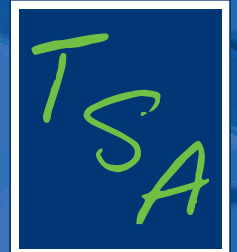
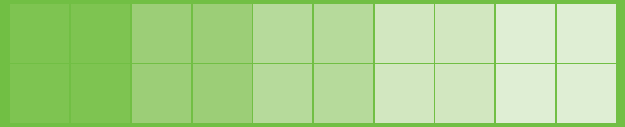


A SIMPLIFIED SUMMARY OF THE AUSTRALIAN TAXATION SYSTEM



TAX SMART
AUSTRALIA
MANUAL
5th Edition

Incorporating
TaxIQ



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ANNUAL TAXATION SUMMARY 2011



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Chapter 1

THE AUSTRALIAN TAX SYSTEM



Chapter 1

THE AUSTRALIAN TAX SYSTEM

HISTORY

Throughout Australia's post-Federation period, income tax collections have been affected by the major World Wars and have certainly played a role in the thorny issue of Commonwealth/State relations.

Prior to Federation in 1901, income tax was first imposed by the States starting with South Australia in 1884, closely followed by Victoria and NSW in 1895.

The Federal Government introduced an income tax in 1916 largely to fund Australia's involvement in the First World War, but it was still the States that collected income taxes, both for themselves and on behalf of the Federal Government. In 1932, at the time of the Great Depression, the Lyons Federal Government briefly took over collection of income tax from the Lang Labor NSW Government. This constitutional crisis was soon resolved however, and the states retained responsibility for tax collection when a new consolidated act (the *Income Tax Assessment Act 1936*) was passed in 1936.

However, in 1942, at the height of World War II, the Commonwealth took over all income tax collection. This

position remains unchanged to the present day. The States received annual grants from the Commonwealth to fund their revenue needs until 1 July 2000, when the Goods and Services Tax (GST) was introduced with proceeds going directly to the States, replacing the grants system.

Over the years there were many changes and insertions into ITAA 1936, rendering the act incomprehensible even to many professionals.

In the mid 1990's the Government decided to "simplify" matters by re-writing the complete act. This process commenced in 1997 with the introduction of the *Income Tax Assessment Act 1997* (ITAA 1997).

Eventually ITAA 1997 will supersede the prior 1936 Act. In 1998 the Howard Government began a comprehensive programme of tax reform and suspended further activity on updating the 1997 Act. This will further delay completion of the 1997 Act. Until ITAA 1936 is completely re-written, tax professionals need to be familiar with both Acts. Following the 2020 Summit, the Rudd Government introduced a "roots and branches" review of the taxation system. The Henry Report which resulted was released by the Labor Government on 2nd May, 2010.

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THE AUSTRALIAN TAX SYSTEM

Over the years numerous taxpayers have argued, some at High Court level, that collection of taxes is unconstitutional. These attempts have proved fruitless with Courts finding that the Commonwealth Government has full power to impose taxes provided it does not discriminate between the States and does not impose taxes on property belonging to a State.

LODGEMENT AND PAYMENT OF TAX

The Australian tax year starts on 1 July and ends on 30 June each year.

Income taxes are determined from taxable income disclosed in income tax returns which are required to be prepared and lodged each year by individuals, trusts, partnerships, companies and other entities.

Each year required lodgement dates are gazetted; however, if a taxpayer is using a tax agent, extra time is normally granted in accordance with the tax agents' lodgement programme. Tax returns are lodged and assessed on an annual basis.

Individual taxpayers usually pay their taxes throughout the year under the Pay As You Go (PAYG) System which involves deductions from salaries and wages or quarterly instalment tax payments.

Most individual business taxpayers are required to meet their tax obligations quarterly.

Income tax rates were reduced when the Goods and Services Tax (GST) was introduced on 1 July 2000, and some taxes such as sales tax were abolished. However, some State taxes such as payroll tax still exist despite the Federal Government's intention that they be abolished. The GST has turned into a cash windfall for the States.

Further obligations some taxpayers have are Business Activity Statements (BAS) and Instalment Activity Statements (IAS).

Partnerships and Trusts do not normally pay tax. The income flows down to individual partners or beneficiaries who are assessed on the amounts distributed to them.

In order to prevent double taxation of dividends, companies can frank their dividends (to reflect company tax paid) and these franking credits are refundable to taxpayers if the amount of tax paid is less than the amount of the franking credit.

Franked dividends paid to discretionary trusts flow through to nominated beneficiaries who are able to claim the franking credits.

Taxable income is calculated by adding all assessable income, then deducting all allowable deductions from the total. To determine the actual tax payable from the table below, multiply the taxable income by the marginal tax rate and deduct any tax offsets and credits.

2009/10 INCOME TAX RATES FOR RESIDENT INDIVIDUALS

Taxable Income	Tax Payable
\$0 – \$6000	Nil
\$6001 – \$35,000	15% of excess over \$6000
\$35,001 – \$80,000	\$4350 + 30% of excess over \$35,000
\$80,001 – \$180,000	\$17,850 + 38% of excess over \$80,000
\$180,001 +	\$55,850 + 45% of excess over \$180,000

2010/11 INCOME TAX RATES FOR RESIDENT INDIVIDUALS

Taxable Income	Tax Payable
0 – \$6000	Nil
\$6001 – \$37,000	Nil + 15% of excess over \$6000
\$37,001 – \$80,000	\$4650 + 30% of excess over \$37,000
\$80,001 – \$180,000	\$17,550 + 37% of excess over \$80,000
\$180,001 +	\$54,550 + 45% of excess over \$180,000

MEDICARE LEVY

In addition to income tax, a Medicare levy of 1.5 per cent is charged on a resident taxpayer's taxable income.

Note that some taxpayers are exempt from the Medicare levy because of their foreign status, or the type of health care which is provided to them.

Low-income earners are exempt, so that in 2009/10, if taxable income is \$18,488 or less, no Medicare levy is payable. There is a shading in arrangement over this level.

A higher threshold of \$31,196 is available if you were married or would have been entitled to certain sole parent or carer rebates that existed prior to 30 June 2000. The threshold amount also increases by \$2,865 for each dependent child or student. A shading in arrangement also applies. The thresholds for the year ending 30 June 2011 will be announced in next May's Federal Budget.

MEDICARE LEVY SURCHARGE

The Medicare Levy Surcharge is levied on payers of Australian tax who do not have private hospital cover and who earn above a certain income. The surcharge aims to encourage individuals to take out private hospital cover, and where possible, to use the private system to reduce the demand on the public Medicare system.

The surcharge covers you and your dependents. Providing

Chapter 1

THE AUSTRALIAN TAX SYSTEM

you contribute to their maintenance (including child support payments), your dependents are your spouse, any of your children who are under 16 years of age, or any of your student children who are under 25 years of age.

The surcharge is calculated at the rate of 1% of taxable income. It is in addition to the Medicare Levy of 1.5%, which is paid by most Australian taxpayers.

You have to pay the surcharge if you are:

- A single person with an annual taxable income greater than \$77,000 in the 2010-11 financial year (previously \$73,000 in 2009-10); or
- A family or couple with a combined taxable income greater than \$154,000 in the 2010-11 financial year (previously \$146,000 in 2009-10). The family income threshold increases by \$1,500 for each dependent child after the first;
- And do not have an approved hospital cover with a registered health fund.

You must also pay the surcharge if you are a prescribed person with a taxable income over the threshold, and have any dependents who are not prescribed persons and who are not covered by an approved health cover policy as described above.

TAXATION RULINGS

A system of public and private rulings was introduced on 1 July 1992. A public ruling or determination essentially sets out the ATO's interpretation of the legislation applied to certain situations. Public Rulings may be relied upon as they are binding on the ATO. If a taxpayer takes a matter to court, it is possible for an unfavourable ruling to be overruled. If a taxpayer requires guidance before making a claim or entering a transaction, a private ruling may be applied for. Once issued, private rulings are binding on the ATO for that particular taxpayer only. Individuals are able to apply for binding oral rulings for simple tax matters. The application must be made orally and generally by the person concerned.

FAMILY ASSISTANCE

Three forms of family assistance are available to taxpayers. These are:

- Family Tax Benefit Part A
- Family Tax Benefit Part B
- Child Care Benefit

The Family Assistance Office administers these benefits and most claimants receive these benefits as direct fortnightly payments or as reduced child care fees. Alternatively, eligible persons can apply for reduced PAYG amounts to be withheld from wages or they may claim the benefit when lodging their tax return.

To be eligible, an income test must be passed which takes into account family income determined as the sum of the following:

- Taxable Income

- Reportable Fringe Benefits - less FBT paid by the employer
- Centrelink or Veterans' Affairs Pensions and Benefits
- Income from overseas not taxable in Australia
- The value of net rental property losses.

The annual amount of any child support/child maintenance paid by the taxpayer or their partner is deducted from this total.

In the 2008 Federal Budget, the Government announced the following changes to the FTB scheme:

- From 1 July 2008, an income test was introduced so that FTB Part B will only be available to families where the annual adjusted taxable income of the principle earner does not exceed \$150,000; and
- From 1 July 2009, the FTB will only be delivered through Centrelink and Medicare, thereby removing claims through the tax system.

In the 2009 Budget it was announced the upper threshold limits would not be indexed from 1 July 2009, for a period of three years. This means less families will be eligible for the benefit.

NON-RESIDENT INDIVIDUALS

Non-residents are usually only required to pay Australian tax on income derived in Australia. They are not taxed on fully franked dividends and a withholding tax system applies to these.

As non-residents are not eligible for the tax-free threshold, it is necessary for them to lodge an Australian tax return.

2010/11 INCOME TAX RATES FOR NON-RESIDENT INDIVIDUALS

Tax thresholds – Income range \$	Tax Payable
\$0 - \$37,000	29%
\$37,001 - \$80,000	\$10730 + 30% of excess over \$37,000
\$80,001 - \$180,000	\$23,630 + 37% of excess over \$80,000
\$180,001 +	\$60630 + 45% of excess over \$180,000

2009/10 INCOME TAX RATES FOR NON-RESIDENT INDIVIDUALS

Tax thresholds – Income range \$	Tax Payable
\$0 - \$35,000	29%
\$35,001 - \$80,000	\$10,150 + 30% of excess over \$35,000
\$80,001 - \$180,000	\$23,650 + 38% of excess over \$80,000
\$180,001 +	\$61,650 + 45% of excess over \$180,000

Chapter 1

THE AUSTRALIAN TAX SYSTEM

OTHER TRUSTS

In situations where the trustee chooses not to allocate income to a beneficiary, the income is accumulated. In such instances the tax is assessed at the highest marginal tax rate (45%) plus Medicare.

AUSTRALIAN BUSINESS NUMBER

The Australian Business Number (ABN) is a single identifier for all business dealings with the ATO and for dealings with other government departments and agencies.

An ABN is required if:

- You carry on a business
- You establish a self managed superannuation fund
- You request endorsement of an income exempt charity or as a deductible gift recipient.

If a supplier does not have an ABN and if you are making a total payment of more than \$75 (excluding GST) you will have to withhold 46.5 per cent of that payment and remit that amount to the ATO. If the supplier has an ABN, make sure that they quote it on their invoice to you.

If you are a Family Trust, you must show both the ACN (Australian Company Number) of the Corporate Trustee and the ABN of the Trust on your tax invoices. If you are a company, you must display your ABN on all tax invoices. The ABN can be used instead of the ACN on other public documents, provided the ACN represents part of your ABN.

TAX FILE NUMBERS

Whether individual or entity, all taxpayers must have a Tax File Number (TFN). As the ATO uses the TFN to identify you, it must be used on all documents lodged with the ATO including taxation returns.

Chapter 2

ACCOUNTING METHODS AND INCOME TAX



Chapter 2

ACCOUNTING METHODS AND INCOME TAX

TIMING OF INCOME AND DEDUCTIONS

The financial year for Australian taxpayers is for the twelve month period ending on 30 June of each year.

Substituted accounting periods are available, but will need to be approved by the Tax Office. However, approval is only granted in exceptional circumstances.

METHODS OF TAX ACCOUNTING

Depending upon the taxpayers circumstances there are three main tax accounting methods that can be used to determine the taxable income of a taxpayer. These methods are:

- The cash or receipts basis of accounting;
- The accruals or earnings basis of accounting; or
- Small Business Entity (SBE), formerly the Simplified Tax System (STS).

Whichever of the first two alternatives is chosen they must be strictly adhered to.

There may be circumstances where monies are received for

goods or services that are not to be rendered until a future time. Under the matching principle these monies would not be income to the taxpayer and would therefore not be subject to tax until the goods or services are actually provided or performed. However, expenses associated with the derivation of this income would need to be reviewed in order to ensure they are taken up in the correct period. An example of this would be annual magazine subscriptions paid in advance to a business.

In addition there are situations where monies not yet received for goods or services already provided or performed may or may not be assessable. This depends upon the tax accounting method used by the taxpayer.

There are specific provisions and rulings relating to the valuing of work in progress (WIP). These provisions differ depending on the tax accounting method used. Work in progress held at the end of the financial year is required to be brought to account by manufacturers. However, this is not generally the case for service providers or professional partnerships. Therefore there is an opportunity for service providers and professional partnerships to defer income tax by not billing for uncompleted work at year end.

Chapter 2

ACCOUNTING METHODS AND INCOME TAX

Guidelines as to which particular method may be relevant to a taxpayer are set out in Taxation Ruling TR 98/1.

In particular the following factors are deemed to be relevant:

- The size of the business - the cash basis may be more appropriate for a small business taxpayer whereas the accruals basis may be more appropriate for a medium to large business taxpayer, or where a trading or manufacturing business is evident.
- The type of the business - generally small businesses will opt for the cash basis whereas larger businesses where a trading or manufacturing activity is evident will opt for the accruals basis.
- Capital items - businesses with heavy reliance on the use of plant and equipment may determine that the accruals basis is more appropriate for their needs.
- Policy for recovery of outstanding debts - the accruals basis may be more appropriate where there are formal procedures for the extending of credit and debt collection.
- Method of accounting - the type of accounting records maintained may indicate which basis of accounting for tax purposes is to be used.
- Trading stock - where a trading or manufacturing business is evident the accruals basis of accounting may be appropriate.

It is necessary to have an understanding of the taxpayer's business and to relate this to the alternative available accounting methods. The relative importance of any individual factor is dependent upon the specific circumstances of a business. It is generally accepted that the smaller the business the more likely it is that the cash basis should be used, whereas the accruals basis is appropriate where a trading or manufacturing business is conducted. There are certain requirements that may assist in determining the accounting method to be used in the situation of the medium to larger businesses.

CASH OR RECEIPTS BASIS

This method requires that income is brought to account only when it is physically received. This receipt includes the situation where income is reinvested, accumulated or capitalised. However, expenses are deductible when they are incurred and not necessarily paid, provided that no further claim is made when they are actually paid. This use of this basis of income is usually attributable to individuals, including professionals, but excluding larger professional partnerships. In this instance, income such as wages, rent, dividends or interest is generally calculated on a receipts basis. However, it should be noted that in rents paid or received by a managing agent in June are still assessable to the taxpayer in that year notwithstanding that they may not have been received prior to the end of June. An exception to this is income from public unit trusts or discretionary trusts that are assessable on a

declared basis.

ACCRUALS OR EARNINGS BASIS

The accruals basis entails accounting for income as it is earned. Medium to large businesses are generally required to use this basis of accounting.

In effect, income is treated as earned when the entity has the right to receive it. This is when goods are delivered or jobs are completed and the relevant invoices mailed. Notwithstanding the income may not have been received, the conditions pertinent to the right to receive it have occurred. In effect, tax will be payable on the debts of the business.

The situation may arise where a debt has been taxed, but is subsequently deemed to be irrecoverable. In this case a deduction for it should be made in the period in which it is considered to be irrecoverable.

Under both the receipts and earnings basis, expenditure is claimable when incurred and therefore deductions are available on creditors at year end.

In summary, small businesses generally find that the cash basis of accounting is the most appropriate. However, there may be a time when as the business grows and increases its turnover, employs more staff, and invests in more capital assets that a change to the accruals basis is required.

Where the change of accounting method takes place at the end of a financial year, a tax benefit may be obtained in respect of income that has been accrued at the date (*Henderson v FCT 70 - ATC 4016*). This will not apply where the business has decided to be a Small Business Entity (SBE).

Chapter 3

ASSESSABLE INCOME



Chapter 3

ASSESSABLE INCOME

Tax is levied on the taxable income of the taxpayer derived during the income year. Assessable income minus allowable deductions equals taxable income.

Assessable income as defined in ITAA 1997 consists of ordinary income and statutory income.

If specially excluded or made exempt, certain types of ordinary and statutory income will not be subject to tax.

DEFINITIONS

Ordinary Income is defined to mean income according to ordinary concepts. However, no specific guidance on what is meant by income according to ordinary concepts is contained in the legislation.

It is the courts that have identified a number of factors to provide guidance as to whether an amount has the character of income according to normal concepts.

These include: recurrence and regularity, provision of a service or work, also the carrying on of a business or profit-making undertaking or scheme.

Statutory Income applies if the amount is not ordinary

income and is included by a specific provision of the Tax Act.

Examples include royalties, some capital gains, lump sum retirement payments, dividend imputation credits and allowances.

Exempt Income is any ordinary or statutory income which the Tax Act specifically exempts from taxation.

CAPITAL -V- REVENUE

The distinction between capital and revenue is a principle established in the Tax Act and extensively dealt with by numerous court findings. It applies to both receipts and payments.

Prior to 1985, income receipts were assessable to tax and payments were deductible if they were connected with the earnings of income; however, capital receipts were not. If no such connection existed, usually such payments were only then based on capital account and were non-deductible.

The capital gains tax regime ensured that from 20 September 1985, that many formerly non-assessable capital receipts would be subject to some form of tax.

Chapter 3

ASSESSABLE INCOME

Generally, taxpayers prefer receipts to be on capital account and payments to be on revenue (income) account. This is because:

- Prior to calculation of tax, capital gains may be subject to various discounts and exemptions
- Outgoings are deductible if they relate to the earning of income
- Outgoings related to capital assets are usually not deductible, but may be added to the cost base of the asset. There is also provision for some building capital allowances
- Capital losses can be carried forward to be offset against future capital gains and cannot be claimed against income on revenue account.

BUSINESS INCOME

Assessable income includes all proceeds from transactions carried out in the ordinary course of business. Where a business enters isolated transactions outside normal activities, if there is a profit making undertaking or scheme, then these receipts are also assessable.

DIRECT COMPENSATION FOR SERVICES

All remuneration for personal services, whether in the capacity of an employee or in connection with employment or personal services is assessable income. Exceptions to this include living away from home allowances and fringe benefits. Voluntary payments or gifts received, resulting from services provided, are also assessable income.

NON-CASH BUSINESS BENEFITS

These are widely defined as benefits received as property or services. Services include any right, privilege or benefit, and may be provided either partly or wholly, or directly or indirectly in a business relationship. If the annual total received is less than \$300 then such payments are exempt from tax, but should the annual benefit exceed \$300 then the total amount will be assessable.

EMPLOYMENT TERMINATION PAYMENTS (ETPs)

From 1 July 2007, the tax treatment of employment termination payments has been rewritten into the Tax Act. Between 1 July 1983 and 30 June 2007, these payments were referred to as "eligible termination payments". From 1 July 2007, it is no longer possible to roll-over an ETP to superannuation.

The tax treatment of an ETP will depend on whether it is a life benefit ETP or death benefit ETP.

From 1 July 2007, a life benefit ETP is only taxed on two components: the tax-free component and the taxable component. The tax-free component comprises the 'pre-July 1983 segment', the 'concessional segment', the 'undeducted contributions segment', the 'post-June 1994 invalidity segment' and the 'CGT-exempt segment

Age of Recipient	Life Benefit ETP	
	Tax-free Component	Taxable Component
55+	Tax-free	15%: \$0 - \$160,000* 45%: \$160,001+
0-54	Tax-free	30%: \$0 - \$160,000 45%: \$160,001+

*Note the ETP cap amount is \$160,000 in 2010/11 (\$150,000 in 2009/10).

Transitional arrangements apply where a person was entitled, as at 9 May 2006, to a payment on termination of employment under a written contract, legal instrument or workplace agreement, provided the payment is made before 1 July 2012.

The tax treatment, which applies to these transitional payments, is:

*The ETP cap amount of \$160,000 is indexed annually, but

Age of Recipient	Life Benefit ETP	
	Tax-free Component	Taxable Component
55+	Tax-free	15%: \$0 - \$160,000* 30%: \$160,001 - \$1,000,000 45%: \$1,000,001+
0-54	Tax-free	30%: \$0 - \$1,000,000 45%: \$1,000,001+

only in \$5000 increments.

The tax treatment of a death benefit ETP (i.e. the payment is made from the deceased's employer, rather than via a superannuation fund) will depend on whether the payment is made to a dependant or non-dependant.

*The ETP cap amount of \$160,000 is indexed annually, but

Recipient	Death Benefit ETP	
	Tax-free Component	Taxable Component
Dependant	Tax-free	0%: \$0 - \$160,000* 45%: \$160,001+
Non-Dependant	Tax-free	30%: \$0 - \$160,000 45%: \$160,001+

only in \$5000 increments. It is not counted towards the life benefit of ETP cap.

The new indexed amount is generally available each February.

Chapter 3

ASSESSABLE INCOME

SUPERANNUATION LUMP SUMS

From 1 July 2007, superannuation lump sums paid from a taxed source to those aged 60 and over are tax-free (i.e. non-assessable non-exempt income).

Tax is still payable on superannuation lump sums paid to someone aged less than 60. The superannuation lump sum is split into the tax-free component and taxable component. The tax-free component comprises the 'crystallised segment' and the 'contributions segment'. The taxable component is determined by subtracting the tax-free component from the total value of the superannuation interest. The taxable component may consist of an element taxed in the fund or an element untaxed in the fund (e.g. paid from an untaxed fund).

Age of Recipient	Superannuation Lump Sum		
	Tax-free Component	Taxable Component	
		Element taxed in fund	Element untaxed in
60+	Tax-free	Tax-free	15%: \$0 - \$1,000,000 ³ 45%: \$1,000,001+
55 - 59	Tax-free	0%: \$0 - \$160,000 ² 15%: \$160,001+	15%: \$0 - \$160,000 ² 30%: \$160,001 - \$1,155,000 ³ 45%: \$1,155,001+
0 - 54	Tax-free	20% of entire taxable component	30%: \$0 - \$1,155,000 ³ 45%: \$1,155,001+

1. Medicare levy of 1.5% is also payable.
2. The low rate cap amount of \$160,000 is indexed annually, but only in \$5000 increments.
3. The untaxed plan cap amount of \$1m is indexed annually, but only in \$5000 increments.

End benefits tax may still apply for certain untaxed superannuation funds (e.g. some public sector schemes) in respect of an element untaxed in a fund (i.e. no contributions or earnings tax has been paid on this element).

FREQUENT FLYER AND CLUB BENEFITS

The ATO accepts as a result of Payne's case that flight rewards received by employees from an employer paid expenditure are not assessable income.

Any customer loyalty programme benefits earned as a result of private expenditure are not assessable.

The ATO has indicated that it will closely scrutinise situations where the number of points accumulated in a year exceed 250,000 and arise from a business relationship or business expenditure, whereby the arrangement has no commercial purpose other than to allow the recipient to receive reward points.

In such cases the ATO will treat such rewards as assessable income or as a fringe benefit.

BARTER EXCHANGES AND TRANSACTIONS

The ATO's view is that barter transactions are assessable and deductible to the same extent as other cash or credit transactions. For tax purposes the ATO considers one trade dollar (T\$1) to be equal to one Australian dollar, unless it can be shown that the T\$1 is being traded consistently at a different value. Barter Exchanges and transactions are coming under increased ATO scrutiny as it is considered that income is not being properly accounted for.

COMPENSATION PAYMENTS

Such payments take many forms and depending on their nature can be treated as assessable income, as a capital gain, as an adjustment to the cost base of an asset, or tax exempt.

- Periodical amounts of workers compensation are taxable
- Lump sum amounts received for personal injury or wrong doing are not taxable as these are private or capital recipients
- Recent changes for personal injury cases allow for structured settlements or orders which allow for such cases that formerly would have been settled for a lump sum to be delivered as tax-free periodic payments to an injured person.

This complex issue is dealt with at length in Taxation Ruling TR 95/35.

REDUNDANCY AND EARLY RETIREMENT PAYMENTS

Tax planning opportunities exist as employees can receive limited bona fide redundancy and approved early retirement payments tax-free. Such payments are not classified as Eligible Termination Payments.

Bona fide redundancy and approved early retirement payments in **2010/11 of up to \$8126 plus \$4,064** for each completed year of service with the employer are tax-free. Such receipts cannot be rolled over or paid in lieu of superannuation benefits and do not form part of a pensions RBL.

The ATO's view on what are genuine redundancy payments is contained in Taxation Ruling TR2009/2.

LEASE INCENTIVES

Usually a cash incentive paid to a business taxpayer to enter into a lease of premises will be assessable income.

Chapter 3

ASSESSABLE INCOME

Some non-cash incentives are tax-free as outlined in Tax Ruling IT 2631.

- Rent free period
- Interest free loan - provided it is a genuine business loan
- Free holiday (this is not deductible to landlord)
- Free fit out (if owned by landlord).

In cases where the free fit out is owned by the tenant the cash incentive will be assessable, but a deduction will normally be allowed for depreciation.

SALE OF FORMERLY LEASED EQUIPMENT

Where you or an associate make a profit on the sale of a motor vehicle informally leased, an amount will have to be included in assessable income. There are three choices available in determining the income (Tax Act Subdivision 20B).

If other formerly leased equipment is sold, the isolated transactions provisions may apply to make such a transaction assessable. If not the profit would be taxed as a capital gain.

BALANCING ADJUSTMENTS

Where plant and equipment subject to depreciation is disposed of for an amount exceeding its written down value, the surplus is known as a "balancing adjustment" and is assessable income.

Chapter 4 EXEMPT INCOME



Chapter 4

EXEMPT INCOME

The Tax Act deals with a wide category of exempt income on which income tax is not payable.

However, such exemptions still should be declared in income tax returns. Although income tax is not payable on exempt income itself, its inclusion in tax returns does alter the rate of tax payable on other income.

Note, that any tax losses carried forward are first applied against exempt income.

ITEMS OF EXEMPT INCOME

Exempt income includes:

- Bona fide redundancy payments (subject to limits)
- Certain pensions and allowances
- Child care payments
- Commonwealth education payments to assist in the cost of rent, commencing employment, travelling, special equipment etc.
- Demerger dividends
- Employment security scheme payments
- Exceptional circumstances relief payments
- Foreign dividends received by an Australian company (where > 10% ownership)
- Foreign earnings of companies operating active businesses through branches
- Frequent Flyer benefits for employees
- Fringe benefits
- International scholarships
- Mutual income
- Open employment incentive bonus
- Pay and allowances for part-time members of the Defence Force Reserves
- Pay and allowances to ADF personnel whilst on operational service
- Periodic maintenance payments received by a spouse, former spouse or child
- Private health insurance payments
- Rent subsidy payments
- Scholarships, bursaries etc, derived by a student receiving full-time education at the school, college or university
- Secondary education and isolated children's education assistance
- Some allowances paid and the value of rations and quarters for members of the Defence Force
- Some Veteran's entitlement pensions and similar benefits
- Wartime persecution pensions.

Chapter 4

EXEMPT INCOME

EXEMPT VETERANS' ENTITLEMENTS

Exempt payments made under the Veterans' Entitlements Act include:

- Attendant allowances
- Bereavement payments
- Carer service pensions in certain circumstances
- Clothing allowances
- Decoration allowances
- Funeral benefits
- Income support supplements in certain circumstances
- Invalidity service pension where under pension age
- Loss of earnings allowance
- Partner service pension when under pension age
- Pension bonus
- Pension for defence or war caused death or incapacity
- Pharmaceutical allowance
- Recreation transport allowance
- Rental assistance etc, paid with Aged Service Pension
- Special assistance
- Telephone allowance
- Temporary incapacity allowance
- Travelling expenses for health treatment
- Vehicle assistance scheme payments
- Victoria Cross allowance.

EXEMPT SOCIAL SECURITY PAYMENTS

Exempt payments under Social Security legislation include:

- Advance pharmaceutical supplements
- Carer allowances, carer payments in certain circumstances
- Disability wage supplements when under pension age
- Disaster relief payments
- Double orphan pension
- Employment entry payment
- Family assistance
- Fares allowance
- Maternity payment
- Mobility allowance
- Parenting payments (under certain circumstances)
- Pensioner bonus
- Pensioner education supplements
- Remote area allowance, etc. paid with AUSTUDY
- Rental assistance and allowances paid with aged pensions
- Rental assistance etc, paid with bereavement allowances
- Rental assistance etc, paid with mature age allowances and mature age partner allowances
- Rental assistance etc, paid with Newstart allowances
- Rental assistance etc, paid with special needs
- Rental assistance etc, paid with partner allowances
- Rental assistance etc, paid with sickness allowances and special benefits
- Rental assistance etc, paid with widow allowance and widow B pension
- Rental assistance etc, paid with youth allowances
- Senior's concession allowance
- Senior's utilities allowance
- Telephone allowance
- Wife pension when under pension age.

HOBBIES

Occasional receipts that involve nothing more than vigorous pursuit of a hobby should not be assessable. It can be a fine line and if you are consistently making profits the ATO will take the view that you are conducting a business.

Other factors the ATO will consider include:

- Size and scale of operations
- Activity levels
- Details of business records kept.

WINDFALL GAINS

Gambling, betting or lottery wins are considered windfall gains and are not assessable unless it is considered that you are in the business of gambling. Examples of professional gamblers include bookmakers, casino proprietors and professional punters.

A professional punter gambling in a systematic way and making profits may be considered to be operating a business and hence, would be assessable on such income. Sadly such people may consistently make losses and professional punters who have tried to offset gambling losses against other income have had little success in the courts!

Conversely those who only occasionally gamble must keep adequate records of any significant win to prove that the payout is from a gambling source and not from other undeclared income.

In the event of an audit, the onus of proof is on the taxpayer and the ATO will deem unexplained increases in cash or assets to be assessable income unless you can prove otherwise.

AUSTRALIANS WORKING OVERSEAS

Up to 30 June 2009, given the global nature of the labour market, many Australians were aware that overseas employment income may be exempt from tax if certain conditions regarding "continuous employment" were met. Here we are dealing with a situation where the taxpayer is still a resident of Australia. However, this overseas income still has to be disclosed in the tax return possibly resulting in Australian sourced salary and investment income being placed in higher marginal tax brackets.

From 1 July 2009, this exemption is only available to income earned from:

- As an aid or charitable worker employed by a recognised non-government organisation; or
- As a government aid worker; or
- As a specified government employee (for example, defence and police force personnel deployed overseas).

Further, income earned by an individual employed on an overseas project approved by the Minister for Trade as being in the national interest will remain exempt, as provided for by existing rules.

To avoid Australians paying double-taxation, a tax offset will be available for any foreign tax paid on their foreign employment income.

Chapter 4 EXEMPT INCOME

MUTUAL INCOME

The principle of mutuality means that a taxpayer's income can only consist of amounts derived from outside the individual or entity. This means that membership subscriptions and profits on sales to club members are not income.

Apportionment rules apply for clubs that are used by both members and non-members and appropriate records must be kept.

A recent High Court decision demolished this long-held principle by holding the mutuality principle did not apply where the members were prevented from obtaining the value of the net assets when the organisation was wound up.

Legislation has now been passed to restore the principle of mutuality to non-profit organisations.

GIFTS

Genuine gifts are not income. This most commonly occurs between family members. Note that if there is a link between the recipients's work-related activities and the gifts received, this will not be the case.

Tips received by waiters, for example, are assessable because they directly relate to the work they are doing.

Gifts made by an employer to an employee are exempt to the employee, but may be subject to FBT.

Chapter 5

TAX DEDUCTIONS



Chapter 5

TAX DEDUCTIONS

BUSINESS AND EMPLOYMENT DEDUCTIONS

Income tax is calculated based on a taxpayer's taxable income. The fundamental equation is: assessable income less allowable deductions equals taxable income.

In claiming income tax deductions there are "general" and "specific" deductions.

The general provision for claiming allowable deductions is section 8(1) of the Tax Act, which states that any loss or outgoing is a tax deduction to the extent that:

- It is incurred in gaining or producing assessable income; or
- It is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

It should be noted, however, under the second limb of section 8(1) that you cannot claim a deduction if the outgoing is of a capital, private or domestic nature.

There are also provisions in the Tax Act that prevent you from claiming certain deductions, for example fines and most entertainment expenses.

SUBSTANTIATION

The key principal underlying substantiation is that to deduct work expenses, a taxpayer needs to have written evidence of the expense. (Division 900 of ITAA 1997.) Note that substantiation applies only to individual taxpayers and partnerships that include at least one individual. Normally the written evidence must be kept for a minimum of five years from the date of lodgement of the return in which the claims are made.

Once you have established that the relevant expenses were incurred in earning assessable income or in carrying on a business, the substantiation rules must be considered before the expense is claimed.

There are exceptions where substantiation is **not** required:

- The total claimed for all employment related expenses is less than \$300.
- Laundry expenses up to a maximum of \$150.
- Travel claims less than the amounts stipulated in TD 2010/16, provided that a bona fide allowance has been paid to you as an employee.
- Car expenses under the cents per kilometre method.
- Overtime meal allowances up to \$25.80 per day (TD 2010/19).

Chapter 5

TAX DEDUCTIONS

Under the substantiation requirements, you must have documentation that contains the following:

- The name of the supplier
- The amount of the expense
- The nature of the 'goods' or services
- The date the expense was incurred
- The date the document was made out.

Small expenses of \$10 or less that total less than \$200 per annum do not require substantiation if you record the details in a book or a diary.

MOTOR VEHICLE EXPENSES

Whilst business travel expenses or employee work-related expenses are deductible, travel expenses incurred travelling between home and work are not generally deductible.

However, if you have a detour for work-related expenses on the journey to see a client, a tax deduction may be claimed.

Taxpayers who have to carry heavy or bulky equipment to their place of work may also claim a deduction.

Examples:

- A self employed tradesman will be able to claim a deduction if he uses his home as his base and when he travels to sites is obliged to take his own tools of trade and equipment.
- Musicians who carry bulky equipment e.g. amplifiers to their place of performance may be able to claim a tax deduction.
- Trips to town by primary producers will be deductible if it can be shown that the principal purpose of the journey was business in nature. Examples could include purchasing equipment and supplies or visiting the bank.

When claiming motor vehicle expenses there are four choices open to the taxpayer. You may alter your choice from year to year and make a fresh choice when replacing a vehicle. If you are choosing the actual cost method it may be necessary to keep a replacement logbook.

If you own more than one vehicle a claim may be made for each vehicle if it can be demonstrated each vehicle has a business use.

CENTS PER KILOMETRE METHOD

This method is available for motor vehicle usage up to 5000 kilometres of business use.

In cases where the vehicle has been used for more than 5000 kilometres in a tax year, this method is still available as long as the claim is reduced to 5000 kilometres.

The rates per kilometre change each year and are released by the ATO. The rates differ according to car engine sizes and are:

ENGINE CAPACITY

Non-Rotary Engine	Rotary Engine	Rate
Up to 1600cc	Up to 800cc	63(c/km)
1601-2600cc	801-1300cc	74(c/km)
Over 2600cc	Over 1300cc	75(c/km)

This method does not have to be substantiated by logbook; however, on occasion the ATO may enquire (particularly in the case of employees) how the motor vehicle has been used for business purposes, and may seek verification from the employer.

Couples engaged in small business may jointly own and use a car for business purposes. In such cases where the vehicle is used separately by each person, it is possible for both to claim a deduction up to the 5000 kilometre limit using the set rate per kilometre method.

This method is popular for small business persons and employees who own older vehicles and as such cannot access high depreciation claims.

ACTUAL COST METHOD

Using this method the total operating cost of the vehicle is determined with an apportionment made between private and business use. A logbook that is kept in the "prescribed format" determines the apportionment. Logbooks may be purchased at stationers and normally state that they comply with ATO requirements. A logbook must be kept for at least 12 consecutive weeks and remains valid for five years as long as there are no substantial changes in patterns of usage. An existing logbook may also be used for a replacement vehicle if patterns of usage remain consistent.

Motor vehicle expenses include all costs and outgoings incurred in operating and maintaining the vehicle. These include, but are not limited to, fuel, tyres, servicing, repairs, maintenance, registration, financing costs (interest), depreciation and/or lease payments. All relevant records to substantiate the amounts claimed must be kept. A depreciation cost limit (maximum amount) applies and for 2009/10 is \$57,466. Cars that cost more than this can only be depreciated from a value of \$57,466.

Be certain to keep change-over details when purchasing new vehicles. The relevant details are make, model and registration number and odometer records of both cars and the date of change-over.

Always be able to demonstrate that your business percentage is based on a reasonable estimate. Although logbooks will be the primary source, changes in patterns of usage or the number of cars you use are also relevant.

ONE-THIRD OF ACTUAL EXPENSE METHOD

You may only elect to use this method if your vehicle has travelled more than 5000 business kilometres in the year. In such instances one-third of expenses incurred in the year are assumed to be business related and tax deductible.

Whilst you do not need to keep a logbook, the substantiation requirements regarding documentation of expenses apply. It must also be demonstrated that the car has travelled more than 5000 kilometres on business. Where a vehicle is not owned for a full year, claims can be made on a pro-rata basis.

Chapter 5

TAX DEDUCTIONS

TWELVE PERCENT OF COST METHOD

This method is available as long as the relevant vehicle has travelled more than 5000 business kilometres in the year and allows a tax deduction equal to 12 per cent of the capital cost of the vehicle, up to the depreciation cost limit of \$57,466.

To make this claim you are required to establish business use exceeding 5000 kilometres with evidence of the cost of the vehicle. Other than this there is no requirement to keep a logbook or document expenses.

For part year ownership, a pro-rata claim is available if you establish that greater than 5000 business kilometres would have been travelled in a full year.

EXCEPTIONS TO MOTOR VEHICLE SUBSTANTIATION RULES

The above rules do not apply to:

- Panel vans, utilities or other vehicles designed to carry weights exceeding one tonne
- Taxis
- Motorcycles and similar vehicles
- A car only used for lease or hire in a business of leasing or hiring
- Panel vans, utility trucks or other vehicles designed to carry less than one tonne, (not being vehicles mainly designed for passengers) where no private use is indicated. This usually means that the only private use is travel between home and work. If a second vehicle is owned, it is suggested this contention of incidental private use can reasonably be made.

Although substantiation may not apply, reasonable documentation should still be kept to justify all claims.

TRAVELLING EXPENSES

Substantiation is required for all domestic and overseas travel expenses. Written evidence must be retained regardless of the length of absence from home. The only exception is expenses incurred by employees that are not in excess of reasonable travel allowances received from employers.

Travel records, being a travel diary or similar document must be kept if you are away from home for more than five nights. The diary must set out:

- The nature of the activity,
- The day and approximate time it began,
- How long it lasted, and
- The location where the activity took place.

The travel records required are for business activities only and it will be necessary to establish that the principal purpose of the trip was for business purposes.

PREPAYMENT OF EXPENSES

Carefully note the tax treatment of prepayments depends on the status of the taxpayer and the amount and nature of the expense. The tax treatment also depends on whether the taxpayer has elected to access the small business entity (SBE) (if eligible).

In general, prepaid expenditure must be apportioned over the period in which the relevant service is provided.

The following expenses are excluded:

- Amounts less than \$1000 (net of GST)
- Amounts paid pursuant to Court Order or government legislation
- Salaries and wages
- Payments by taxpayers using the SBE as long as the period of service does not exceed 12 months.

Individuals and SBE taxpayers are still able to participate in "tax effective" investments such as forestry plantations by making a prepayment of management fees.

Individuals with negatively geared investments can still make prepayments of interest.

TRAVEL CLAIMS WITHIN AUSTRALIA

The substantiation requirements do not apply to 'travel expenses' incurred by an employee who receives a travel allowance for travel within Australia and the claim for costs of accommodation, food, drink and other incidentals do not exceed reasonable amounts as determined by the ATO. These are the 2010/11 daily rates for accommodation, meals and incidentals as outlined in TD 2010/16.

Place	Salary below \$97,100	Salary \$97,101-\$172,700	Salary above \$172,700
Adelaide	\$267.35	\$319.50	\$363.05
Brisbane	\$311.35	\$367.50	\$390.05
Canberra	\$255.35	\$317.50	\$384.05
Darwin	\$282.35	\$363.50	\$419.05
Hobart	\$227.35	\$284.50	\$349.05
Melbourne	\$283.35	\$331.50	\$419.05
Perth	\$274.35	\$345.50	\$429.05
Sydney	\$293.55	\$359.50	\$419.05

LONG DISTANCE TRUCK DRIVERS

If in receipt of a travel allowance, employee truck drivers who are required to sleep overnight away from home can claim food and drink expenses up to stipulated daily rates without substantiation.

Expenses must be substantiated if no allowances are paid or if amounts paid are in excess of stipulated amounts.

Acceptable daily rates for 2010/11 are:

Salary of \$97,100 and below \$84.90 per day
Salary of \$99,101 and above \$92.65 per day

NON-COMPULSORY UNIFORMS

Deductions are not allowed for non-compulsory uniforms unless the design of the uniform is entered on the Register for Approved Occupational Clothing at the time the expense is incurred.

Chapter 5

TAX DEDUCTIONS

CONVENTIONAL CLOTHING

This is generally disallowed, but there are some interesting exceptions:

- A professional actor who buys stage clothing specific to a production.
- A police officer doing surveillance or undercover work who incurs costs to buy clothing he would not normally wear.
- A television game show host who purchases evening and formal wear to complement the prizes and sets.

OCCUPATIONAL CLOTHING AND PROTECTIVE GEAR

Clothing expenditure is generally private expenditure and not deductible. However, there are circumstances where expenditure on certain types of occupational clothing gives rise to a deduction listed below:

Occupation Specific

Generally, a deduction will be allowed for occupational specific clothing, which clearly identifies a person as a member of a specific profession, vocation, trade, occupation, or calling. Examples may include a barrister's robes; a chef's checked pants and a nurse's uniform. A business suit is not occupation specific and therefore not tax deductible.

Protective Clothing and Footwear

Such costs are deductible where the clothing is specially designed to protect the taxpayer from personal work injury, disease or death.

Compulsory Uniform

For expenditure to be deductible, the wearing of the uniform must be an express policy of the employer, consistently enforced and applicable to all employees at the same class.

Glasses, Sunhats and Sunscreen

Since the Morris case (2002), expenditure on sunglasses, sunscreen, and sunhats is deductible for taxpayers who are required as part of their duties to work outside and be exposed to sunlight while performing their duties.

Examples of such taxpayers include those involved in farming, outdoor sports, the construction industry, courier services and other outdoor services.

HOME OFFICE EXPENSES

A taxpayer can make expenditure claims for home office expenses if it can be shown that part of the home is used for income earning purposes and has the character of a place of business, or is used in connection with income earning activities, but is not a place of business.

Where additional running costs are incurred because of income producing activities, an individual taxpayer may make a claim for home office expenses based on:

- Actual expenses
- Diary records for a typical four week period in each year. This will establish a pattern for the entire year.

In broad terms the following types of expenses are normally incurred:

- Telephone and internet expenses
- Heating and lighting expenses
- Equipment depreciation
- Occupancy expenses where the home is a place of business. These include rent, interest, etc.

Occupancy expenses are deductible only if a particular or part of the dwelling is set aside and is clearly identifiable as a place of business and used exclusively for business purposes. Having a computer alcove at home will not meet this test.

Note: If you elect to claim occupancy expenses there are Capital Gains Tax implications. Having accepted that your home is a place of business the main residence exemption will be affected.

INTEREST

The fundamental test in determining the deductibility of interest is the "use test", being the use to which the finances have been put. Security is irrelevant and under section 8(1) of the Tax Act you can only claim a deduction for interest expenses if the funds have been used in gaining or producing assessable income or in carrying on a business for that purpose.

Examples:

1. A business owner has a business overdraft limit, which is secured on business assets. The owner decides to use funds of \$15,000 to finance an overseas holiday. The interest cost on this \$15,000 of the overdraft is not deductible because the borrowings have not been used for business purposes.
2. A business borrows \$30,000 to purchase a new computer system. The loan is secured on the owner's home. Interest on the loan is deductible because the monies have been borrowed for business purposes and the interest expense has been incurred in carrying on the business.

As long as existing loan arrangements remain unchanged, interest on borrowings that remain after ceasing business are deductible. Interest in connection with borrowings necessarily incurred prior to commencement of business may also be deductible if there is a sufficient connection with the expense and future income derived. Interpretive decision ID 2006/269 indicates that interest incurred on borrowings by a sole trader to pay income tax is deductible under section 8(1), ITAA 97. This has long been the case for companies (IT 2682).

TELEPHONE

If you are required to contact clients or your employer on a regular basis, or if you are required to be on call, home telephone rental expenses may be partly deductible.

Claims can be made in either of the following ways:

- A diary or log is kept for 28 days, establishing a pattern of usage for the whole year; or
- Actual expenses based on a completely itemised account.

Chapter 5

TAX DEDUCTIONS

It is suggested that the itemised account method is too onerous and the 28 day diary method is recommended.

REPAIRS

Deciding whether a claim should be made should be relatively simple; however, items of expenditure may be capital in nature and this issue has been tested in the Courts on numerous occasions. The dictionary definition of repairs is "the restoration of some material thing by the removal of some decayed or worn out parts".

Before making a claim, carefully consider whether the expense is:

- A capital expense in respect of recently acquired property
- An improvement
- The replacement of a subsidiary part or of an entirety.

If you replace or reconstruct entire premises or plant, this is not a repair. Essentially a repair involves the restoration of an object to the condition it formerly had, without changing its character. Tax Ruling TR97/23 provides guidance on this issue.

Chapter 6

TAX AUDITS AND TAXPAYER RIGHTS



Chapter 6

TAX AUDITS AND TAXPAYER RIGHTS

TAX AUDITS - WHAT ARE THEY?

The ATO is responsible to the government and the community for collecting the revenue and ensuring that everyone pays the correct amount of tax.

A tax enquiry or audit is an examination of your tax affairs by the ATO to see if you have done what you are required to do under the tax laws, including whether you have declared all the assessable income you receive and are entitled to the deductions and tax offsets you have claimed on your tax return. The ATO assumes that you are trying to deal honestly with your tax.

Some ATO visits are just to provide assistance and information while others are routine checks of simple details you would normally have on hand, such as your Australian Business Number or GST registration. If a tax officer visits you, they will let you know the purpose of the visit at the outset.

The enquiries or audits conducted vary in their complexity. Sometimes they only involve a phone call or a letter asking you to provide further information or verification of your claims. In some cases a tax officer may visit you. In some cases you may be asked to bring all your records for examination.

The ATO sometimes decides to look more closely at tax returns making similar claims or from within the same industry and can request the records and paperwork you used to complete your tax return.

It is also possible that your tax return has been audited without you knowing about it. The ATO receives information from a number of sources as a matter of course. For example, banks are required to provide details of how much interest each account held with them has earned. Using this information, it is a simple check to see whether or not taxpayers have declared that interest in their return. The ATO also cross-reference Centrelink payments with tax returns.

The ATO will send you a letter if they detect that an amount is missing on your tax return. If you agree the amount should be on your return you don't need to do anything. The ATO will issue you with a Notice of Assessment telling you how much you need to pay. This may include interest penalties. If you disagree with the ATO, the letter will tell you what to do.

IF YOU ARE SUBJECT TO ENQUIRY OR AUDIT

If the ATO undertakes checks of your tax affairs it doesn't mean they think you are dishonest. If you make an honest