



ACROSS THE BOARD

TAXATION AND ACCOUNTING SERVICES

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Tax incentive for angel investors in start-ups

For more than two years now (from 1 July 2016) two key tax incentives have been available for investors considering putting their money behind qualifying start-up businesses — or as the ATO has dubbed them, early stage innovation companies (ESICs).

About this newsletter

Please accept this latest newsletter with our compliments. We hope you and your colleagues will find the topics interesting and thought provoking. If you would like to discuss how your circumstances may be affected please contact the office on +61 2 9585 8722 or via email to svukici@tpg.com.au.

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The incentives provide eligible taxpayers who invest in new shares in an ESIC with:

- a non-refundable carry forward tax offset equal to 20% of the amount paid for their qualifying investments. This is capped at a maximum tax offset amount of \$200,000 for “sophisticated” investors and \$50,000 for non-sophisticated investors (more below) each income year
- modified CGT treatment. Under this incentive, capital gains on qualifying shares that are continuously held for between one and 10 years may be disregarded. However capital losses crystallised on shares held for less than 10 years are also disregarded.

Tax incentive for angel investors in start-ups cont

The maximum tax offset cap doesn't limit the shares that qualify for the modified CGT treatment.

If the investor is a trust or partnership, special rules apply so that the entitlement to the tax offset flows through to the member of the trust or partnership. And if the investor is a super fund, the trustee of the fund and not the fund members would be entitled to the tax incentives. Also note that shares acquired under an employee share scheme do not qualify.

Limits to the tax offset

Tax offsets directly reduce the amount of tax you have to pay, with each dollar of tax offset reducing your tax payable by the same amount. As the early stage investor tax offset is a "non-refundable" tax offset, it can reduce your amount of tax payable to zero, but it cannot result in a tax refund on its own.

If you don't use all of your early stage investor tax offset in one year, you can carry forward the remaining amount for use in future income years. However, the total amount of early stage investor tax offset that you, and your affiliates combined, can use or carry forward in an income year cannot exceed \$200,000.

Sophisticated investors

ASIC's rules provide that "sophisticated investors" who meet certain requirements don't have to be provided with documents such as a prospectus or product disclosure statement when being offered shares.

You may be a sophisticated investor if, for example:

- you hold a certificate issued by a qualified accountant that confirms you meet certain asset and income requirements and the certificate is provided no more than six months before the shares are offered to you. This certificate is available only if you have gross income of at least \$250,000 for each of the last two financial years or net assets of at least \$2.5 million
- you paid at least \$500,000 for the qualifying shares
- you are offered the qualifying shares through a financial services licensee who is satisfied that you have previous investment experience that allows you to assess the offer, and you sign a written acknowledgement that the licensee hasn't given you a disclosure document in relation to the offer
- you have or control gross assets of at least \$10 million (including any assets held by an associate or a trust that you manage).

A sophisticated investor whose investments qualify for the early stage investor tax incentives is not restricted

on the amount they can invest in an ESIC. Note however the cap on the tax offset mentioned above.

Limits for non-sophisticated investors

If you don't meet the requirements to be a sophisticated investor, there is a limit on the total amount that you can invest to access the tax incentives. This limit is \$50,000, and is intended to ensure that the tax incentives don't encourage retail investors to be over-exposed to the risk that is inherent in investing in start-ups.

Qualified ESIC requirements

To qualify for the tax incentives, investors must have bought new shares in a company that meets the requirements of an ESIC. And note that if a company later ceases to be an ESIC, this won't affect the investor's entitlement to the early stage investor tax incentives for the shares.

As far as the vehicle that is invested in, the requirements for a qualifying ESIC include that it is an Australian-incorporated company that satisfies both elements of a two-limb test — these being an "early stage" limb and an "innovation" limb.

Briefly, to satisfy being considered "early stage", a company must be registered on the Australian Business Register, have had total expenses of \$1 million or less and assessable income of \$200,000 or less in the previous income year, and have equity interests that are not listed on any stock exchange.

The "innovation" bone fides require that the company satisfies one of three test options. There is a principles-based test in which the company must demonstrate such things as high growth potential, the ability to scale up the business, a focus on commercialisation, demonstrable competitive advantage and other selective principles.

Another option, which can be a more suitable path for many businesses, is a test based on a list of objective criteria, each of which is assigned a certain number of points. The company must satisfy enough of the criteria to make up at least 100 points. The criteria include, but are not limited to, such things as having enforceable rights on an innovation, having a written agreement to co-develop and commercialise an innovation, and having a certain percentage of notional expense deductions for the R&D tax incentive.

The last option is to apply, and receive, a private ruling from the ATO that determines the company is indeed qualified as an early stage innovation company. ■



Guide to making motor vehicle expense claims

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A perennial topic regarding tax deductions is claiming expenses for a car. The following notes summarise the most salient points when it comes to claiming a deduction for motor vehicle expenses. Of course every person's circumstances may be different, but the following covers most of the relevant information.

Key points to keep in mind include:

- the way a claim is calculated depends on your business structure
- if business changes structure, your entitlements and obligations may also change
- you must apportion expenses between business and private use
- records need to be kept for five years.

The common types of motor vehicle expenses you can claim include:

- fuel and oil
- repairs and servicing
- interest on a motor vehicle loan

- lease payments
- insurance
- registration
- depreciation (decline in value) of the vehicle.

TYPES OF MOTOR VEHICLES

The type of motor vehicle you drive can affect how you calculate your claim. A motor vehicle is either a car or an "other vehicle".

1. Car

A car is a motor vehicle that is designed to carry:

- a load of less than one tonne, and
- fewer than nine passengers.

Most four-wheel drives and some utes are classed as cars.

2. Other vehicle

If your motor vehicle is not a car it's an "other vehicle". According to the ATO, other vehicles include:

- motorcycles
- minivans capable of carrying nine or more passengers
- utes or panel vans designed to carry loads of one tonne or more.

Note that expenses incurred in running a ute are not automatically tax deductible; you need to use the ute in your business and claim the business portion only.

continued overleaf ⇨

Guide to making motor vehicle expense claims *continued*

BUSINESS STRUCTURE

Your business structure can affect your entitlements and obligations when claiming deductions for motor vehicle expenses.

Sole traders and partnerships

If you operate your business as a sole trader or partnership (where at least one partner is an individual), the way to calculate your deduction depends on the type of vehicle and how it is used. The vehicle can be owned, leased, or hired under a hire purchase agreement.

You can only claim motor vehicle expenses that are part of the everyday running of your business (such as travelling to and from different business premises).

If the vehicle is used for both private and business purposes, it is expected that you will exclude any private use (such as driving your children to school).

Cars

For cars, you can use the cents per kilometre method or the logbook method.

1. Cents per kilometre method

You can claim a maximum of 5,000 business kilometres per car. The rate per kilometre (66 cents in 2017-18 and 68 cents in 2018-19) takes into account your car running expenses, including depreciation. You can't make a separate claim for depreciation of the car's value.

You don't need written evidence, but you must be able to show how you worked out your business kilometres (for example, calendar or diary records). For claims above 5,000 kilometres you must use the logbook method or actual costs to claim the entire amount.

2. Logbook method

You can claim the business-use percentage of each car expense, based on logbook records. You must record:

- when the logbook period begins and ends
- the car's odometer reading at the start and end of the logbook period
- details of each journey including
 - start date and finishing date
 - odometer readings at the start and end
 - kilometres travelled
 - reason for the journey.

You must keep the logbook for a period (at least 12 continuous weeks) that is representative of your travel throughout the year. You can then use this for five years.

Work out the percentage of business travel from your logbook and use this to claim your business-related car expenses. You can't claim capital costs such as the purchase price of the car but you can claim this as depreciation.

Other vehicles

For all other vehicles, you can't use the cents per kilometre or logbook method. Your claims must be for actual costs for expenses, based on receipts. You can use a diary or journal to separate private use from business use. Ask this office for more guidance.

Companies and trusts

If you operate your business as a company or trust, you can only claim the actual costs for motor vehicle expenses that are part of the everyday running of your business (such as travelling to and from different business premises, visiting clients or picking up goods for sale). Actual costs are based on receipts for expenses incurred.

Note that you cannot use a simplified method, such as cents per kilometre, to calculate your claim.

Make sure private use is separated from business use – by keeping a logbook or diary, recording the purpose of each trip and what portion was for business.

If your business is a private company that provides a vehicle to a shareholder or their associate to use in their capacity other than as an employee, this may be treated as a dividend or loan (known as Division 7A) that could affect the deductibility of your motor vehicle expenses. Ask us if this seems to fit your circumstances.

MOTOR VEHICLE OWNERSHIP

There are further considerations depending on the ownership of the vehicle.

1. Vehicle owned or leased by your business

Your business can claim a deduction for the running expenses of a vehicle that is owned or leased by your business.

If the vehicle is available for private use by an employee or their associate (such as a spouse), fringe benefits tax (FBT) may apply.

continued overleaf ➡

Guide to making motor vehicle expense claims *continued*

2. Vehicle owned by your employee

If your employee uses their own vehicle for business-related purposes and you pay them a motor vehicle allowance or reimburse them their costs, your business can claim a deduction for the allowance or expenses reimbursed, such as the cost of fuel.

Note that you can't claim depreciation if the vehicle is owned by your employee.

Your employee can claim a deduction for costs related to the business use of their vehicle in their own tax return, less any reimbursements or allowance they received from your business.

DEPRECIATION OF A MOTOR VEHICLE

If you work out your deduction for expenses using the logbook method or actual costs, then you can generally claim a deduction for capital costs, such as the purchase price of a motor vehicle, over a period of time. This is known as depreciation or a decline in value.

You can apply the:

- **simplified depreciation rules** – by adding the motor vehicle's cost to the small business pool or using the instant asset write-off (if eligible), or
- **general depreciation rules** – by claiming a deduction over the effective life of the asset.

You can only claim depreciation on the business portion of the motor vehicle's cost.

If the business vehicle is a car, there's a limit on the cost you can use to work out your depreciation claim. For the 2017-18 and 2018-19 income years, the limit is:

- \$57,581, or
- the cost of the vehicle if it's less than this amount.

If you use the cents per kilometre method, depreciation of the vehicle is already taken into account.

RECORDS YOU NEED TO KEEP

The records you need to keep depends on the method you use to calculate your motor vehicle expenses. Regardless of the method you use, you will need to keep:

- loan or lease documents
- details on how you calculated your claim
- tax invoices
- registration papers.

Please ask us if you require any guidance on any of the above matters. ■



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This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs.



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The ATO is looking for personal services income diverted to SMSFs

The ATO has announced that it is reviewing arrangements where members of an SMSF (typically at, or approaching, retirement age) purport to divert income earned from their personal services to their fund, which results in minimising or even avoiding tax altogether on that income.

The ATO says these arrangements typically display all or most of the following features:

- An individual performs services for a client or other “acquirer” of the personal services for which the individual does not directly receive any (or adequate) consideration for the services provided.
- The client does not pay or remit funds to the individual directly; rather the client remits the consideration for the services provided to a company, trust or other non-individual entity (which may be an unrelated third party).
- The entity then distributes the income to an SMSF, of which the individual is a member, purportedly as a return on an “investment” of the SMSF in the entity.
- The trustee of the SMSF treats the income received as subject to a concessional rate of tax, or as exempt current pension income of the SMSF.

The ATO also points out that such arrangements may also include one or more of the following characteristics or variations:

- The income may be remitted by the entity to the SMSF via a written or oral agreement between them, instead of as a return on an investment in the entity.
- The SMSF may receive the income from more than one entity or through a chain of entities. Alternatively, the entity may distribute the income to more than one SMSF of which the individual and/or associates are members.

WHAT ARE THE ATO'S CONCERNS?

The worry for the ATO is that in order to avoid paying tax at applicable personal marginal rates, individuals are entering into these arrangements in an attempt to divert “personal services income” (PSI) to an SMSF, where the

income is concessional tax or treated as exempt current pension income.

The ATO says that it considers that:

- The arrangement may be ineffective at alienating income such that it remains the assessable income of the individual.
- The income may be included in the individual's assessable income as personal services income.
- The amounts received by the SMSF may constitute non-arm's length income of the SMSF, such that the income is not eligible to be concessional tax and is not exempt current pension income.

Of course, the ATO considers that the general anti-avoidance rules may apply to cancel tax benefits obtained by the individual.

It says other compliance issues for arrangements of this type may include:

- the amounts received by the SMSF under the arrangement could instead be deemed to be a contribution to the fund, and subject to the contributions caps
- superannuation regulatory issues, in particular the SMSF is maintained for purposes other than those set out in the sole purpose test, leading to the SMSF being made non-complying or the disqualification of an individual as a trustee.

WHAT THE ATO IS DOING ABOUT IT

The ATO says it will be undertaking reviews of a number of cases involving arrangements of this type, and will be engaging with taxpayers whose affairs concern it in this regard where it becomes aware of this occurring. ■

For certain travel expense claims, the term “itinerant” needs clarity



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Being able to make claims for work-related travel expenses is generally an enviable deduction situation, and one that a good many taxpayers would like to achieve — especially given that the status of being deemed an “itinerant” worker brings with it an expectation of a lot of travel kilometres.

While itinerant work is generally held to be undertaken by certain trades or classifications of workers, such as those working in primary production or mining, “itinerancy” can equally apply to any individual worker subject to their employment satisfying certain characteristics and criteria.

Broadly, the definition of “itinerant” refers to shifting places of work. However, as the term is used by the ATO in determining eligibility to make claims for certain travel expenses, it is important to get it right.

The characteristics or indicators of itinerant work, as set out in the rules, are that:

- travel is a fundamental part of the employee’s work
- the existence of a “web” of work places in the employee’s regular employment, that is, the employee has no fixed place of work

- the employee continually travels from one work site to another. An employee must regularly work at more than one work site before returning to his or her usual place of residence
- other factors that may indicate itinerancy (to a lesser degree) include:
 - the employee has a degree of uncertainty of location in his or her employment (that is, no long term plan and no regular pattern exists)
 - the employee has to carry bulky equipment from home to different work sites
 - the employer provides an allowance in recognition of the employee’s need to travel continually between different work sites.

The ATO points out however that the above characteristics, while not exhaustive, do give some guideline for determining itinerancy. It says that no single factor however should be relied upon, and that individual circumstances and the nature of work duties can also be factors in any final determination.

The legislation does not define “itinerant”. Therefore the ATO approach in labelling employment as being itinerant in nature, and eligible for certain travel expense deductions, is not arrived at by a prescriptive approach, but rather through the use of illustrative case studies.

The following examples can be helpful in determining if the above characteristics or indicators have been met, and if therefore a taxpayer has a “reasonably arguable” position in regard to claiming certain travel expenses.

continued overleaf ⇨

For certain travel expense claims, the term “itinerant” needs clarity *continued***TRAVELLING IS A FUNDAMENTAL PART OF THE JOB**

Travel must be a central feature of the employee’s duties, and the very nature of the work means that it must be carried out in different locations.

⇒ Example

Jisa has supervisory responsibilities for a chain of retail outlets. Her duties require her to travel to several stores each day to assess each store’s performance and to attend head office weekly to file reports. She does not visit the stores in a regular pattern. Travel is a fundamental part of Jisa’s employment because the nature of the job itself makes travelling a necessary element of her duties. She is considered to be engaged in itinerant employment.

⇒ Example

Kayla is an agency nurse who travels to several hospitals to relieve staff shortages. She is employed by the hospital at which she performs the duties. Kayla remains at the one hospital until completion of her shift. Travel is not a fundamental part of Kayla’s employment, as she is not required to travel in the performance of her work once she commences duty. Kayla’s employment is not considered to be itinerant.

WEB OF WORK PLACES

If part of the employee’s work requires them to perform work at a single site and then move to other sites on a regular basis, it would be considered that a “web” of work places exists.

⇒ Example

Jimmy sells equipment and supplies for a pharmaceutical company. He is required to travel to many clients each day to obtain sales of his company’s products. He attends the employer’s office monthly to complete paperwork. Jimmy’s work requires him to travel to several workplaces (a “web” of work places). As he performs his duties at many different locations, his employment would be regarded as itinerant.

Care should be taken however, as performing work at different locations might not constitute a “web” of work places for the purpose of itinerancy as each work place might be regarded as a regular or fixed place of employment.

⇒ Example

Chris works for an accountancy firm and attends head office three days a week. He works the remaining two days at a suburban office. His work does not display a “web” of work places because:

- upon commencement he is not required to travel in the course of his duties
- Chris has two regular places of work.

CONTINUAL TRAVEL FROM ONE SITE TO ANOTHER

Continuously travelling from one workplace to another is a key factor in order to deem work as itinerant. However there needs to be a substantial link with the job to continuously travel for work.

⇒ Example

Tara works as a repairer for a manufacturer of office equipment. She is advised by mobile phone throughout the day of further clients to visit, and attends the employer’s office weekly to complete paperwork and re-stock spare parts. Her work involves continuous travel from one location to another and her work is itinerant.

Continual travel refers to the amount of times an employee changes work locations. It requires an employee to work at more than one work site in order to be deemed to travel continuously. If an employee stays at a particular work site for a short period spanning several days or few weeks they may still be regarded as engaged in itinerant employment provided their usual pattern of work involves continual travel to more than one work site before returning to their usual place of residence.

⇒ Example

Priya is a fruit picker. She does not have a regular circuit, but organises her next job before completing the work at the current farm. She normally works and lives at many properties before returning home, remaining at each farm for two to three weeks. Priya is engaged in itinerant employment because:

- her employment has a web of work places
- there is continual travel from one farm to another before returning to her normal place of residence.

continued overleaf ⇨

For certain travel expense claims, the term “itinerant” needs clarity *continued*

OTHER FACTORS

1. Uncertainty of location

One of the key elements for being classified as an itinerant worker is travelling to different workplaces, but the element of uncertainty of location is generally another distinct characteristic of itinerant employment. This only relates to uncertainty in terms of location and not the availability of employment.

⇒ Example

Paul is a shearer who has agreements with various property owners and therefore travels on a circuit to the same farms each year returning home only periodically. When he finishes work at a property, he travels directly to the next property on his circuit. Although there is no uncertainty in Paul's employment pattern, his work is considered itinerant. This is because:

- travel is a fundamental part of his work
- his work structure displays a “web” of workplaces
- he continually moves from one place of work to another before returning home.

2. Carry heavy equipment

A deduction may be allowable if the costs can be attributed to transporting bulky equipment, rather than merely travelling from one work site to another. If the equipment is transported to and from work by the employee as a matter of convenience or personal choice, it is considered that the transport costs are private and no deduction is allowable.

⇒ Example

Neal is a bricklayer who is employed at a building site for six months. He carries a cement mixer, a ladder, shovels, trowels and other equipment to and from the site each day. A secure storage area is not provided at the work site. Neal is deemed to be not engaged in itinerant employment. However, a deduction is allowable for the cost of travelling between home and work due to the carriage of bulky equipment.

⇒ Example

Violetta is employed as an electrician. She travels daily between several work sites, carrying a small tool box, and would not be allowed a deduction for the cost of transport between home and work on the basis that she is required to carry bulky equipment. However, she would qualify for a deduction on the basis that her employment is itinerant. The carriage of equipment may support the characterisation of Violetta's employment as itinerant because it arises from the practical necessity for her tools of trade to be readily available for use at each work site.

3. Provision of allowance

A payment of an allowance for travel by an employer does not of itself indicate whether the work performed is of an itinerant nature or not. Such “official” recognition from an employer may indicate that travel is a necessary element of work, however it is also the case that a particular employer may pay an allowance irrespective of whether the employee is required to use it in travelling. This factor would need to be considered with other characteristics of the employee's work, as mentioned above. ■