NEWS BULLETIN

Love & Partners
CHARTERED ACCOUNTANTS

... Benefit from our experience ...

November / December 2020

Love & Partners News

Job Timeframes

What a year it has been for everyone, with the effects being felt in many difference aspects of people's daily lives.

Unfortunately, for us as Accountants the flow on effect of COVID-19 and the stimulus options, such as JobKeeper, provided by the government, has meant that our workload has increased. This has caused delays in processing tax work.

Naturally we will complete your work as soon as possible and prior to any deadlines, and greatly appreciate your understanding that our turnaround time will unfortunately be longer this year than you may be used to.

Christmas Wishes

It is hard to believe that we have reached the festive season. What a year it has been! We hope that this year more than most, Christmas will be filled with family, love, laughter and hopefully a break!

Love & Partners will be taking their usual break over the Christmas and New Year period. We will **close on Wednesday 23rd December 2020 at 12:00 and will reopen on Monday 11th January 2021 at 8:00am.**

Every year, Love & Partners make a donation at Christmas in lieu of Christmas Cards. This year our donation is going to local charity *Team Adem*.

"Since 2011, *Team Adem* has grown to become an established and respected Sunshine Coast charity and is making a profound difference to many lives. *Team Adem* continues to help and support organisations that care for patients, families and seriously ill children affected by a cancer diagnosis *Team Adem's* most significant achievement however, is its ever-growing blood donation community, which is making a lifesaving difference to over 1200 Australian lives every month."

Should you wish to know more about this charity, or make a donation yourself, please head to https://teamadem.com.au/

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What the "full expensing" write-off deduction means for business

The Federal Budget measure of allowing businesses to fully write-off eligible assets is a boon to Australian businesses, even though the measure is temporary. Just to recap, businesses with aggregated annual turnover of less than $5 billion will be able to deduct the full cost of eligible capital assets acquired from 7:30pm AEDT on 6 October 2020 (Budget night) and first used or installed by 30 June 2022.

"Full expensing" in the year of first use will apply to new depreciable assets and the cost of improvements to existing eligible assets. For small- and medium-sized businesses (with aggregated annual turnover of less than $50 million), full expensing also applies to second-hand assets.

Businesses with aggregated annual turnover between $50 million and $500 million can still deduct the full cost of eligible second-hand assets costing less than $150,000 that are purchased by 31 December 2020 under the existing instant asset write-off. Also businesses that hold assets eligible for the existing $150,000 instant asset write-off will have an extra six months, until 30 June 2021, to first use or install those assets.

Small businesses (with aggregated annual turnover of less than $10 million) can deduct the balance of their simplified depreciation pool at the end of the income year while full expensing applies. The rules that prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out will continue to be suspended.

Some existing conditions remain

The small business entities capital allowance provisions has always contained a section that permits assets that cost below a certain value to be written off 100% in the year the asset is first used or is installed ready for use for a taxable purpose. Initially, this amount was $1,000 but it has been subject to significant change in recent years.

On 12 March 2020, the Federal Government made announcements about stimulus packages intended to ameliorate the impending economic impact of COVID-19. If, in the period beginning on 12 March 2020 and ending on 30 June 2021, a small business taxpayer started to hold an asset and started to use it or have it installed ready for use for a taxable purpose, and the asset cost $150,000 or more, the decline in value deduction in relation to the asset for the year is 57.5% with the remaining amount being added to the general small business pool.

The new full expensing rules, applicable from Budget time on 6 October 2020, means that there is no limit on the cost of an eligible asset that can be written off by 100%. The backing business investment initiative will still be applicable to assets costing $150,000 or more and that were held and installed ready for use in the period 12 March 2020 to 6 October 2020.

The general small business pool is, broadly, a running total of the costs of fixed assets acquired by a small business entity that have not yet been depreciated and deducted for tax purposes. The pool, due to its method of operation, spreads the cost of assets over a number of years for tax purposes. The pool balance is added to when new assets are acquired and reduced when depreciation tax deductions are claimed, and balancing adjustment events occur. The "termination value" of an asset to which a balancing adjustment event has occurred is subtracted from the pool.

The small business capital allowance provisions have always contained a de-minimus provision that permits the total value of the pool to be written off when it falls below a certain value.

Meeting the required conditions

A number of conditions must be satisfied for assets to be full expensed. First of all the asset must be used in a business. Accordingly the full expensing of assets does not apply to an employee who has purchased a work-related asset. Also no balancing adjustment event must occur to the asset in the current year.

Note also that some assets are excluded such as capital works and assets allocated to a software development pool.

In most circumstances, a depreciating asset is “held” when the taxpayer becomes the legal owner of the asset, which is frequently not at the time of purchase or order. The taxpayer must start to use the asset, or have it installed ready for use, for a taxable purpose in the year (“the current year”) in which the taxpayer wants to write-off 100% of the cost of the asset.

Anti-avoidance provision

It must be the case that the entity did not have a pre-commitment to acquire the asset prior to Budget night on 6 October 2020. Further, the asset must not have been held prior to that time. If a business had already entered into a commitment or had, in fact, purchased such an asset prior to that time, there is an obvious tax planning technique that could be engaged in to enable the new full expensing rules to apply to the asset.

The strategy targeted is where an order is cancelled and the business enters into a new purchase contract after 6 October. If an asset had already been held, the asset can be sold and a new one purchased after that time. Due to this, the new rules contain an anti-avoidance provision that seeks to prevent this type of tax planning where the asset acquired after budget time on 6 October 2020 is “identical or substantially similar” to the asset that was purchased or held prior to that time. Also, the actions engaged in by the taxpayer must be for the purpose of ensuring the asset started to be held at or after Budget time.

Other considerations

One important point is that when an asset on which full expensing has been claimed is later disposed of for consideration, that the full amount of the consideration will need to be returned as assessable income due to a balancing adjustment event.

So, the new full expensing legislation does not give a taxpayer any extra tax deductions. It just gives them sooner than before.

For most business entities, particularly small businesses, the depreciation recognised for accounting purposes is often equal to that claimed for tax purposes. With assets being able to be fully expensed for tax purposes, it could come about that a business will re-consider whether this is the best accounting policy. The full expensing of assets obviously lowers profits and might, artificially, put a business into a loss situation.

Depending on who uses the financial statements of the business, having a poor accounting result may not be desirable. For example, financiers might prefer to see a better accounting outcome than might result if full expensing of assets is adopted for accounting purposes.

In arm’s length partnerships, a proper accounting for the depreciation of fixed assets may give a more palatable outcome when it comes to distribution of profits. If partners are being admitted or are departing, the business owners may prefer a profit and loss statement that shows a fair depreciation of fixed assets rather than an artificial tax number.

Both tax and SMSF audits are still on ATO’s radar, but some leniency given

While the ATO has lately been focusing on the rollout of stimulus measures, it has also flagged that audit work is not off the table completely.

In late July, when the ATO fronted a parliamentary Senate Select Committee on COVID-19, its representative said plans were to start tax audits sometime between September and October 2020.

Time and efforts however were diverted to the rollout of the JobKeeper scheme and other stimulus measures, with the ATO sourcing staff for this work by redeploying people from initiating audits, saying it had been a “conscious choice” not to initiate new audits during the peak of the pandemic.

But that, as they say in the classics, was then — and this is now. The takeaway for everyone is that audits will not go away, and will come at some point, so taxpayers and SMSF trustees need to have their affairs in order.

It may therefore be worth recapping some of the main triggers for tax audits, which includes:

- falling outside the ATO’s small business benchmarks
- discrepancies between tax return income, and the income declared throughout the year on activity statements
- failing to lodge activity statements or returns on time
- underpayment of superannuation guarantee
- lifestyle assets not matching income
- business vehicles, but no FBT return is lodged, and
- consistently showing operating losses.

For the SMSF sector, “reciprocal” SMSF auditing (where two auditors agree to audit each other’s funds) are expected to be an ATO focus when auditing gets back into full swing.

In January 2020, the Australian Professional Ethical Standards Board (the body that oversees and issues standards that SMSF professionals should comply with) released guidelines regarding independence. These guidelines specifically spelled out a potential new direction regarding the independence standards expected for SMSF auditing practices. The guidelines state that an auditor cannot audit an SMSF where the auditor, their staff or firm has prepared its financial statements, unless it is a “routine or mechanical service”.

For firms that provide both accounting ***and*** auditing services, it may come down to many firms making a choice between providing one service or the other. The thing to be aware of is that the ATO has already flagged that the issue is already on its radar. It has however said it is not going to “commit compliance resources” until at least 2021.

No penalties for asset valuations if insufficient evidence

In the meantime, the ATO has stated that that it will not impose penalties if it is satisfied that SMSF trustee finds it difficult to obtain the required valuation evidence for fund assets due to the impacts of COVID-19.

“If we are satisfied this was due to the impacts of COVID-19, the contravention will not result in penalties,” the ATO says. “Instead the trustee will receive a letter from us advising them to ensure they comply with our valuation guidelines and have supporting valuation evidence by the time of their next audit if possible, as repeated contraventions can lead to penalties.”

The rules state that it is not the auditor’s role to determine the market value of the fund’s assets but that it is the trustee's responsibility to provide documents requested by their auditor which supports the market valuation for their assets. This is the area that is subject to ATO leniency for the COVID-19 conditions.

The ATO does advise however that auditors should consider the need to modify their audit report and lodge an auditor/actuary contravention report (ACR), if necessary, during the 2020 and 2021 financial years. The ACR should include the reasons why the trustee was unable to obtain the appropriate evidence.

ATO's cyber safety checklist

Scammers never seem to rest, with even the lastest JobKeeper iteration coming in for some scam treatment. In a new update the ATO reports that it is receiving reports of email scams about JobKeeper and backing business investment claims. "The fake emails say we're investigating your claims. They ask you to provide valuable personal information, including copies of your driver's licence and Medicare card."

During this time of heightened scam activity, the ATO is encouraging individuals and businesses to:

1. Use multi-factor authentication where possible and don't share your password with anyone
2. Run the latest software updates to ensure operating systems security is current
3. Secure your private wi-fi network with passwords (not the default password) and do not make financial transactions when using public wi-fi networks
4. Exercise caution when clicking on links and providing personal identifying information
5. Only access online government services via an independent search – not via emails or SMS
6. If in doubt, call the ATO on an independently sourced number to verify an interaction Educate your staff on cyber safety and scams.

To report a data breach or scam visit ato.gov.au/onlinesecurity

The investment option that can hide unexpected GST

New residential property is a popular investment for many, and can be especially so for self-managed superannuation funds, however the ATO is concerned that not every investor in residential property is fully aware that it is an option that may bring with it unexpected GST obligations.

The ATO says that from 1 July 2018, most purchasers must withhold an amount from the contract price at the date of settlement and pay it directly to the ATO. The sale price is paid to the property supplier. This applies to:

- new residential premises
- land that could be used to build new residential property ('potential residential land').

Purchasers who engage a representative when buying new residential property will need to complete a signed declaration so the representative can lodge two required forms and pay GST on behalf of the purchaser.

Purchasers who have a GST withholding obligation must complete and lodge two forms:

- when they sign the contract, lodge Form one: *GST property settlement withholding notification* using information from the supplier notification (see below)
- when the property settles
    - lodge Form two: *GST property settlement date confirmation*, and
    - pay the GST withheld amount.

Ask us if you require these forms.

If there were any mistakes on Form two, the ATO should be contacted to have it cancelled before lodging a new form. If multiple properties are bought, lodging a new form for each property transaction will be required.

Supplier notification

To complete Form one, the supplier (seller/vendor) needs to give the buyer a "supplier notification" so the purchaser knows whether or not there is a GST withholding obligation.

If there's an obligation to withhold GST, the supplier notification must include:

- the name and ABN of all suppliers
- GST branch number (if applicable)
- the amount of GST to be withheld (rounded down to the nearest dollar)
- when the GST must be paid
- GST-inclusive contract price (plus the GST inclusive market value of non-monetary considerations).

A supplier's written notice can be relied on:

- when it states a purchaser isn't required to pay an amount to the ATO. In most states and territories the standard contract of sale clearly states if a purchaser is required to withhold GST or not
- if the purchaser is unaware of an error on the notice and the supplier doesn't tell them.

However, if the purchaser or their representative knows that a supplier is registered for GST and selling new residential premises, the ATO considers it unreasonable not to withhold and pay an amount to it at settlement.

The ATO has stated that it won't retrospectively penalise purchasers who acted reasonably if it's later found that a supplier hasn't met their obligations.

Rounding of GST where fractions of a cent result

The ATO has devised special rounding conventions where an amount of GST includes a fraction of a cent. Although it labels these conventions "rules", there is no obligation for parties on either side of a transaction to follow them, as the ATO states: "You and your customer do not need to use the same rounding rules."

Where there is only one taxable sale on a tax invoice, the amount of GST should be rounded to the nearest cent (rounding upwards from 0.5 cents).

Where there is more than one taxable sale on a tax invoice, there are two conventions, dubbed by the ATO as the "total invoice rule" and the "taxable supply rule":

- **Total invoice rule** – under this rule, the unrounded amounts of GST for each taxable sale should be totalled and then rounded to the nearest cent (again rounding up from 0.5 cents).

Alternatively, if all the taxable sales on a tax invoice include an amount of GST that is exactly one 11th of the price, the business may choose to add up the GST-exclusive value of each taxable sale, calculate GST on that amount, and then round to the nearest cent.

- **Taxable supply rule** – this rule deems that the business needs to work out the amount of GST for each individual taxable sale. Where the unrounded amount of GST has more decimal places than a standard accounting system can record, the amount should be rounded up or down as appropriate. Then the individual amounts are added up, and this total is rounded to the nearest cent (again rounding up from 0.5 cents).

JobKeeper extension's alternative turnover tests

The extension of the JobKeeper scheme is now based on current GST turnover, not projected turnover. The basic test compares year-on-year turnover. If there were events or circumstances outside the usual business settings that resulted in your relevant comparison period in 2019 (September or December 2019 quarter) not being appropriate, then an alternative test may apply.

However, if an entity satisfies the basic test, it does not need to satisfy an alternative test. Also, you only need to satisfy one of the alternative tests listed below even if more than one could apply.

The alternative turnover tests can be used to determine whether an entity has satisfied the actual decline in turnover test for the September 2020 quarter or the December 2020 quarter.

The ATO has provided alternative turnover tests for those businesses that don't fit the usual parameters, which can then be applied to qualify for JobKeeper payments. The following are scenarios that may fit a number of situations. Ask us if these may help you business qualify.

- Business that started after the comparison period started but before 1 March 2020
- Business acquisition or disposal that changes the entity's turnover
- Business restructure that changed the entity's turnover
- Business that has had a substantial increase in turnover
- Business affected by drought or natural disaster
- Business that has an irregular turnover
- Sole trader or small partnership with sickness, injury or leave
- Business that temporarily ceased trading during the relevant comparison period

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 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 tax losses 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 the 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.

But in a way it’s inevitable, whether through the outcomes from COVID-19, retirement, health reasons or, in a more ideal 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 – this 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 due to you ceasing business.

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 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).

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 you can’t 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.

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

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 also 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.

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.

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.