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IN THIS ISSUE

TEMPORARY FULL EXPENSING CHANGES

NEW ATO FOCUS – PRIVATE WEALTH

LOSS CARRY BACK FOR COMPANIES

TEMPORARY FULL EXPENSING CHANGES

On 2 December 2020, legislation was introduced to make certain changes to the Temporary Full Expensing (TFE) rules.

The original TFE rules came into effect on 6 October 2020 which allow eligible businesses to deduct the full cost of eligible depreciating assets first held, and first used or installed ready for use between 6 October 2020 – 30 June 2022.

The legislative changes make the following amendments:

- an alternative mechanism to test whether an entity satisfies the $5 billion turnover threshold; and
- the ability for entities to opt out of TFE on an asset-by-asset basis.

Alternative Test

An entity will satisfy the alternative $5 billion test if the following requirements are met:

1. the entity is a company;
2. the entity's total ordinary and statutory income other than non-assessable non-exempt income is less than $5 billion for either the 2019 or 2020 income years; and
3. the total cost of certain depreciating assets first held and used, or first installed ready for use in the 2017, 2018 and 2019 income years combined exceeds $100 million.

Under the alternative test, the TFE will not be allowed for intangible assets, assets previously held by associates and assets available for use by associates that are not Australian residents.

The alternative test was introduced to allow Australia-based businesses that are connected with large global groups to access the TFE measures.

Choice to Opt Out

The changes the TFE rules will allow entities to opt out of the TFE and the accelerated depreciation rules on an asset-by-asset basis. Once the choice is made, the normal depreciation rules under Division 40 of the ITAA 1997 will be applicable to the relevant asset.

The opt-out choice is a welcome change for taxpayers who were previously concerned about the adverse implications from applying TFE and accelerated depreciation and finding themselves in a tax loss position whereby they would be limited in making franked distributions.

If you have any queries about the TFE rules, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

NEW ATO FOCUS – PRIVATE WEALTH

The ATO's private wealth groups program is extensive and should not be ignored as just another ATO initiative. Having delivered on their Top 1,000 and Top 500 reviews, the ATO's broader private wealth groups review program targets:

1. Next 5,000 – group controlled wealth of > $50M.
2. Medium and Emerging (M&E) – controlled wealth of >$5M or Australian business turnover > $10M

These initial assurance reviews are anticipated to lead to a number of income tax and GST reviews, audits and disputes for private groups.

Focus Areas

The ATO's approach under the Next 5,000 & M&E programs will involve an initial Streamlined Assurance Review. Where a private group scores a low assurance rating, they will be referred to the next stage for a comprehensive Streamlined Assurance Review (income tax) and/or GST Assurance Review. Essentially, the ATO are taking a targeted, systematic approach to reviewing private wealth groups by assessing their risk (income tax and GST) under the four pillars of the "justified trust" methodology.

ATO Assurance Reviews – Four Pillars		
1.	**Effective Tax Governance & Risk Management**	
	➢ Documented tax risk management and governance guidelines; ➢ Internal & external use of advisors; ➢ Information Systems risk assessment.	➢ Periodic independent internal controls testing for GST ➢ Data controls in place for GST purposes ➢ Documented GST control frameworks
2.	**Significant & New Transactions**	
	➢ Restructures ➢ Group structure ➢ Tax Losses (including capital vs revenue) ➢ Financial acquisitions	➢ Acquisitions & disposals ➢ International issues ➢ Property transactions
3.	**Tax Risk Flagged to Market (ATO Rulings/Advice)**	
	➢ Tax consolidations ➢ Tax deductions & tax losses ➢ Dividend withholding	➢ Self-managed super funds ➢ Property contracts & recognition ➢ Loans and/or shareholder/associate payments

	➢ International transactions TP/TOFA	➢ Uncertain tax positions
4.	**Alignment of Accounting and Tax Results**	
	➢ Tax effect accounting ➢ Reconciliation of tax to financial information ➢ Elections or choices	➢ Tax return schedules & disclosures ➢ Differences in BAS and financial information

What actions are needed?

First and foremost, is to be prepared. The ATO is essentially conducting risk profiling on the private wealth group segment. Where a private wealth group is assessed at a low assurance level, these reviews can soon turn into lengthy and costly disputes and will impact the level of ATO scrutiny of the group going forward.

If you or your client are likely to fall within the Next 5,000 or M&E private wealth groups segment, there are practical actions that can be taken to prepare for these assurance reviews.

Proactive actions you can take to prepare include:

1. Conducting a gap analysis by assessing your governance framework and controls compared to ATO best practice guidelines to determine areas where you can improve.

2. Assessing any tax risks flagged to the market and documenting how these risks have been managed where they apply to your group.

3. Formally documenting your tax risk management and governance framework and/or tax processes with regard to the size and complexity of your group.

4. Ensuring that all contemporaneous documentation and advice has been retained and collated that supports the tax treatment of your significant or new transactions.

5. Reviewing all material tax and GST transactions and BAS adjustments to ensure they are explainable and supported by documentation.

Typically these reviews cover two financial years and/or 3 consecutive BAS periods. Where gaps or risk areas are identified, seek further advice to mitigate and manage these potential deficiencies.

For further details on the above, and how we can assist in preparing your private wealth group please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

Loss Carry Back for Companies

As part of the 2020-21 Federal Budget measures, the Government announced that a temporary loss carry back for companies would be introduced. The proposed measure has now become law.

The loss carry back is available in the 2020-21 and 2021-22 income years for tax losses incurred in the 2019-20, 2020-21 and 2021-22 income years. This is a choice and eligible entities must make the choice when they lodge their income tax returns.

To be eligible for the loss carry back, an entity must satisfy all of the following requirements:

1. the entity is a corporate tax entity during the relevant income years (e.g. from the income year the loss is carried back to the current income year);
2. the entity carries on a business and has an aggregated turnover of less than $5 billion; and
3. the entity has lodged the tax return for the current year and each of the five years immediately preceding it, except where the entity is not required to lodge a return for that particular year.

A corporate tax entity includes a company (private or public), a corporate limited partnership or a public trading trust. This means the loss carry back is not available to sole traders, partnerships and trusts.

The following losses cannot be carried back:

1. losses which have been transferred between companies in the same foreign banking group;
2. losses which have been transferred by a joining entity to the head company of a consolidated group; and
3. losses which arose as a result of excess franking offsets.

An entity's loss carry back tax offset is worked out using the following method statement:

1. Step 1: Work out the amount of the loss to be carried back
2. Step 2: Reduce the step 1 amount by net exempt income
3. Step 3: Convert the step 2 amount to a tax equivalent amount
4. Step 4: Work out the amount of the loss carry back tax offset component for an income year

The company's loss carry back tax offset component for the income year is so much of its income tax liability for the income year as does not exceed the Step 3 amount.
Further, the amount of the loss carry back tax offset is limited to the lower of the following amounts:

1. the entity's income tax liabilities for the 2018-19, 2019-20 and/or 2020-21 income years (calculated using the method statement); and
2. the entity's franking account balance at the end of the current year.

The following table illustrates the relevant years where the loss carry back provision operates:

Year Income Tax Paid	**Year Tax Losses Incurred**		
	2019-20	**2020-21**	**2021-22**
2018-19	Available	Available	Available
2019-20	-	Available	Available
2020-21	-	-	Available

Please note that the loss carry back for the 2019-20 income year can only be claimed in the 2020-21 income tax return. This is because the announcement was originally made in October 2020 where the 2019-20 income tax return form for companies had been issued and some eligible entities may have lodged their returns for that year.

The loss carry back provision can be used in conjunction with the temporary full expensing of assets. This is illustrated in the following example adapted from the Explanatory Memorandum:

> After the 2020-21 Federal Budget announcement, ABC Corporation decided to purchase plant & equipment for $500,000 to be used in its business on 1 December 2020. Under the temporary full expensing measure, ABC Corporation can claim the full cost of the plant & equipment in the 2020-21 income year. As a result, ABC Corporation makes a tax loss of $150,000 for the 2020-21 income year.
>
> ABC Corporation had taxable income of $2 million and an aggregated turnover of less than $50 million in the 2019-20 year. As such, the company's corporate tax rate for that income year was 27.50%. It paid income tax of $550,000 in that income year. The company had no net exempt income in that income year.
>
> The company's franking account balance at the end of the 2020-21 year was $1.3 million.
>
> ABC Corporation can choose to carry back the tax loss of $150,000 incurred in the 2020-21 income year to the 2019-20 income year. Based on the method statement, the loss carry back tax offset component is $39,000 (being $150,000 x 26%). As this amount is less than the company's income tax liability for the 2019-20 income year ($550,000) and its franking account balance for the current year ($1.3 million), the company's loss carry back tax offset component for the 2019-20 income year is $39,000.
>
> Therefore, when ABC Corporation lodges its income tax return for the 2020-21 income year, it will be entitled to a refundable loss carry back tax offset of $39,000.

If you have any queries about the loss carry back provision for companies, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.