vehicles such as buses. Cars specially fitted out to transport disabled people are generally excluded, if the vehicle is supplied inclusive of GST.

Cars that are more than two years old escape the tax, so in general the LCT applies to mostly new vehicles – a second hand luxury car which has had some depreciation therefore may be a good buy.

Fuel-efficient cars (that is, those that burn less than seven litres of fuel per 100 kilometres) are given a break. As long as the fuel-efficient vehicle costs less than $75,526 (for 2016-17), there's no LCT to pay.

Keep this tax in the back of your mind when you shop for your next set of wheels.