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For a fraction of the potential professional cost, our Safe Tax service has been developed to control the costs associated with Tax and Workers Comp audits.

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## **Are you on the tax office hit list? How to identify if you're a Tax Office target and what to do about it..**

Another financial year is fast coming to a close and once again it is tax time. The word on the street is that the Tax Office has more auditors on the books at the moment than at anytime in the past decade. Further, with increasingly sophisticated methods of matching the information you declare to the Tax Office against your records practically everywhere else, we reveal who is on the hit list and why.

### **Small and medium sized enterprises and their executives**

The first rule, regardless of who is on the hit list, is to lodge your tax return on time (or at least enabling us to lodge it on time). Here are some areas to look at to make sure your business doesn't become an audit target:

#### ***Your income vs company income***

An emerging focus for the Tax Office is how income flows between a company, its executives, and any related entities. Generally, the Tax Office has not mapped this level of interaction before unless there has been a problem. Now, technology has advanced to explore these relationships. In other words, the Tax Office will be looking at the income you declare relative to that of your business and its related entities, and then making a call as to whether you should be further investigated. One key area is company loans to shareholders.

If your business has outstanding company loans to shareholders, be wary of Division 7A. If you have a debit loan account this can be deemed an unfranked dividend in the hands of the shareholder. A debit loan account arises when the company makes payments on behalf of a shareholder or advances funds to them. Where an unfranked dividend occurs, the dividend is declared as income on the shareholder's personal tax return and taxed at their marginal tax rate.

If your company has an outstanding debit loan, you need to decide how you will manage this. You may need to document the loan agreement. If you already have an existing loan agreement then make sure that you make the minimum loan repayments before 30 June. Also, the Tax Office amnesty that enabled taxpayers to correct past loan account errors ends on 30 June. If you have not tidied up this area, now is the time.

### ***GST integrity***

GST on property transactions is a continued focus. In particular:

- unreported property sales, particularly of new residential premises;
- valuations used under the margin scheme;
- incorrect reporting of adjustments arising from a change in the extent of creditable purpose; and,
- incorrect treatment of supplies to associates.

In addition, where GST refunds are high or above an industry standard, expect a call from the Tax Office. The Tax Office has tackled a number of GST frauds of late where falsified or overinflated invoices have been used to generate higher refunds.

### **The wealthy**

Over the last few years we have seen a number of high profile targets such as Glenn Wheatley, fall foul of the Tax Office. Off shore tax minimisation schemes are a primary target.

Key triggers that might make you a Tax Office target include:

- discrepancies between lifestyle and reported income;
- significant variations in tax payments;
- A history of aggressive tax planning by individuals or their adviser;
- unexplained losses; and
- offshore dealings.

Last year, the tax office undertook 22 audits of high wealth individuals, netting \$280 million in revenue. This year, they will almost double the number of audits and undertake 200 'risk reviews'.

### **Contractors and the self employed**

Contractors, even those working through a company structure, can fall foul of the alienation of personal services income (PSI) rules. The PSI rules are designed to ensure that contractors really are in business for themselves rather than being quasi-employees (and thus paying less tax than their salaried colleagues and receiving larger deductions). Under these rules, unless certain conditions are met, the Tax Office treats any income as income earned by you rather than income earned by the business. This means that your personal tax rates will apply to your business income and you will be denied access to a range of tax deductions normally available to business.

To qualify as a personal services business, you need to pass at least one of four tests. The first is the results test – to pass this test your contract needs to be able to demonstrate that you are contracted to produce a particular result, such as the completion of a project, you provide your own tools and equipment, and are responsible for correcting defects. If you fail this test and 80% or more of your income is from one client, there are another three tests that might apply.

Even if the rules didn't affect you in the past, this is an annual test. If your circumstances have changed, you need to make sure you are not caught.

## Landlords

Here is the Tax office's list of common mistakes made by landlords:

- Claiming deductions for rental properties not genuinely available for rent.
- incorrectly claiming deductions for properties only available for rent part of the year, for example a holiday home.
- incorrectly claiming the cost of structural improvements as repairs when they are capital works deductions, such as remodelling a bathroom or building a pergola; and
- overstating deduction claims for the interest on loans taken out to purchase, renovate or maintain a rental property. A loan can be taken for both income-producing and private purposes, like to buy a car or go on an overseas holiday. The interest on the private portion of the loan is not tax deductible.

There are two categories of rental property expenses you can claim:

- expenses for the year you paid them, like council rates, repairs, insurance and loan interest; and
- expenses that are deductible over a number of years, like borrowing costs, creating structural improvements and costs of depreciating assets.

Renovation costs and costs to repair damage, defects or deterioration existing on purchase cannot be claimed as an immediate deduction. These costs are capital expenditure, depending upon what is repaired or improved, and must be claimed as either decline in value deductions over the asset's effective life, or as capital works deductions over 40 years.

**If you need help with your 2008 affairs, call us before 30 June has passed.**

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