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How long can the ATO hold on to your GST refund?

Have you ever been under pressure with cash flow problems and wondered how long the ATO is able to hold on to your goods and services tax (GST) dollars?

Up until relatively recently, the common practice with regard to GST credit refunds, should something about the return seem to the ATO to be untoward or downright suspicious, was to hold on to that refund pending further investigation. If the ATO had reasonable grounds to suspect that, for example, input tax credits claimed in a business's business activity statement (BAS) were not entirely legitimate, or should be further investigated, the claimed amounts could be held back while verified.

Retaining a refund, as practiced up until now, was undertaken after the ATO considered the impact such an action would have on the taxpaying entity's financial position. And it was generally held that any such retention of refunds, and related investigations, would not go beyond timeframes that would be considered "reasonable".

However new draft legislation was issued early in 2012 which seemed to stretch the definition of "reasonable" to its limits — some would say to breaking point. This proposed change to the law, in its draft form, would have allowed the ATO to withhold a GST refund for up to 60 days (after being required to notify the taxpayer, often within 30 days). A request for further information from the ATO could result in that refund being held beyond this 60 days, and should yet further verification be warranted in the opinion of the ATO, the holding period could also be extended.

The negative impact on the cash flow position of a small business in this situation may be obvious to many readers, however (and this was a sticking point for many) the only factor in the proposed new process that considered the circumstances of the taxpayer was for the ATO to consider "the impact of retaining the amount on the entity's financial position". And the proposed legislation only required the ATO to consider this when looking to extend the holding period beyond 60 days — no doubt terminally late for some businesses.

The law that has now passed has taken what many would deem to be a more realistic stance on the retention of GST refunds.

The relevant case

The proposed changes had their genesis in a reaction from the ATO (some would say an overreaction) after it lost an appeal in relation to a particular case involving GST refunds. The business involved, a buyer and seller of mobile phones and other such equipment called Multiflex, had claimed net GST refunds due to

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acquisitions of electronic goods in Australia which were then exported as GST-free supplies. The ATO decided that any refunds, which were sizeable, should be withheld as it had reasonable grounds to suspect that the input credits claimed were not legitimate. It was also of the view that any "reasonable" period (which, remember, it was required to consider) would take into account the time taken for investigations.

The Federal Court found that any reasonable period should generally only involve the time taken for administrative processes, and should not encompass the time that investigations require — and therefore the ATO was directed by the court to pay the GST refunds to Multiflex. The court found that the continuing delay in relation to paying out the company's GST refunds was likely to have a significant impact on its ability to continue trading.

The decision was appealed unsuccessfully to higher courts, and in the end the ATO was obliged to pay a GST refund within the time it takes to undertake the necessary administrative processes for a taxpayer's return and to make the payment, despite concerns the ATO may hold over the veracity of facts or the validity of a refund claimed. This was in no small part due as a consequence of the relatively recent introduction of a self-assessment system for indirect taxes (again which need not be covered in too much detail here, however ask this office if you're interested).

The consequences

So the ATO was faced with an obligation to pay out GST refunds claimed once a business's return had been processed, and then seek to recover any payouts if subsequent checks found these amounts claimed to be in error, overstated, or outright fraudulent. As with many such circumstances of course, there is risk in paying first and verifying later, and so the ATO maintained the view that whatever the reasons for incorrect GST refund claims — whether carelessness, recklessness or fraud — it would be necessary regardless for there to be an integrity requirement to enable the ATO to delay some refunds in certain circumstances.

In short, there are now new provisions and amendments, which interestingly considered New Zealand legislative provisions and a British judicial approach in developing the new GST refund laws.

The provisions continue to allow for the previous practice of retaining a refund should circumstances dictate that the ATO may be best served by doing so, however there are now important statutory conditions imposed. If the ATO has reasonable grounds to require verification of information provided relating to a GST refund (and/or the taxpaying entity requests verification), the ATO must have regard to certain factors. These are:

- the impact on the taxpayer's financial position
- the impact on its revenue
- the likelihood there is fraud or evasion, intentional disregard or recklessness with regard to tax law.

If the ATO considers that an amount should be retained after an initial period (14 or 30 days, depending if the amount relates to a "running balance account" surplus or a credit in the taxpayer's favour), the taxpayer must be informed before that time is up. The same tests of reasonableness apply if more time is subsequently required. Objections can be lodged after the designated period of retention is expired.

Timeframes written into the law as it stands provides that the ATO can only retain a refund until the time it would no longer seem to be reasonable to ask for verification of information. It also cannot hold on to a refund (beyond the notification period) if it fails to actually notify the taxpayer that this is a possibility, nor if the relevant tax assessment has been amended (an amendment ends the retention period allowed).

So while there is an upfront obligation on the ATO to refund GST credits upon an assessment being issued, there are also provisions to retain refunds in particular circumstances. One requirement that must be met however is that the ATO must be able to show reasonable grounds for it to request verification of information that relates to a refund. Ask this office for more guidance and advice. ■

Seller beware: ATO targets eBay sales

More than 11,000 individuals and businesses who may be evading their tax obligations through various online selling websites such as eBay and Gumtree will be targeted by the ATO as a part of its data matching program. Individuals who are involved in selling goods and services of a total value of $20,000 or greater will be targeted. In light of these activities, it is crucial that taxpayers know the distinction between a "hobby" and "business" when it comes to online selling.

The cautionary tale of the turtle seller

A court case in 2010 highlighted the importance of taxpayers knowing the difference between performing a hobby and carrying on an online business. The case centred around a taxpayer that raised and sold over 1,200 turtles. They were sold after being purchased from an interstate supplier and advertised on the internet; payments were then received in both cash and direct deposit. Gross sales were in excess of $100,000 over a three-year period and were not reported on income tax returns.

Although the taxpayer claimed that he was simply enjoying a pastime, the court concluded that he was conducting an online business and therefore the gross income was assessable income. The individual was required to pay the primary tax and additional penalties and costs.

The conviction of the turtle seller serves as a warning of what happens if taxpayers fail to correctly identify that they are carrying on a business.

Checklist for online selling

We have provided a checklist from the Tax Office below which should help you determine if your online selling constitutes a business or a hobby.

1) Did you set up your online sales with the intention of being a business? Does it have a significant commercial purpose or character?

   If you set up a "shop" on an online trading or auction site, you may be carrying on a business – this is more likely if you paid fees to operate this "shop". You are also more likely to be considered a business if it involves commercial sales of product rather than sales to relatives and friends.

2) Do you have more than just the intention to engage in business?

   If the online space you sell on looks like a shop, has a brand name, a proper business name and any other signs that people would likely consider to be a business, then you are most probably carrying on a business – again, this is more likely if you paid fees for this to occur.

3) Is your main intention to make a profit?

   If the answer is "yes", you may be carrying on a business. However, even if you do not make a profit, you may still be carrying on a business. If you deliberately buy items to sell online for more money than you paid, then you are likely to be carrying on a business. Conversely, if you sell household goods that you do not want anymore – although you may get a "good price" – it is unlikely to be a business.

4) Do you make repeated or regular sales?

   If you sell a number of items every week (or month) for an extended period of time, you may be carrying on a business. These sales could be to the same customer, or a number of different customers.

5) Do you sell your online items for more than cost price?

   If your answer is "yes", you are most likely carrying on a business. For instance, if you make or buy an item cheaply and then sell it online for significantly more than you paid for it, you have made a profit and may need to declare that income.

6) Do you manage your online selling as if it were a business?

   In the ATO's view, you are most likely carrying on an online business if any of the following applies:

   - your online selling activity is organised, methodical, and has systems and processes in place
   - your activity has characteristics of size, scale and permanency
   - you have invested sufficient capital in the activity
   - you advertise your online space
   - you give quotes and supply invoices, and keep some or all of your records
   - you have a business plan
   - you use specialised knowledge or skills
   - you have prior experience in the activity's area
   - you have conducted ample market research

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Seller beware: ATO targets eBay sales (cont)

- you spend a significant amount of time on the online activity
- the activity is your main income-earning activity rather than a part-time sideline project
- you sell your items in a similar manner to other businesses in your industry instead of in an ad hoc manner, and
- your activity is better described as a business, rather than a hobby, recreation or sporting activity. Common areas where people are likely to carry out a hobby rather than a business include hobby farming, motor car/bike racing, and hobby ceramics.

7) Is what you are selling online similar or the same as to what might be sold in a "bricks and mortar" business?

   If the items or services you are selling are reasonably easy to find in an offline store, then you are probably carrying on a business and these sales should be included as business income.

Note: Each time you answer "yes" to a question, the likelihood that you are carrying out a business increases. However, all the questions need to be considered together to get an accurate picture of your situation as no one indicator is decisive – consult this office to discuss your personal circumstances.

Why is it important if my online activity is a business?

The classification of whether a taxpayer is conducting a business is critical as there are a number of tax and reporting obligations that have to be fulfilled. Obligations that are imposed if you are conducting a business typically include:

- online sales income will have to be declared as assessable income; however, expenses incurred in earning this income will generally be deductible
- an Australian business number (ABN) may need to be applied for
- you may be required to register for goods and services tax (GST) in some cases
- accurate records of expenses and sales will need to be kept in line with legal requirements, and
- if the online activity results in a loss, you may be entitled to offset this loss against other income or carry it forward to offset against future income.

Important: *Your ability to apply current year tax losses from business activities against other income (such as salary and wages) are subject to the non-commercial loss rules under tax law – consult this office for details.*

Case studies

The case studies below further explain the distinction between carrying out a hobby or a business – first focusing on an individual that sells online but is not conducting a business, and then on an individual who sells online but is a business.

Selling online but not as a business

Camille wants to clear her wardrobe of excess clothing, and decides to list them as on sale on the internet. Some of the items sell for more than her buying price, others for less. She charges the buyers postage and receives a total of $2,065.

Conclusion: *Camille is not carrying on a business because she:*

- *did nothing to improve the value of the items*
- *does not sell any more items for a long time*
- *does not pay the online auction site for a "shop" space*
- *generally receives less than the original purchase price of the clothes, and*
- *has no intention to sell clothes online as a business.*

Selling online as a business

For two years, Jim from J's Carpentry has had a listing on Gumtree for selling his carpentry work.

Even as his business gets busier and he needs to employ someone, Jim still uses the same Gumtree listing because he is now established and has good ratings – he does not want to disadvantage his business. He continues to use this site to sell his work and services and makes over 1,000 sales per year at a total value of $100,000.

J's Carpentry also trades offline and reports an annual income of $458,000. He has an ABN and is registered for GST. Jim does not include the income from his online sales, but he does claim the GST credits.

Conclusion: *Jim is carrying on a business and is avoiding his tax obligations by:*

- *not reporting all his income, and*
- *claiming the GST credits for the online portion of his work.*

Jim should immediately amend the relevant income tax returns to include his online sales.

Consult this office for further information on how to determine if you are partaking in a hobby or online business. There are various tax implications which may ensue from miscategorising your online activities. ■

Hankering for a Harley? Think again, SMSFs

The ATO regularly warns self-managed superannuation funds (SMSFs) of the perils of investing in artwork, but do trustees know about the significant risks of motor vehicle investments?



Common questions SMSF trustees need answers to include:

- is a vehicle such as a Harley Davidson considered a motor vehicle under the government's new *Superannuation Industry (Supervision) Amendment Regulations 2011 (No.2)*?
- are you allowed to take your motor vehicle investment out for a ride to keep it in good health?, and
- can you keep it in your garage if you buy it as an SMSF investment?

Trustees will find that motor vehicles include, but are not limited to, motor cars and motorcycles such as the Harley Davidson. As for taking the motor vehicle out for a run to maintain its value and storing it in a personal garage, neither is permitted under new regulations.

Maintenance drive for a motor vehicle investment

The ATO states that: "The regulations do not allow for any use of the motor vehicle by a related party of the fund regardless of the purpose for that use. This means you cannot drive the vehicle for any reason, including taking it for a maintenance drive or to have restoration work undertaken." That aside, a person who is not a member of an SMSF or a related party is allowed to drive the motor vehicle for maintenance purposes.

Storage of motor vehicle investment

A motor vehicle cannot be stored or displayed in the "private residence" of any related party of the fund – including all above and below ground premises of a private dwelling due to it being considered a personal use asset under SMSF regulations. The definition of "private residence" was expanded under new regulations to include land on which the private residence is situated and all other buildings on that land, such as garages or sheds.

There is an exception to that rule. SMSF trustees are permitted to store personal use assets in premises owned by a related party, such as a purpose-built storage facility, provided the premises are not part of the private residence of the related party.

Buyers will have to have storage arranged before they add a motor vehicle to the fund however, and a written record of the decision related to the storage is mandatory and must be kept for 10 years. The written record could be documented in the minutes of a meeting of the trustees and can be either in hard copy or electronic format.

Regulations dictate that the asset cannot be displayed in any way if it is stored at a related party's business premises. Displaying a Harley Davidson in the foyer of a related party's office where it is visible to clients and employees is therefore strictly prohibited, similar to how a painting cannot be displayed in a company boardroom.

Who is a related party?

A related party of a fund is defined to include:

- members of the fund
- relatives and any partnerships of member, including other partners in a partnership. Relatives are further divided into:
  - a) parents
  - b) spouses
  - c) grandparents
  - d) siblings
  - e) uncles and aunts
  - f) nephews and nieces
  - g) lineal descendants
  - h) adopted children of a fund member or a fund member's spouse
  - i) spouse of any individual (other than a member).

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Hankering for a Harley? Think again, SMSFs (cont)

Such exhaustive definitions ensure any personal use of a collectable investment is strictly prohibited.

Additional features of the new regulations

Below is a list of the other important requirements SMSF motor vehicle investors should take heed of:

- Leeway period. If a fund owned a motor vehicle acquired before the new regime came into effect on July 1, 2011, the trustees have until July 1, 2016 to comply with the new rules.
- Ensure your asset is professionally valued. This is important if a fund wishes to sell an asset, including to a related party, which it can do. The transfer of ownership of collectables and personal use assets to a related party of an SMSF must be done at a market price determined by a qualified independent valuer – usually a member of a relevant professional body or trade association.
- Immediate insurance of DIY fund collectables. While a fund is permitted to lease a collectable such as a Harley to a showroom, so long as there is no member or related party link and the lease is on arm's length terms, the Harley is still required to be insured in the name of the SMSF fund. An SMSF fund is unable to rely on the insurance policy held by a showroom. The new regulations state that a trustee must ensure that the Harley is insured within seven days of the date of purchase by the fund. If an unexpected problem occurs, trustees either need to sell out of the investment or they will commit an offence that leaves them personally liable to a $2,200 fine. Artwork that is not insured may also end in the ATO declaring the fund to be non-compliant.

Consult this office to ensure your SMSF stays compliant with the plethora of rules and regulations that pertain to motor vehicles as well as artwork investments. ■

Can your business dig a deduction out of expenditure's "blackhole"?

If you haven't heard of "blackhole" expenditure before, it is a term used to describe some legitimate capital business expenditure that, by accident, design or otherwise, falls outside of the ambit of other provisions of Australia's tax legislation. It broadly refers to certain outgoings that are neither depreciable nor deductible in general terms, and that are not included in the cost base of a CGT asset.

In other words, it is expenditure that is not covered by any other income tax laws. The present rules apply to expenditure incurred from July 1, 2005.

Business taxpayers are allowed by law to deduct particular business capital expenditure, in equal proportions over five years, where:

- the expenditure is not otherwise taken into account in some way elsewhere in the income tax provisions, such as a deduction, an addition to the cost base of a depreciating or CGT asset or in relation to a CGT event
- a deduction is not specifically denied by some other provision of the tax law, and
- the business is, was, or is proposed to be carried on for a taxable purpose.

The five year period must start in the year that the expenditure is incurred, and the deduction must be taken over five consecutive years at 20% a year.

This deduction for blackhole expenditure may be available to a taxpayer that used to run a business, a taxpayer that is setting up a prospective business, or a business that is currently operating, provided the expenditure is capital in nature.

If the expenditure is for a proposed business, there must be a serious plan for the business to be initiated within a reasonable time — that is, not be merely a "pie-in-the-sky" dream – in order to qualify for a deduction. There is even provision for a taxpayer themselves to seek a claim for a proposed enterprise, even if a business structure has yet to be initiated.

However even blackhole provisions have exceptions. The types of business capital expenditure that cannot form part of a blackhole deduction include if the expenditure:

- forms part of the cost of land
- is in relation to a lease or other legal or equitable right
- is expenditure of a private or domestic nature

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Employee motor vehicles, FBT-free? Yes please!

Providing certain benefits to staff instead of cash as part of their remuneration is fairly common practice. The usual outcome for employers is an exposure to the joys of fringe benefits tax — at the FBT rate of 46.5%. There is also the added bother of keeping appropriate records, accounting for the benefits provided, and lodging an FBT return every year.



There exists however, in the maze of the ATO's legal database, a legitimate way to provide remuneration to employees in a form other than cash while not being required to account for these benefits via the fringe benefits tax regime.

Positives for employers include:

- no need to lodge an annual FBT return (a notice of non-lodgement may be required)
- the portion of remuneration represented by the benefit will be taxed at the employer's rate of tax instead of 46.5%, and
- mitigating the risk of an FBT tax audit exposure.

This may be particularly attractive to people with a business that is a company or trust where they are an employee of that company or trust, or to closely held groups where a closely held company or trust employs related parties.

The secret to this tax and headache saving tactic is contained in a "miscellaneous taxation ruling" (ruling MT2050 — ask this office if you want to see this). The basic premise of the ruling is that a benefit provided to an employee, where the employee agrees to kick-in something towards the tax cost of the said benefit (known as the "recipient's contribution"), can be accounted for via journal entry in some situations — that is, the benefit can be dealt with in the business's books and income tax return, needing no separate FBT return. The employee does not need to physically pay an amount in order to provide the contribution under this ruling.

The ruling states that such journal entries are permitted in the employer accounts if the following conditions are met:

a) the employee has an obligation to make a contribution to the employer towards a fringe benefit

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Can your business dig a deduction out of expenditure's "blackhole"? (cont)

- is incurred in relation to gaining or producing exempt income or non-assessable non-exempt income
- is incurred by way of returning an amount the taxpayer has received, and
- is for another entity, a return on an equity interest, or debt interest that is an obligation of the taxpayer.

Note that the non-commercial loss provisions for an individual may apply where a blackhole deduction results in a business loss for an individual taxpayer. This will effectively quarantine the business loss to be carried forward and offset against future business profits.

You may also qualify for blackhole deductions if you are a shareholder in a company, a partner in a partnership, or a beneficiary of a trust that carried on a business, and you personally incur the capital expense to wind-up the entity.

A blackhole expenditure deduction may be made available so that taxpayers obtain some tax relief for business-related capital expenditure where no other relief is available under the tax laws. But make sure that the expenditure in question is capital in nature before taking this path, and remember that there are limitations and exceptions.

Advice from a tax professional will most likely be very worthwhile. ■

Employee motor vehicles, FBT free? Yes please! (cont)

b) the employer has an obligation to make a payment to the employee (for instance a pre-existing loan account or some other obligation)

c) the employer and employee agree to set-off the employee's obligation to the employer against the employer's obligation to the employee.

The end result, tax-wise, is that the amount involved is counted as assessable income of the employer for income tax purposes (and may be subject to GST if the employer is registered), and so generally attracts income tax at the employer's rate of tax (which can be less than the 46.5% payable under the FBT rules).

The employer could use this ruling for example in regards to a motor vehicle acquired for their employee. The private use portion associated with it could be eliminated as the FBT provisions apply, with the employee contribution available to reduce the taxable benefit.

This would mean 100% of the expenses of the motor vehicle would be claimable to the employer using this method (rather than an apportionment based on a mix of private and business use). If the taxable value of the car is less than the total expenses of running it, the employee contribution added to assessable income may well be less than the deductible expenses incurred on the car.

It is important that the arrangement is set up correctly (we can help with this), and that the conditions mentioned above are satisfied. But once put in place, and assuming the arrangement suits your circumstances, both

- apportioning the deduction for costs incurred in respect of motor vehicles provided to employees, and
- lodging FBT returns,

could eventually become a dim memory.

The beaut ute

The fact that motor vehicles are hugely attractive as a fringe benefit places another opportunity at the feet of employers in the form of another miscellaneous taxation ruling (MT2024 this time).

This ruling basically states that a dual cab vehicle may be eligible for an exemption to FBT where private use is limited to certain work-related travel. It will more than likely be preferable to have a declaration prepared to cover the relevant facts, which we can help draft for you. It is a taxpayer's responsibility to ensure that any statements made in a declaration are true and correct.

Again, see this office for more information if this tactic seems to suit your business's circumstances. ■

Did you know...

Change to tax refunds

From July 1, 2013, your income tax refunds will be deposited into a bank account when we lodge your tax returns for you via the electronic lodgement service (ELS). Depending on the arrangement you have with us, refunds can be deposited straight into your account, or in some cases where we have a trust account, they can be directed into our trust account. As a result, you will no longer be able to use cheques for the purpose of receiving your tax refund. If you haven't already, you are required to supply us with details of your bank account and financial institution to ensure there are no untimely delays with your tax refunds.

Loss carry-back offset delayed

In the 2012-13 Federal Budget, the government announced its intention to provide tax relief for companies by allowing them to carry-back tax losses. In this way, businesses would be able to claim a refund against tax previously paid. The tax amendment was tabled in Parliament last February, but has not yet become law. The ATO has therefore advised that if a company is to lodge its 2013 income tax return (including if it uses early balancing substituted accounting periods), it should not claim the loss carry-back tax offset until the law has officially passed. Once the changes are enacted, we will be able to help with advice about how to claim the loss carry-back tax offset, if applicable.

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