

The Law Handbook

YOUR PRACTICAL GUIDE TO THE LAW IN NEW SOUTH WALES

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Note to readers: While every effort has been made to ensure the information in this book is as up to date and as accurate as possible, the law is complex and constantly changing and readers are advised to seek expert advice when faced with specific problems. *The Law Handbook* is intended as a guide to the law and should not be used as a substitute for legal advice.

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Taxation

Anna Ziaras – Legal Writer

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[38.10] This chapter considers the key tax issues facing small business operators, wage and salary earners and those on modest incomes from other sources.

Because much basic information about the tax system is readily available from the Australian Taxation Office (ATO) website (www.ato.gov.au), the focus of this chapter is on disputes and legal difficulties. If you have a specific problem, you should consult a specialist publication, or a tax agent.

As well as having a comprehensive website, the ATO also handles personal enquiries. People may be reluctant to contact the ATO for fear of attracting undue attention, but a simple enquiry is unlikely to lead to an audit. The ATO also gives free written advice (in the form of private rulings) if taxpayers are unsure about how the tax laws apply to their particular circumstances.

Remember, however, that the ATO will be giving you its version of what the law means.

Taxation rulings

References are made in this chapter to rulings. These are statements by the Commissioner of Taxation on how the law will be applied in certain areas. Rulings

and other ATO advice (eg, interpretative decisions and ATO guidelines) can be viewed on the ATO Legal Database at www.ato.gov.au/Law/#Law.

Public rulings (eg, the TR, TD and GSTR series) are legally binding on the ATO. This means that persons who are covered by, and rely on, a ruling are protected from any additional tax, penalties and interest charges if they make an error because the ruling is incorrect or misleading.

A *product ruling* is a type of public ruling dealing with the availability of tax benefits from tax-effective investment schemes.

Private rulings and class rulings

The ATO can, on request, make a *private ruling* dealing with the affairs of a particular taxpayer, or a *class ruling* dealing with a specific class of persons. These rulings are binding on the Commissioner in relation to the affairs of those taxpayers only.

Application forms are available from the ATO's website. Also, available are details of the supporting documents and information required to be supplied with the more common subject matters of private ruling applications. Taxpayers are encouraged to use these forms, although a written application that contains all the necessary information, including copies of the relevant documents, is also acceptable.

INCOME TAX

The Australian income tax system

[38.20] Legislation

The main Commonwealth statutes dealing with income tax (which is a federal tax) are two *Assessment Acts*:

- the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936);
- the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997).

Some important provisions dealing with administrative matters such as PAYG withholding, PAYG instalments, penalties, rulings, objections and appeals are in the *Taxation Administration Act 1953* (Cth) (TAA 1953). There are also a number of related statutes (eg, the *Income Tax Rates Act 1986* (Cth)) and regulations (eg, the *Income Tax Assessment Regulations 1997* (Cth)).

Relationship between the Assessment Acts

The Tax Law Improvement Project was set up in the 1990s to rewrite and restructure the *ITAA 1936* in order to make it more user friendly. The result was the *ITAA 1997*, which is now the principal income tax statute. The *ITAA 1997* has a simpler English style and addresses the reader as "you". All the sections have hyphens (eg, ss 6-5, 8-1).

Many parts of the *ITAA 1936* have yet to be rewritten and remain in operation, including important provisions dealing with trust income, partnerships, concessional offsets, withholding tax and tax avoidance schemes.

Freedom of information and confidentiality

The Commissioner of Taxation is subject to the *Freedom of Information Act 1982* (Cth) (Chapter 25,

Freedom of Information). This means that people can make a written request to see their own files, within the limits laid down in that Act.

The ATO is bound to secrecy with regard to a taxpayer's affairs. An individual's privacy is protected by the *Privacy Act 1988* (Cth) and the confidentiality provisions in the *TAA 1953* and other tax laws. These laws prohibit ATO officers from accessing, recording or disclosing a person's tax information, unless it is in the performance of their duties.

[38.30] Residency and source

The concepts of residency and source are central to Australia's income tax system. Taxpayers are classified as either Australian residents or non-residents (called foreign residents in the *ITAA 1997*) and are taxed differently based on this classification. There is also a special class of taxpayers called "temporary residents", who are treated as non-residents for some purposes.

Like most countries, Australia taxes residents on their worldwide income but taxes non-residents only on income from Australian sources. In some cases, non-residents pay higher rates of tax on their Australian income than do residents, but do not pay the Medicare levy.

Who is a resident?

A resident is defined in s 6(1) of the *ITAA 1936*, not very usefully, as someone who resides in Australia. The section then provides various tests to determine when a person is a resident (eg, the ordinary concepts, domicile and 183-day tests).

Whether an individual is a resident is primarily a question of fact. Actual presence in the country for more than 183 days in an income year makes a person a resident unless they can prove they do not intend to live here and have a usual home elsewhere.

A company is a resident if it has been incorporated in Australia or, alternatively, if it carries on business in Australia and either its

central management and control is in Australia or resident shareholders control its voting power.

A trust is a resident if it has a resident trustee or if its central management and control is in Australia.

There are no specific rules concerning the residence of partnerships, which are not tax-paying entities. Partnership income is attributed to the partners, so the impact of Australian tax on partnership income is determined by reference to the residence of each partner and the source of the income.

When does a person become a resident?

Taxation Ruling TR 98/17 discusses (from the ATO's perspective) the factors that determine when a person entering Australia becomes a resident.

A person with Australian domicile

It is possible to be a resident while not actually living here by retaining Australian *domicile* (not citizenship, which is not the test for tax purposes). This is a legal concept used to determine which legal system should apply to someone for various purposes. For adults, it is normally the place they regard as their permanent home, even if they are absent from it frequently.

Long continuous absence

In practice, someone who is continuously absent from Australia for two years or more will generally be treated as a non-resident by the ATO (see Taxation Ruling IT 2650).

Overseas students

Overseas students are generally treated as residents only if they enrol for a course of study longer than six months.

Permanent entry status

A migrant with permanent entry status is generally treated as a resident on arrival (see Taxation Ruling IT 2681).

Taxable income

[38.40] What is income?

A person's liability to pay income tax is worked out by reference to the person's *taxable income* for the income year (*ITAA 1997*, s 4-10). Taxable

income is the person's *assessable income* minus *allowable deductions* (s 4-15).

A person's assessable income for an income year is the sum of the taxpayer's *ordinary income* and *statutory income* derived in that year. Net

capital gains are included in assessable income (see [38.280]).

An item of ordinary or statutory income can be excluded from assessable income if it qualifies as *exempt income* or *non-assessable non-exempt income*.

The actual amount of income tax payable depends on the applicable tax rate for the income year (see the table at [38.270]) and whether any tax offsets (or rebates) are available (see [38.70]).

An income year is from 1 July to the following 30 June.

Some individuals (primary producers, authors, inventors, performing artists, production associates and sportspeople) have the option of averaging their income over five years, and their tax liability is determined according to a further set of calculations (*ITAA 1997*, Div 405).

Ordinary income

Ordinary income is “income according to ordinary concepts” (s 6-5(1)).

“Income” is not a precise term, and it is not defined in the legislation. It has been given substance, however, in many judicial decisions. The courts accept that ordinary income generally arises in one of three ways:

- as a reward for providing personal services (eg, salary and wages and professional fees);
- as profits from carrying on a business, including profits from unusual or isolated business transactions;
- as a return on an investment (eg, interest from a bank account, rent from an investment property and dividends from a company).

These categories are not mutually exclusive (eg, interest can be derived from passive investments or from carrying on a business).

Some payments, like social security benefits, overseas pensions and various compensation payments, do not neatly fit within these three categories (eg, they might not be received as rewards for services), but it is generally assumed that they are ordinary income because they are regular payments which a person depends on (*Federal Commissioner of Taxation v Anstis* [2010] HCA 40).

Even if an amount is ordinary income, a specific provision of the *Assessment Acts* may modify the manner in which the amount is calculated or otherwise treated for tax purposes.

What is not income?

Income does not include windfall gains such as lottery and betting wins, inheritances and gifts (not arising out of employment) or amounts received from pursuing a hobby (see [38.140]).

Statutory income

Statutory income is an amount that is included in assessable income under a specific provision of the *Assessment Acts* (s 6-5(2)). Some items of statutory income (like dividends and annuities) are also ordinary income, while other items (like net capital gains (see [38.280])) are not.

Section 10-5 contains a comprehensive table of provisions under which statutory income needs to be included in a taxpayer’s assessable income.

Exempt income

Exempt income is an amount of ordinary or statutory income that is specifically made exempt from tax under a Commonwealth law (s 6-20).

There are two main classes of exempt income (s 11-5):

- the income of tax-exempt entities like registered charities (see [38.120]);
- income that is exempt because it is a certain kind of income (eg, some government pensions and the family tax benefit).

Exempt income is not counted in working out taxable income, but is counted in reducing tax losses.

Non-assessable non-exempt income

The term “*non-assessable non-exempt income*” refers to ordinary or statutory income that a Commonwealth law expressly states neither assessable income nor exempt income. Examples include the tax-free components of employment termination payments and superannuation benefits.

Non-assessable non-exempt income is not counted in determining taxable income or in reducing tax losses, so it has no effect on the income tax system.

[38.50] Foreign source income

Foreign source income is a type of income derived by Australian resident individuals and companies

from overseas salaries and foreign assets and businesses.

If the Australian tax payable on the amount earned is greater than the tax paid in the overseas country, the taxpayer is required to remit the difference to the ATO. For example, if the income is \$100, the foreign tax is \$30 and the Australian tax is \$40, the taxpayer gets a *foreign income tax offset* of \$30 and pays \$10 in Australian tax. If, however, the foreign tax is \$40 and the Australian tax is \$30, the taxpayer pays no Australian tax. However, refunds are not given. This means that people pay tax at whichever is the higher rate.

Salaries and wages earned overseas

Salary or wages earned in another country by an Australian resident is generally subject to tax in Australia, although the individual can claim a foreign income tax offset for any foreign tax paid (thereby avoiding double taxation).

Certain government and aid program workers are exempt from paying tax in Australia on foreign employment income.

Investment income

Foreign earnings that are not exempt are subject to the foreign income tax offset system.

Australia has a network of *double tax agreements* with most of its major trading partners. These have little impact on wage and salary earners, but may affect the taxation of investment income.

Any problem about the application of double tax agreements is likely to require expert advice. The ATO is a first port of call, but it may be necessary to consult one of the large accounting or law firms with expertise in the area.

[38.60] What is a deduction?

A taxpayer's taxable income for an income year is the taxpayer's *assessable income* (see [38.40]) minus the *allowable deductions* incurred by the taxpayer in that year.

There are two types of allowable deductions – general deductions and specific deductions.

A *general deduction* is a loss or outgoing incurred (ITAA 1997, s 8-1):

1. in gaining or producing assessable income; or

2. in carrying on a business for the purpose of gaining or producing assessable income.

An amount is not deductible under s 8-1 to the extent that:

1. it is an amount of capital, or of a capital nature (although it may be deductible under another provision);
2. it is of a private or domestic nature (eg, childcare expenses or the cost of travelling from home to work); or
3. another provision of the legislation prevents the expense (eg, a penalty) from being deductible.

A *specific deduction* is a deduction available under a provision other than s 8-1.

Common types of deductions that may be claimed by employees and business taxpayers are listed at [38.150].

[38.70] Tax offsets

Tax offsets are not deductions from assessable income, but are actual reductions of tax. They are called rebates and credits in the *ITAA 1936*. Some of them have quite complex conditions.

The types of offsets, and a person's eligibility to claim a particular offset, can vary from year to year and especially when there is a change of government. Some of the offsets available for 2018–2019 are:

- low income (full offset of \$445 on incomes up to \$37,000);
- low and middle income (for taxable income under \$126,000);
- dependant (invalid and invalid carer);
- senior Australians and pensioner;
- private health insurance;
- superannuation contributions on behalf of a spouse earning less than \$40,000.

Remember that most offsets are limited to the amount of tax otherwise payable (the dividend offset is an exception). Tax offsets do not reduce the Medicare levy.

Franking credits

Franking credits accompanying dividends also act as tax offsets. If the credits are more than required to offset all other tax payable, they give rise to a cash refund.

Tax returns

[38.80] Towards the end of each income year, which runs from July to June, the Commissioner for Taxation initiates the tax return process by publishing a notice in the *Commonwealth Gazette*.

[38.90] Lodging a tax return

Generally, anyone who earns over the minimum taxable income must lodge a tax return. Some people are also required to lodge activity statements (see [38.270]).

The ATO encourages individuals, including sole traders, to lodge electronically by using the web-based service myTax. People can also lodge paper tax returns (by post).

People should keep copies of their tax returns, along with supporting documents and receipts, for five years (see [38.160]).

Lodgment dates

An individual's tax return is generally due by 31 October. The due date is extended if a registered tax agent prepares and lodges the person's tax return.

Applying for an extension

A person who for some reason cannot lodge a tax return by the due date should apply to the ATO for an extension before the due date to avoid a penalty. The request should be in writing and must state the reasons for the delay, propose a deferred date for lodgment and give an assurance that future obligations will be met on time once the circumstances giving rise to the delay are resolved (see ATO Practice Statement PS LA 2011/15).

[38.100] Who must lodge a tax return?

Residents

Income below the threshold

For residents, the general rule is that no tax is payable if taxable income is at or under the threshold (\$18,200 for 2018–2019) and a tax return does not need to be lodged.

Some people may have to lodge a tax return despite being below the tax threshold; for example, if they:

- incur a net loss for tax purposes;
- pay excess tax instalments;
- carry on a business.

Income over the threshold but no

tax payable

Some people earning more than the threshold may not have to pay any tax due to various tax offsets (see [38.70]), but they still have to lodge a tax return.

People under 18

Persons who are aged under 18 at the end of the income year (30 June) must lodge a tax return if their total income from sources other than personal services is more than \$416. This is due to special rules which seek to discourage adults splitting their income and diverting it to their underage children or grandchildren (*ITAA 1936*, Div 6AA). Where these rules apply, the child is taxed at penalty rates if the child's "unearned income" exceeds \$416.

Unearned income essentially covers passive income like interest, dividends, royalties, rent and other income from property. Some passive income is exempt from these rules, including income from testamentary trusts and from child maintenance trusts where there is a family breakdown.

Children who work full-time are generally excluded from these rules.

People joining or leaving the workforce

The tax-free threshold (\$18,200 for 2018–2019) is available only on a pro rata basis for people joining the full-time workforce for the first time and those leaving Australia permanently – for example, a migrant starting work in Australia on 1 February will get five twelfths of the tax-free threshold.

Companies, trusts and partnerships

Superannuation funds, partnerships, trusts and resident companies (except non-profit companies) must file tax returns whatever their income.

Non-profit companies

Non-profit companies (including most clubs and associations) must file a tax return if their income is over \$416.

Non-residents

Non-residents do not have the benefit of a tax-free threshold and should lodge tax returns if their income exceeds \$1, unless it has been subject to a tax applicable to their Australian income called *withholding tax*.

[38.110] Tax refunds

Apart from the legal requirement to lodge tax returns, individuals must lodge a tax return to obtain a refund of tax that has been overpaid because, for example:

- they earned less than the taxable minimum but had tax deducted by their employer;
- tax was deducted from interest or dividend payments;
- they had work-related deductions to claim.

[38.120] Exemptions

Various categories of income, people and institutions are exempt from tax, but, generally, taxpayers receiving exempt income must either file tax returns or seek an exemption.

Pensions

Some pensions are not exempt (see Taxable items at [38.140]); however, pensioners below the threshold or eligible for the senior Australians and pensioner rebate may not be liable to pay some or all of the tax otherwise payable.

Charitable and community groups

An important exemption for many community groups is the income of non-profit organisations like registered charities, ancillary funds, public educational institutions, scientific organisations and community service organisations (*ITAA 1997*, Div 50).

Donations for charitable purposes are not income; the only difficulty is likely to be with income from investments, property or some subsidiary business activity.

Tax-deductible donations

If a group seeks to collect tax-deductible donations, it must comply with the requirements of Div 30 of the *ITAA 1997*. This is discussed in more detail in Chapter 8, Community Organisations.

Other exempt bodies

Other exempt bodies include:

- local government;
- public and non-profit hospitals;
- trade unions and employers associations;
- service clubs such as Rotary and Lions (but not lobby groups);
- non-profit music, scientific, art and literature societies;
- non-profit sports clubs (including animal racing clubs).

[38.130] Tax agents

Because of the complexity of the tax system, most taxpayers lodge tax returns through tax agents, usually qualified accountants registered as tax agents by the Tax Practitioners Board.

Only registered tax agents may charge for preparing tax returns or objections (solicitors are partially exempt from this restriction). Registered BAS agents can charge fees for preparing activity statements. The Tax Practitioners Board maintains a register of tax agents, BAS agents and tax (financial) advisers, which the public can search to ensure the agent is registered.

Fees are between \$80 and \$300 for individual tax returns. This is tax deductible, as is the cost of tax advice and the cost of disputing an assessment and dealing with a tax audit.

One advantage of using registered agents is that they are able to spread their workloads and have some ability to delay lodging their clients' tax returns and activity statements.

[38.140] Income that must be declared

Apart from common forms of income such as salary or wages, trading profits, rent, interest and dividends, there are a number of other types of income that must be declared on the tax return. These include:

- allowances paid in connection with a job (eg, for car, entertainment or clothing). Travel allowances and overtime meal allowances paid under an industrial law, award or agreement do not need to be declared if they are not on the employee's payment summary, they do not exceed the Commissioner's reasonable allowance amount and the whole amount was

spent on deductible expenses (see Taxation Determination TD 2019/11);

- tips received in the course of employment;
- amounts withheld from salary or wages for benefits such as medical fund contributions and superannuation. Employees are not taxed on employer contributions to superannuation when they are made, but superannuation pensions are taxed;
- an interest in income under a will, as opposed to specific gifts or sums of money;
- capital gains on assets acquired since 19 September 1985. There are some exemptions and concessions, the most important to most people being the family home. Cars are also exempt (see [38.280]);
- compensation paid periodically to replace wages or as a lump sum for lost wages (not fixed awards or lump sum damages for loss of future earnings);
- lump sums on retirement or termination of employment.

Note, however, that amounts paid out of taxed superannuation funds since 1 July 2007 are generally tax free.

- lump sums representing arrears of wages and workers' compensation. A rebate is available in certain circumstances (*ITAA 1936*, ss 159ZR–159ZRB);
- payments under a testator's family maintenance order;
- distributions from a trust (including present entitlements where no payment is actually received). The trustee is taxed on income to which no beneficiary is presently entitled and also where the beneficiary is under a legal disability (*ITAA 1936*, Div 6).

Non-taxable items

Amounts that are not taxable include:

- various government pensions, allowances and education payments (eg, the disability support pension, carer allowance and crisis payments);
- bequests (specific gifts or sums of money, not an interest in income such as that received under a trust);
- damages awarded for a personal injury claim;
- family assistance payments;
- gambling wins, unless betting activities are so organised and on such a scale that the taxpayer

can be regarded as being in the business of betting;

- proceeds from hobbies;
- tax refunds;
- inheritances in the form of assets or a lump sum. Regular payments from an estate are taxed as income;
- proceeds from a life insurance policy, other than in pension or annuity form;
- usually, medical benefits from superannuation funds;
- medical benefits fund reimbursement;
- lottery wins and prizes, except that a prize won in the course of employment, particularly if it is an award for skill, it is likely to be taxed as income;
- profit on the sale of capital assets acquired on or before 19 September 1985;
- prizes from quiz shows, unless the winner is a professional contestant;
- student scholarships. (The income still counts for social security purposes and allowances such as newstart may be reduced.) Payments from a future employer to whom a student is bonded are assessable income. Fees paid to an educational institution by the employer are not assessable to the student, but the employer is liable to fringe benefits tax on the amount;
- workers' compensation in the form of a fixed sum award for loss of future earning capacity.

Benefits to employees such as the use of a company car, low-interest loans, low-rent housing and discounted or free goods and services are generally not taxable to the employee, but are subject to fringe benefits tax in the hands of the employer (see [38.290]).

[38.150] Deductions that can be claimed

Work-related items

There are a number of items that wage and salary earners can claim as deductions, provided they are incurred in gaining or producing assessable income (see [38.60]). Typical deductible expenses include:

- car expenses (see [38.160] for the record-keeping requirements);
- trade union fees;
- accident insurance premiums, where the policy is for a regular payment in lieu of wages.

Money received under the policy is assessable income;

- self-education expenses. The first \$250 is not deductible;
- computers. Three years is an acceptable depreciation period for laptops and four years is acceptable for desktop computers;
- books and journals. Books costing \$300 or less can be claimed for in the year of acquisition. The value of books costing more than this must be added to business assets and then depreciated. Subscriptions to professional and trade journals are fully deductible;
- computer software. Software up to \$300 a unit is fully deductible in the year of acquisition. Other software must be depreciated;
- home office expenses, limited to such expenses as electricity and depreciation on furniture. There is no deduction for mortgage interest;
- professional libraries, which may be depreciated at 10% or 15% annually, depending on which method is chosen;
- special clothing and the costs of laundering it. In general, it must not be adapted for “domestic” purposes or social use;
- travelling expenses between two jobs or in the course of employment (to the extent that these expenses are not reimbursed by the employer). Records should be kept of the kilometres travelled and of expenses. The cost of travelling to and from work and home is considered to be a private expense and is not deductible;
- tools of trade. It may be necessary to depreciate major items annually rather than claim the full cost in the year they are acquired.

Depreciation rates

The decline in value (depreciation) rate for assets costing more than \$300 is determined by the taxpayer, who has to make a judgment about the asset’s effective life. The abovementioned rates are the “safe harbour” rates – the rates that the ATO accepts as reasonable without further inquiry (see Taxation Rulings TR 2018/4 and TR 2019/5).

Apportionment

A person needs to apportion the amount of the deduction if the item (eg, computer, internet or mobile phone) is also used for private purposes. A diary needs to be kept to record the amount of time home office equipment is used for work and private purposes. The diary must include

a representative period of at least four weeks to establish a pattern of use for the income year (see ATO Practice Statement PS LA 2001/6).

Self-education expenses

The first \$250 of self-education expenses incurred in connection with a prescribed course of education is not deductible.

If you spend \$250 on non-deductible self-education expenses, however, that takes you to the deductibility threshold. So if you spend \$250 on tango lessons at a “place of education” (and you are not a professional dancer), anything you then spend on work-related self-education becomes deductible.

You must establish a sufficiently close connection between the expenses and the employment. Generally, any expenditure directed towards maintaining or updating skills in a particular occupation will be deductible.

Business-related items

The deductions available to sole traders and other business entities depend on the nature of the business but may include items such as:

- payments to employees and superannuation contributions;
- advertising and marketing;
- interest on money borrowed to provide working capital or to purchase income-producing assets;
- insurance premiums (eg, for workers’ compensation);
- accounting and audit fees;
- legal expenses arising from day-to-day business activities;
- professional or business association subscriptions and fees;
- rebates and discounts to customers;
- running and operating costs of business premises (including a home office).

Donations

Gifts of \$2 or more to approved organisations are deductible (*ITAA 1997*, Div 30). Receipts should be kept as evidence. Receipts are not required if the gift is \$10 or less (eg, a bucket donation).

Approved organisations include registered charities, public or non-profit hospitals, public health institutions, various public educational bodies, public libraries, art galleries and museums. These bodies must be endorsed by the ATO as

deductible gift recipients, and they should indicate their status on their receipts.

The ATO can advise whether any particular body qualifies; many are named in the *ITAA 1997*.

If the gift is of property rather than money, a deduction is allowed if the property was purchased within 12 months of the gift. Property valued at over \$5,000 can be gifted at any time.

For more on tax-deductible donations, see Chapter 8, Community Organisations.

[38.160] Substantiation requirements

Evidence required

Expenses incurred in producing income are deductible against income, but employees must keep evidence showing the amount, date and nature of the expense where the *total* claim for expenses is more than \$300. In other words, receipts or statements must be obtained from the supplier of the goods or services.

This documentary evidence is shown to the ATO only if it is requested, but without it, the expense, even if it was legitimately incurred for work purposes, is not deductible.

Individual expenses under \$10

There is a trivial exemption. Documentary evidence of individual items costing less than \$10, totalling \$200 or less in the income year, is not required. A diary record by the taxpayer is enough.

Total expenses over \$300

If the expenses exceed \$300 a year, the whole amount must be substantiated.

Relieving provisions

In the first few years of the operation of these provisions, it became evident even to the ATO that they were too harsh and there is now a relieving provision that gives the Commissioner a discretion to dispense with the substantiation provisions if satisfied that the money was actually spent on some work-related expense.

Car and travel expenses

Car expenses, overseas travel expenses and what is termed "extended domestic travel" (over five nights

away from home) are singled out for special attention by the substantiation provisions.

This applies to self-employed people as well as employees, but not to companies and trusts (which, however, may be affected by similar provisions concerning fringe benefits tax).

Car expenses

Individuals and partners in a partnership must use either the *cents per kilometre method* or the *log book method* to calculate deductions associated with the use of their car to produce assessable income.

Cents per kilometre method

Under the cents per kilometre method, a deduction is allowed on the basis of a fixed amount (\$0.68 for 2018–2019) per business kilometre travelled. The deduction is capped at 5,000 business kilometres for each car the taxpayer owns or leases.

Actual car expenses do not need to be calculated or substantiated. However, a reasonable estimate needs to be made of the number of *business kilometres* travelled, so evidence of how this was arrived at (eg, diary entries) should be kept.

Log book method

Under the log book method, deductions can be claimed by reference to the *business use percentage* of the car expenses for the income year. A log book, odometer records and written evidence of car expenses must be kept. A reasonable estimate can be made of fuel and oil costs.

Keeping a log book

For the first year for which vehicle expenses are claimed, the log book should be kept for a continuous period of 12 weeks at any time in the year.

Once the extent of business use of the vehicle during the log book period has been established, the taxpayer must estimate the business proportion of vehicle expenses for the full year, taking into account the pattern of use established in the log book period and allowing for variations in the pattern throughout the year, due to things like holidays and seasonal factors.

The proportion of business use nominated for the full year must not exceed the proportion established by the log book records in the 12-week substantiation period.

In subsequent years, the taxpayer can claim deductions by using the business proportion determined in the first year where, on a reasonable

estimate, it has not fallen substantially (ie, by more than 10%).

The taxpayer must also record the total kilometres travelled in each year.

Claims for more than one car

Where expenses are claimed for more than one car, log books must be kept for each car.

Change of business use

For most taxpayers, business use of a vehicle remains fairly constant. However, if business use changes substantially, the taxpayer must reassess the situation.

Where business use falls by more than 10%, the taxpayer must adopt the lower figure for that income year and keep a log book for another 12-week period in the following year.

A taxpayer who wants to substantiate an increase in the proportion of business travel needs to keep a log book for a further 12 weeks.

Change of vehicle

The business travel calculation may be transferred when the car is replaced.

If the claim is wrong

If an audit shows that the business use of a vehicle is in fact substantially less than claimed (ie, by more than 10%):

- where an error in the log book is identified, the claim is reduced to reflect the correct business proportion; or
- if the taxpayer is eligible, the claim is allowed on the basis of one of the formulas; or
- the claim may be completely disallowed.

Where substantial overclaims are detected, the normal regime of penalties applies (see [38.170]).

What records must be kept?

It is not necessary to keep receipts for petrol and oil; however, for auditing purposes, the type of vehicle and odometer readings at the beginning and end of each income year must be recorded.

Unregistered vehicles

The motor vehicle substantiation rules do not apply to unregistered vehicles used principally for business purposes, such as on a farm.

Travel expenses

There are recording requirements in addition to the general substantiation requirements for travel costs claimed as business expenses for:

- overseas trips;
- domestic trips of more than five nights away from home.

Essentially what is required is a diary of business activities conducted on the trip.

If the employer pays a travel allowance

It is not necessary to substantiate expenses and keep a diary for domestic travel in excess of five nights away if an employer pays a travel allowance and the Commissioner thinks that it is a reasonable amount (ie, it does not exceed Australian public service rates, which vary according to the employee's salary and destination. Details of these rates are available on the ATO's website).

There is a more limited concession for international travel (accommodation expenses still require substantiation) but the travel diary requirement must still be complied with.

Self-employed people

Self-employed people, who do not receive travel allowances, must substantiate expenses on extended domestic travel.

Documentary evidence

Documentary evidence under these provisions is to be kept for five years from the date the tax return is lodged.

The documents must be obtained or the records made at the time the expenses are incurred, or as soon as practicable thereafter.

[38.170] Incorrect tax returns

ATO investigations

The Commissioner has wide powers to obtain information and to obtain access to premises and documents (*TAA 1953*, Div 353). This power must be exercised reasonably, and a temporary denial of entry to obtain legal advice is permitted.

The ATO has occasionally resorted to search warrants under the *Crimes Act 1914* (Cth), but these are executed in conjunction with the Federal Police.

Data matching

The ATO uses data matching to quickly identify persons who might not be complying with their tax obligations, by comparing amounts shown in tax returns and activity statements with data matched from various sources. For example, the ATO receives investment income information and credit and debit card details from banks and other financial institutions, while details of property transactions are obtained from state and local governments.

Data matching can also identify persons who are not (but should be) in the tax system.

Taxpayer self-assessment

Australia's tax system is based on self-assessment and voluntary compliance. Tax returns and other forms lodged with the ATO are accepted as correct without detailed checking by the ATO, and refunds or assessments are issued accordingly.

This is not a licence for taxpayers to write their own refund cheques. A tax return may still be subject to an audit, especially if it has some unusual feature such as a high level of deductions for that class of taxpayer.

The ATO pays close attention to work-related deductions and rental property expenses.

Audits

Where non-compliance is suspected, the ATO may check the accuracy of a taxpayer's tax returns or activity statements. If the ATO considers that the taxpayer may not be meeting certain tax obligations, or if it does not believe that a review can look into the issues sufficiently, it may conduct an audit of the taxpayer's tax affairs.

The taxpayer will get a letter or phone call from the ATO asking them to visit the ATO (or elsewhere if it is more convenient) with all the books and records relevant to a particular income year. There is a form to fill in, and the taxpayer can bring a tax adviser if they wish.

What does the audit consider?

The audit is likely to concentrate on:

- whether amounts claimed as deductions have actually been spent;
- whether they are really work or business related; and
- in particular, whether the *substantiation requirements* (see [38.160]) have been met.

Deliberate avoidance

Spot checks are made to identify people working at more than one job under different names. However, the ATO has continuing difficulty in locating people paid by employers who do not need to claim the payment as a deduction. In some industries, the practice of paying cash without deducting tax is widespread.

The verdict

At the end of the audit, the ATO will explain the basis of any adjustments made as a result of the audit, inform the taxpayer of any errors detected (which has resulted in the taxpayer paying too much or too little tax), explain the reasons for any penalty or interest, give the taxpayer the opportunity to explain any circumstances which could justify a reduction of any penalty or interest and provide the taxpayer with written notification of the outcome of the audit, the taxpayer's review rights and any remedies that may be available.

Penalties for incorrect tax returns**If the taxpayer makes a mistake**

A person who avoids tax by making a mistake in their tax return (or other document like a business activity statement) will have to pay at least the shortfall and interest. If they have not taken reasonable care, there may be a penalty.

In either case, the ATO generally has two years in which to amend the assessment (*ITAA 1936*, s 170(1)). A four-year amendment period applies to taxpayers with complex tax affairs.

If the shortfall is deliberate

If the Commissioner believes that there has been fraud or evasion, the assessment can be amended at any time (*ITAA 1936*, s 170(2)) and the penalty is higher.

Penalty tax

A penalty tax can be imposed if a person fails to make adequate disclosure to the ATO.

Taxpayers have to make quite complicated decisions about the impact of tax laws on their affairs, though there is always the possibility of obtaining a private ruling (at no charge) from the ATO (see [38.10]). The penalty depends on the extent to which the taxpayer or a tax agent was at fault in not making an accurate tax statement, as follows:

- lack of reasonable care – 25%;
- recklessness – 50%;
- intentional disregard – 75%.

Interest on the tax due is also charged.

Remittance and review of penalties

The Commissioner has discretion to remit a penalty. ATO Practice Statement PS LA 2011/2 lists situations in which this might be appropriate, including inadvertent arithmetical errors and voluntary disclosure before tax is due.

Penalties can also be reviewed by the Administrative Appeals Tribunal (*TAA 1953*, s 14S).

[38.180] Other tax offences

The *TAA 1953* also creates a range of tax offences, including for:

- refusal or failure to lodge a tax return or other document;
- making false or misleading statements;
- incorrectly keeping records with intent to mislead or deceive;
- obstructing ATO officers (ss 8B–8ZN).

Serious offences, like obtaining a financial advantage falsely or by deception, can be prosecuted under the *Criminal Code Act 1995* (Cth).

Penalties

Penalties are quite severe and can even include a prison sentence. A court can also order a penalty tax of up to 200% of the tax avoided (or 300% for recurring offenders).

The courts have said that penalty tax should be imposed unless there are exceptional circumstances, but that typical offences should not attract the maximum penalty.

Custodial sentences are frequently imposed for more serious offences (such as failing to remit PAYG withholding amounts or defrauding the Commonwealth). Quite lengthy sentences have been imposed on people involved in offshore tax evasion schemes.

ATO policy on tax offences

The ATO has shown a marked preference for imposing tax penalties rather than prosecuting. Prosecution is mainly reserved for persistent and wilful defaulters.

Tax assessments

[38.190] Once a tax return has been lodged, the ATO assesses tax payable based on the information in the return and any other information (it may rely purely on the return (*ITAA 1936*, s 169A)). A notice of the assessment is then given to the taxpayer.

How long does it take?

A paper return lodged early in July may be dealt with in three or four weeks; one lodged in September may take 10 weeks. Self-assessment and electronic lodgment have speeded up the process, so if no reply is received within about 10 weeks, it is worth enquiring about the progress of the return at the ATO, which can at least confirm that the return has been received.

Taxation enquiries

The most convenient way of inquiring about the progress of a tax return is through the ATO's telephone inquiry service. For speedy service, taxpayers should

quote their tax file number, which will be on previous years' assessment notices.

[38.200] Objections

The taxpayer has either two or four years (from the date the notice would have been delivered in the normal course of post) to object to the assessment. The Commissioner may agree to extend this period.

Which period applies depends on the type of taxpayer; most individuals and small business taxpayers have two years (see [38.170]).

The rules for objections and appeals are set out in Pt IVC of the *TAA 1953*. The notice of objection needs to be carefully drafted to cover all possible grounds, as amendment is also difficult.

How to object

The objection need not be in any specific form provided it is in writing and adequately raises the

disputed issues and the facts and legal grounds on which it is based. It must make clear exactly why and how the assessment is considered to be wrong – statements that “it is incorrect” or “it is excessive” is not sufficient.

The onus of proving the assessment wrong is on the taxpayer.

The ATO response

Once the objection is sent to the ATO, it may be several months before a decision is reached, though acknowledgment is usually sent promptly.

The objection is nearly always considered in the branch office by specialist staff, and a written notice is sent of the decision – to disallow the objection or to allow it in whole or in part.

The ATO officer considering the matter may contact the taxpayer or their adviser seeking further information, giving the taxpayer a valuable lobbying opportunity.

Time limits

If the ATO does not make a decision within 60 days, the taxpayer can ask for a decision within the next 60 days.

If the ATO still fails to make a decision, the objection is deemed to be dismissed, opening the path for an appeal.

The taxpayer then has 60 days to request in writing that the Commissioner either:

- treats the objection as an appeal and forward it to the Federal Court; or
- refers the decision to the Administrative Appeals Tribunal (AAT).

Reconsideration

At this stage, the Commissioner may reconsider the decision and issue an amended assessment.

The taxpayer may be asked for further information. If the Commissioner does reconsider the decision in time, there is no obligation to forward the objection to the AAT or Federal Court until 60 days after the taxpayer has supplied the information.

[38.210] Appeals

From here on, the procedure starts to cost. A non-refundable fee must be paid when the matter is set down for hearing in the AAT. The standard

AAT fee is \$932, but it may be reduced to \$92 if the disputed amount is under \$5,000. Lower AAT fees apply in relation to certain small business taxation decisions. The fees are higher for Federal Court applications. Various persons are exempt from paying Federal Court fees, including those entitled to legal aid, Health Care Card holders and recipients of youth allowance or Austudy. The AAT fee for such persons is \$100.

In both AAT and Federal Court proceedings, the taxpayer has the burden of proof. This onus remains with the taxpayer during any appeals, including those initiated by the Commissioner. To succeed, the taxpayer needs to prove, on the balance of probabilities, that the ATO’s assessment is excessive.

The Administrative Appeals Tribunal

The AAT is independent of the ATO and is the place to go if the argument is basically about facts. Proceedings are fairly informal, and it is feasible for taxpayers to appear for themselves and even, occasionally, to win.

Representation

The taxpayer may be represented by a lawyer or someone else, such as a tax agent. The ATO is represented by its own officers in routine cases. If the matter is before the AAT’s Small Business Taxation Division, the taxpayer will have access to a case manager.

Tribunal proceedings

The AAT is not bound by the rules of evidence and may allow evidence not admissible in court. Hearings are in private if the applicant wishes (most decisions are publicly reported, although the taxpayer’s name may be kept private).

The AAT puts strong emphasis on settling matters, and of the several hundred matters that go to the AAT annually only 50–100 ever proceed to a formal hearing.

Costs

Costs will not be awarded against a taxpayer.

The Federal Court

If the matter involves a question of law or is a test case, a Federal Court appeal might be better, despite the formality and cost. It may also be quicker. About 50 cases go to this court each year.

Appeals by the Commissioner

If a taxpayer who has succeeded in the AAT is one of many in a similar situation, there is likely to be a Federal Court appeal by the Commissioner – although, normally in such cases, the ATO pays the taxpayer’s costs, even if it succeeds on appeal.

Appeals from the AAT to the Federal Court are not automatic. They can be made only on questions of law (*Administrative Appeals Tribunal Act 1975* (Cth), s 44). Mixed questions of law and fact are not necessarily excluded, although the Federal Court does not generally permit a re-hearing of the facts.

The Full Federal Court

There is a right to appeal further in a matter that came directly to the Federal Court.

When a case originated in the AAT, the Federal Court must give leave for an appeal to the Full Federal Court (three judges rather than one).

The High Court

A taxpayer who finds some difficult or important question of law arising out of their affairs can appeal to the High Court, with leave of that court, from any decision of the Federal Court.

Leave is rarely given, and perhaps five tax cases each year reach the High Court. Sometimes these are test cases, with the ATO picking up the bill for both sides.

The Taxpayers’ Charter

The ATO’s Taxpayers’ Charter sets out what can be expected from the ATO and what the ATO expects from taxpayers in return.

The charter has no legal force, but it may be useful in cases of obvious administrative abuse.

The taxpayer

Taxpayers are expected to:

- be truthful with the ATO;
- keep records;
- take reasonable care in preparing tax returns;
- lodge tax returns on time;
- pay tax on time.

The ATO

The ATO undertakes to:

- treat taxpayers fairly and reasonably;
 - treat them as honest in their tax affairs unless they show themselves to be otherwise;
 - offer professional service;
 - respect privacy;
 - explain decisions;
 - give reliable advice;
 - allow professional representation;
 - help taxpayers reduce compliance costs.
-

[38.220] Complaints

The Inspector-General of Taxation

The Inspector-General of Taxation investigates individual complaints against the ATO. Such complaints must relate to “administrative matters”, for example, the conduct of ATO officers and the timeliness of the ATO’s response.

Details of how to lodge a complaint are available at igt.gov.au/making-a-complaint.

Payment of tax

[38.230] Payment of tax is required on the date specified in the notice of assessment, which must be at least 21 days after the notice is served.

[38.240] If there is a dispute

Tax that is not paid by the due date is a debt due to the Commonwealth and can be recovered by the Commissioner, even if an appeal is pending (*TAA 1953*, Sch 1, s 255-5).

Effect on other court orders

If there is a genuine dispute as to liability, a court may decide not to make orders against a taxpayer in another matter that would prejudice their position before the appeal is decided.

For example, the court is unlikely to grant a bankruptcy petition (or application for a winding-up order in the case of a company) until a dispute about tax liability is settled.

[38.250] Extensions of time and payment by instalments

The Commissioner may grant an extension of time or allow payment by instalments, if satisfied that the taxpayer really cannot afford to pay on time (TAA 1953, Sch 1, s 255-10).

How long?

An extension will not normally exceed three months and will not go beyond 15 June in the income year the assessment was issued.

Making an application

Applications for an extension of time or payment by instalments should be in writing and include:

- the taxpayer's tax file number, the assessment number, the income year, the amount involved and the due date;
- a brief statement of reasons, including the taxpayer's financial position;
- a definite offer to pay:
 - by a specific date; or
 - by instalments beginning and ending on specific dates.

Ideally, an application should be made at least 10 days before the due date for payment, but the Commissioner may extend this time.

If the unpaid tax exceeds \$2,000 or the extension sought exceeds three months, the Commissioner's usual practice is to require a detailed statement of the taxpayer's assets and liabilities with the application.

If additional tax is to be avoided, proof of the taxpayer's "innocence" (ie, that their inability to pay was not their fault) will need to be shown in the application.

If the taxpayer is also lodging an objection

Separate letters should be written for objections and applications for time to pay even if they are about the same matter, because these issues are dealt with by different parts of the ATO.

[38.260] Hardship relief

The Commissioner has the power to release an individual or deceased estate from an income tax liability if paying the liability would cause serious

hardship to the individual or the deceased's dependants (TAA 1953, Sch 1, s 340-5).

How to apply

An application form (*Application for Release from Payment of Some Taxation Liabilities*) is available from the ATO website and can be lodged online or sent to the ATO at Reply Paid 3129, Penrith, NSW 2740. It requires the applicant's income, expenditure, assets and liabilities to be stated in minute detail.

Before an application is dealt with, all returns in arrears must be lodged.

What does the ATO consider?

ATO Practice Statement PS LA 2011/17 sets out guidelines that the ATO follows in determining whether or not there is serious hardship.

A taxpayer is left with enough to clothe and feed their family before being called on to pay the ATO. A person with a modest house, motor vehicle and furniture would not necessarily be required to sell those assets, but boats, holiday houses and caravans would be regarded as available.

It is not easy (but it is possible) to have tax reduced or cancelled (about half the applications received are allowed), but the ATO may agree not to force payment until the taxpayer's finances improve.

Effect on recovery action

It normally takes some time for the ATO to act on the application, but in the meantime, it should take no further legal steps to force payment. If it does, the existence of the hardship relief application should be pointed out.

Who is it for?

Hardship relief is not for people with substantial assets, even if they will suffer great loss by being forced to sell assets to meet their tax debt. However, past involvement in tax avoidance schemes will not necessarily disqualify an applicant for hardship relief (*Powell v Evreniades* (1989) 20 ATR 472).

It may be useful for people like social security recipients who do not have tax deducted from their benefit but are over the tax threshold.

If an employer fails to remit tax payments

PAYG and FBT instalments can be written off under hardship relief.

Effect of bankruptcy

Bankruptcy releases a person from most existing debts, including tax (see Chapter 6, Bankruptcy).

[38.270] PAYG – pay as you go

Employers have deducted tax from their employees' wages on behalf of the ATO, since World War II, initially through the pay-as-you-earn (PAYE) system and, since 2000, through the pay as you go (PAYG) system.

The PAYG system is not confined to payments to employees. Other payments, including payments under a labour hire agreement and payments where an ABN is not quoted for a supply, are subject to PAYG withholding.

How are PAYG instalments collected?

The ATO issues an *instalment rate* to non-wage or salary taxpayers based on the previous year's income, so a taxpayer starting in business will not get an instalment rate until after their first tax return is assessed.

There is provision for a new business to make voluntary payments before an instalment rate is issued.

How is the rate assessed?

The ATO assumes that income earned in the current year will be the same as that earned in the previous year, plus an *uplift factor* based on any increase in GDP (gross domestic product), and assesses the taxpayer accordingly.

When is the tax payable?

If non-wage or salary income exceeds \$8,000, instalments are calculated quarterly (30 September, 31 December, 31 March and 30 June) and are normally payable 28 days after the end of the quarter (28 February for the quarter ending 31 December).

If income is expected to decrease

If the non-wage income will not recur or will be less in the current year, a person paying quarterly can vary their instalment rate by notifying the ATO that they wish to estimate their tax (called a benchmark tax amount). The ATO then advises the

appropriate instalment rate. This can be done each quarter, but there are penalties if the instalment turns out to be too low – so it is important not to underestimate future income.

If income is expected to increase

There is no need to apply to increase the instalment amount even if it is expected that non-wage income will increase in the current year.

When can PAYG tax be paid annually?

If the *notional income* (estimated income for the current year as notified by the ATO) is less than \$8,000 and the taxpayer is not registered or required to be registered for GST, the tax can be paid annually. The due date for individuals is 21 October, after the end of the income year.

Self-employed people in this situation should put money aside for tax as they earn it.

How much?

The amount of PAYG tax payable depends on many factors. The table below is a guide.

The Medicare levy of 2% (see below) is added to these amounts. Any tax offsets or rebates are subtracted from the tax figure calculated. Generally, the low income tax offset ensures that the first \$20,542 of income is not taxed.

PAYG withholding

Tax is deducted from salary, wages and related payments at scheduled rates for employees who provide their tax file number to their employer.

Investors must quote a tax file number to avoid having tax withheld at the top rate (47%).

Tax must also be withheld at the top rate from payments for *supplies* as defined in the GST legislation if an Australian business number is not quoted. It may be worthwhile for someone running a small business with a turnover below the GST threshold of \$75,000 to get an Australian business number and go through the exercise of lodging business activity statements (see Reporting requirements at [38.270]) to preserve cash flow. The tax instalments required are calculated on the rate on last year's income, which may be considerably less than the top rate.

The Medicare levy

The Medicare levy (2% of taxable income for 2018–2019, subject to low-income concessions) is

collected with income tax but is payable by resident individuals only. Higher income taxpayers who do not have private patient hospital insurance may be liable to pay a Medicare levy surcharge in addition to the general levy.

Reporting requirements

When the GST was introduced, the government took the opportunity to “rationalise” reporting requirements.

Business activity statements

Taxpayers registered for GST must report quarterly (or monthly if their annual turnover is \$20 million or more) by lodging a *business activity statement*.

PAYG withholding amounts must be reported quarterly if the annual amount is \$25,000 or less, monthly if it is more. Other PAYG and fringe benefits tax instalments are due quarterly.

Investment activity statements

Taxpayers who are not registered for GST lodge a quarterly *investment activity statement*, which is mainly for reporting the investment income (interest, dividends and rent) of taxpayers not carrying on a business. If annual income is likely to be less than \$8,000, an investment activity statement is required only annually.

Annual tax returns

Taxpayers required to fill out a business or investment activity statement must still lodge an annual tax return.

Tax file numbers

The ATO assigns a unique nine-digit number to each taxpayer, to identify people with the same or similar names and to make tax evasion more difficult.

OTHER TAXES

Capital gains tax

[38.280] Capital gains tax (CGT) is generally thought of as a tax on the rich. However, increasing levels of share ownership by small investors and investment property ownership means that it is affecting more and more middle income earners. It is extremely complex, and any attempt at a brief explanation is likely to be an over-simplification. The following is a very general overview.

Tax rates for resident individuals 2018–2019

Taxable income	Tax payable
\$0–\$18,200	Nil
\$18,201–\$37,000	19% of excess over \$18,200
\$37,001–\$90,000	\$3,572 plus 32.5% of excess over \$37,000
\$90,001–\$180,000	\$20,797 plus 37% of excess over \$90,000
Over \$180,000	\$54,097 plus 47% of excess over \$180,000

To get a tax file number, a person must prove who they are by producing at least three original identification documents at an ATO branch or post office. Various combinations, such as a current Australian passport or an Australian birth certificate plus two secondary documents (eg, a Medicare card, driver’s licence, student card or bank statement), are accepted. Applicants aged under 16 only need to provide one primary document and one secondary document.

If a tax file number is not provided to employers, investment institutions or social security officers among others, they must withhold tax at the maximum rate (47% for resident individuals for 2018–2019) on any income due. Once it has been withheld, there seems to be no way of getting it back except by lodging a tax return after the end of the income year.

The TFN system also applies to certain payments made by Centrelink and Veterans’ Affairs and to various government services and schemes (eg, superannuation portability, HELP and paid parental leave).

The CGT rules are in the *ITAA 1997* (Pt 3-1, Divs 100–152).

Taxing capital gains

CGT generally applies to assets acquired after 19 September 1985. The liability to pay tax arises when a *CGT event* happens to the asset and the taxpayer makes a capital gain. Income losses,

except in some special cases, can be offset against realised capital gains.

If the taxpayer makes a capital loss, the loss can be offset against other capital gains, but cannot be offset against other income.

Where a taxpayer has a *net capital gain* for an income year, this is treated as statutory income and forms part of the taxpayer's assessable income (see [38.40]). This means that the net capital gain is taxed like other items of income (ie, at the taxpayer's marginal tax rate).

The "net capital gain" is the sum of all capital gains made by the taxpayer during the income year, reduced by any capital losses from that year and any unused capital losses from previous income years (s 102-5). Each capital gain may have been reduced by:

- the 50% CGT discount (if the taxpayer is a resident individual or trustee and the asset was held for over 12 months); and
- one or more small business concessions (if the taxpayer is a small business entity and the asset was an active asset of the business).

CGT events

The CGT rules have over 50 CGT events (Div 104), the key one being the disposal of an asset by selling it or giving it away (CGT event A1). Other common CGT events that can give rise to a taxable capital gain (or a capital loss) are:

- the loss or destruction of an asset (CGT event C1);
- the end of an option to acquire shares, units or debentures (CGT event C3);
- the creation of a contractual right (CGT event D1).

Residents and non-residents

Residents are taxed on capital gains arising from any source.

Non-residents and temporary residents are taxed on gains on assets situated in Australia (rather broadly defined).

The CGT discount

When a resident taxpayer has held an asset for over 12 months, the CGT discount can apply to reduce the assessable capital gain by 50% (Div 115).

Companies are not entitled to the CGT discount. Individuals who are non-residents or temporary residents also cannot access the CGT discount.

Small business concessions

The CGT provisions include a range of generous concessions to reduce, roll over or even eliminate a capital gain made on an asset that has been used in a small business (Div 152). These concessions are available to sole traders and to other taxpayers carrying on a business through all forms of business vehicles, including companies and trusts, if they satisfy the relevant conditions in Div 152. These conditions include a threshold test (the \$2 million aggregated turnover test or the \$6 million maximum net asset value test) and an active asset test.

Rollover relief is also available if a small business entity (aggregated turnover of under \$10 million) changes the legal structure of the business by transferring business assets to another small business entity, but the ultimate economic ownership of the assets remains unchanged (Subdiv 328-G).

Record keeping

A major issue in CGT affairs is the keeping of records relating to taxable assets. Small share investors need to record all their trades to establish the base cost of their shares and the net CGT liability.

Assets disposed of as gifts

Assets disposed of by way of gift are subject to CGT. The recipient is treated as having acquired the asset at its fair market value.

Assets passing on death

Assets passing on death are not taxed at that point (s 128-10). CGT liability is deferred until the asset is sold. This is a very important concession, but to make the most of it, action must be taken before the person's death, usually by suitable provisions in a will.

If the asset was the deceased's main residence and was not being used to produce income, a 100% exemption from CGT applies if the property is disposed of within two years of the deceased's death. In the case of the sale of the property, the two-year period is measured from the date of death until settlement of the contract. A full exemption is also available if the property is disposed of following occupation by a surviving spouse, a beneficiary or a person with a right to occupy.

“Rollovers”

In some situations, *rollovers* are available which result in the deferring of CGT liability (*ITAA 1997*, Divs 122–126). These include cases of:

- compulsory acquisition by governments, or where property has been stolen or destroyed (a rollover is allowed if the proceeds are reinvested within a set time in replacement assets);
- asset transfers on marriage or relationship breakdowns;
- ownership changes associated with some business reorganisations.

Major capital improvements

Major capital improvements to assets acquired before 20 September 1985 are treated as new assets subject to CGT, which leads to some tricky valuation problems.

Exemptions from capital gains tax

Major exemptions are discussed below.

The taxpayer's home

The taxpayer's main residence and surrounding land to a limit of two hectares are exempt (Subdiv 118-B).

A taxable gain could arise if part of the land is subdivided and sold. The rules on this exemption are so complicated that a book has been written on them.

Life insurance and superannuation policies

Proceeds of life and superannuation policies are exempt, unless the taxpayer was not the original owner (Subdiv 118-D).

Light motor vehicles

Gains on light motor vehicles, such as cars and motorcycles, are exempt (s 118-5).

Personal use assets and collectables

Gains on personal use assets acquired for \$10,000 or less are exempt (s 118-10). These are assets for

the personal use and enjoyment of the taxpayer and their family – clothing, white goods, furniture, sporting equipment, cameras, boats and so on.

This concession does not cover works of art, jewellery, rare books, stamps and coins and antiques (*collectables*).

Disposal of personal use assets above the \$10,000 cost threshold can give rise to a taxable gain, but not an allowable loss. Disposal of collectables bought for more than \$500 each gives rise to taxable gains, but losses can only be offset against taxable gains on other listed assets.

It is therefore important to keep records of the purchase and sale of both collectables and personal use assets that are likely to appreciate in value.

Interestingly, ATO statistics suggests that little or no tax is collected on personal use assets.

Exempt bodies

Bodies exempt from income tax, such as registered charities, are also exempt from CGT.

Getting advice

It is no exaggeration to say that capital gains tax is a legal minefield, and even professional advice on specific problems is likely to be tentative.

For a clear and detailed explanation, see the *Australian Tax Handbook 2019* (Thomson Reuters, Sydney).

Advice is also available from the ATO, and there are many public rulings and ATO guides on the topic.

Keep records!

Perhaps the most important piece of advice in relation to capital gains tax is that anyone acquiring assets that are likely to be subject to tax must keep records of their value at the time they were acquired until they are disposed of. If, for example, a valuable artwork is acquired as a legacy, it should be valued and the valuation kept until it is sold.

Fringe benefits tax

[38.290] Fringe benefits tax (FBT) is a tax imposed on employers who provide certain non-cash benefits (“fringe benefits”) to their employees or to the associates of their employees. The key

legislation dealing with FBT is the *Fringe Benefits Tax Assessment Act 1986* (Cth).

For an employer to be liable to FBT, a taxable fringe benefit must be provided “in respect of

the employment of the employee". Examples of taxable fringe benefits are low-interest loans, low-cost accommodation, allowing the employee to use a work car for private purposes and providing entertainment (food, drink or recreation). Salary and wages, superannuation contributions and workers' compensation payments are not fringe benefits.

When an employer is liable to pay FBT on the value of the fringe benefit provided, the employee is not assessed on the value of the benefit (even if it is treated as part of the employee's remuneration package).

Exempt benefits

Some benefits exempt from FBT are:

- residential accommodation for live-in residential care workers and their families;
- free or discounted transport, if the employer's business is providing transport and travel is to and from work or on the employer's scheduled metropolitan services;
- recreational and childcare services provided by the employer on the employer's premises (and elsewhere in the case of government-funded childcare services);
- private use of business property on an employer's premises;
- the first \$1,000 worth of "in house" fringe benefits – discounted goods and services of a type normally sold by the employer in the course of business. Note that no taxable fringe benefit arises anyway unless goods are sold to the employee at less than cost or services are sold at a discount greater than 25% of the employer's usual selling price;

- relocation costs (travel, temporary accommodation, furniture removal, costs incurred in purchase and sale of houses);
- small, occasional, hard to record benefits (eg, a bottle of wine at Christmas);
- emergency relief, safety awards (to \$200), long service awards (to \$1,000) and meals for domestic employees.

In addition, specific exemptions and concessions apply to some non-profit organisations (charities, public and non-profit hospitals and public ambulance services), although the value of exempt fringe benefits that may be provided by many such entities is capped.

Concessional benefits

These are benefits taxed at less than their market value or cost to the employer:

- cars, especially if the statutory formula is adopted (see Car expenses at [38.160]);
- loans, if the interest rate charged is equal to or greater than the benchmark rate;
- remote area accommodation and holiday travel (50% of the usual value).

Advantages of fringe benefits

A number of benefits are exempt from FBT and are income tax free to the employee (see Exempt benefits at [38.290]). The employer also gets a tax deduction for the cost of the benefit.

Further, some fringe benefits taxable to the employer are taxed at values well below the cost an employee would incur if they had to pay for them personally (eg, cars, loans, remote area housing, discounted goods and services).

These may be attractive benefits, particularly for employees on the maximum rate of income tax.

Goods and services tax

[38.300] The goods and services tax, better known as the GST, is a tax on goods and services at the rate of 10%. It came into effect on 1 July 2000.

The GST is a Commonwealth tax, but the proceeds go to the states. The key legislation is the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

How does the GST system operate?

Taxpayers need to have an Australian business number (ABN) and be registered for GST if they carry on an enterprise in Australia and their GST turnover is \$75,000 or more (or \$150,000 for non-profit organisations). The amount of the GST turnover is the sum of the values of all the supplies

the taxpayer has made, or is likely to make, over a 12-month period.

Taxpayers with a GST turnover under the threshold can still apply for an ABN and voluntarily register for GST if they are carrying on an enterprise. Taxi drivers (including Uber drivers) who carry on an enterprise must be registered for GST regardless of their turnover.

The term “enterprise” is widely defined for GST purposes and covers all business and trading activities. A landlord who lets out a property is carrying on an enterprise.

Taxpayers who are registered for GST must:

- include GST in the price of supplies that are subject to GST (*taxable supplies*) and issue tax invoices for supplies with a GST-inclusive value of more than \$82.50;
- obtain tax invoices for business purchases;
- lodge business activity statements (see [38.270]);
- claim GST credits for GST included in the price of most business purchases.

GST-free items

Although the coverage of GST is extensive, some supplies are GST free. These include:

- most basic food items and beverages – there is a detailed food list on the ATO’s website, which lists the GST status of major food and beverage lines;
- medical and health services (subject to certain exceptions like purely cosmetic procedures) and certain health-related goods like medicines and medical aids;

- residential care for aged and disabled people;
- education courses and certain related goods and services;
- childcare;
- exports;
- religious services;
- non-commercial supplies from charities (eg, selling donated second-hand goods);
- bulk water, sewerage and drainage;
- the sale of a business as a going concern (if the parties agree to treat the supply as a going concern);
- international transport.

If an item is GST free, the supplier gets a credit of tax for acquisitions relating to the supply.

Financial services

Some financial services are *input taxed*; that is, there is no GST paid on their supply, but the supplier does not get an *input tax credit* for the tax already paid on the services.

Services in this category include shares, loans, the provision of money generally, superannuation funds and life insurance.

Legal and accounting services, general insurance and other advisory services are excluded, and GST is payable.

Residential premises

The supply of residential premises, either by sale or by rent, is *input taxed*, so that while no GST is payable there is no credit for any tax already paid.

State taxes

[38.310] Payroll tax

Payroll tax is levied by state governments and paid by employers on their employees’ wages.

“Wages” includes salaries, commission, remuneration, bonuses and allowances, whether paid or payable in cash or in kind. The payroll tax base includes the value of some fringe benefits to employees.

An employee for the purposes of the *Payroll Tax Act 2007* (NSW) is broadly an employee by the common law definition (see Chapter 22, Employment).

The rate in NSW is 5.45%.

Exemptions

Small payrolls

There is an exemption for small employers with payrolls under a threshold amount (\$850,000 for 2018–2019). There are complicated provisions to prevent larger employers from splitting up their operation into smaller units to take advantage of this exemption.

An employer needs to register with the NSW Office of State Revenue (by completing an online application form) within seven days after the end of the month in which its total Australian wages exceed the threshold.

Exempt bodies

A number of bodies are exempted from payroll tax on wages paid, including:

- religious or public benevolent institutions, for times when the employee is engaged in the religious or public benevolent work of the institution;
- non-profit organisations whose objectives are solely or dominantly for charitable, benevolent, philanthropic or patriotic purposes.

Wages for non-charitable activities paid by these organisations are not exempt from payroll tax, apart from the initial exemption of \$850,000.

For more on this, and for the definition of a charity, see Chapter 8, Community Organisations.

[38.320] Duties

Historically, stamp duty was a tax imposed by state governments on “instruments” (documents)

rather than transactions. However, the enactment of *Duties Act 1997* (NSW) changed the focus from instruments to “dutiabale transactions” concerning “dutiabale property”.

A dutiabale transaction includes:

- the sale or transfer of dutiabale property;
- the surrender of an interest in land;
- a declaration of trust.

Dutiabale property includes land and business assets such as goodwill and intellectual property.

The rate of duty payable depends on the nature of the transaction, the type of dutiabale property and its value. Duty is either charged at a flat rate or based on the value of the transaction (“ad valorem” rate).

A number of transactions are exempt from duty, including transactions relating to marriage breakdowns and wills.

Contact points

[38.330] If you have a hearing or speech impairment and/or you use a TTY, you can ring any number through the National Relay Service by phoning **133 677** (TTY users, chargeable calls) or **1800 555 677** (TTY users, to call an 1800 number) or **1300 555 727** (Speak and Listen, chargeable calls) or **1800 555 727** (Speak and Listen, to call an 1800 number). For more information, see www.communications.gov.au.

Non-English speakers can contact the Translating and Interpreting Service (TIS National) on **131 450** to use an interpreter over the telephone to ring any number. For more information or to book an interpreter online, see www.tisnational.gov.au.

Changes are expected to the websites for many NSW government departments that were not available at the time of printing. See www.service.nsw.gov.au for further details.

Administrative Appeals Tribunal

www.aat.gov.au
ph: 1800 228 333 or 9276 5101

Australasian Legal Information Institute (AustLII)

www.austlii.edu.au

Australian Financial Complaints Authority

www.afca.org.au
ph: 1800 931 678

Australian Information Commissioner, Office of

www.oaic.gov.au
ph: 1300 363 992

Australian Prudential Regulation Authority

www.apra.gov.au
ph: 1300 55 88 49 or 8037 9015

Australian Taxation Office

www.ato.gov.au
ph: 132 861
Complaints
ph: 1800 199 010
Albury
430 Wilson St Albury, NSW 2640
Chatswood
56–64 Archer St, Chatswood
NSW 2067
Corrimal (Wollongong)
Cnr Underwood & Collins Sts,
Corrimal, NSW 2518

Newcastle

279 King St, Newcastle, NSW 2300

Parramatta

2–12 Macquarie St, Parramatta,
NSW 2123

Penrith

598 High St, Penrith, NSW 2750

Rockdale

75 Railway St, Rockdale, NSW 2216

Sydney CBD

Shop 1, 32 Martin Place, Sydney,
NSW 2000

Postal addresses

PO Box 9990 in each city

Australian Taxation Office Legal Database

www.ato.gov.au/Law/#Law

Inspector-General of Taxation

igt.gov.au
Complaints line
ph: 1300 44 88 29

Ombudsman, Commonwealth

www.ombudsman.gov.au
ph: 1300 362 072 or 6276 0111

Federal Court of Australia

www.fedcourt.gov.au

Law and Justice Foundation of NSW

www.lawfoundation.net.au

LawAccess NSW

www.lawaccess.nsw.gov.au
ph: 1300 888 529

Legal Aid

www.legalaid.nsw.gov.au
ph: 9219 5000
Free Legal Helpline
ph: 1300 888 529
Youth Hotline
ph: 1800 101 810

Office of State Revenue

www.osr.nsw.gov.au
ph: 9689 6200
Duties
ph: 1300 139 814 or 9685 2146
Payroll Tax
ph: 1300 139 815 or 9761 9366
Land Tax
ph: 1300 139 816 or 9761 4956

Tax Practitioners Board

www.tpb.gov.au
ph: 1300 362 829