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Crowdfunding and tax

Not so many years ago, the concept of raising funds via crowdfunding would more likely be seen as a way to fund community-based, local-issue or help-your-neighbour initiatives. But increasingly these days crowdfunding is viewed as a viable source of seed capital, and is no longer regarded as the shy little sister of venture capitalism.

Some quite serious money can be raised through crowdfunding, using internet platforms, mail-order subscriptions, benefit events and other methods to find supporters and raise funds for a project or venture. And when these efforts are put in place, the ATO is more likely than not to take an interest and will generally be on the lookout to make sure any tax obligations are not forgotten in the glow of success.

But as crowdfunding has, and continues to be, a rapidly evolving phenomenon, the ATO has found that it needs to keep some nimbleness in its approach to crowdfunding arrangements — as the industry expands or changes,

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Crowdfunding and tax continued

and new developments arise, the ATO is aware that it will need to review and update the information and guidance that taxpayers require.

The trouble, or challenge, with crowdfunding is that tax consequences can vary, depending on the nature of an arrangement and also a taxpayer's role in it, plus that individual's circumstances.

For example, with the recent crowdfunding efforts to relieve Australia's drought-stricken farmers, ATO advice was the following: "Where the amounts are spent on deductible expenses, such as purchasing feed for livestock, there will be no net taxable outcome, as the income amounts will be offset by the deductions obtained. This means, for most farmers, there will be no tax payable in relation to money donated to them for their farm expenses. Income tax will only be paid if the farmer makes a net business profit."

From the ATO's point of view, it is important to determine whether money raised is income, which will also mean there could be allowable deductions, and whether there is a need to consider GST.

The roles

There are usually three parties (or roles) in a crowdfunding arrangement:

- the initiator of the project or venture or the campaign creator (who may act in a personal capacity or use a company or organisation as the vehicle to progress the crowdfunding project or venture) known as the "promoter"
- the organisation providing the crowdfunding website or platform, known as the "intermediary", and
- individuals or entities that contribute or pledge money, known as "contributors".

Each party may have income tax and GST obligations, depending on their circumstances and the nature of the crowdfunding arrangement.

The types

The ATO considers that the various platforms that are generally used can be consolidated into four main types (or models) of crowdfunding. Each uses a different strategy to attract funding and each may have different tax consequences for the parties involved.

In **donation-based crowdfunding**, a contributor makes a payment (or "donation") to the project or venture, without receiving anything in return. The contributor's donation may simply be acknowledged – for example by adding their name to a list on the crowdfunding website.

In **reward-based crowdfunding**, the promoter provides a reward (goods, services or rights) to contributors in return for their payment. For example, the contributor may receive merchandise or a discount. In many cases, there are different levels or types of reward, according to the level of contribution and whether the fundraising reaches the prescribed levels.

In **equity-based crowdfunding**, the contributor makes a payment in return for a share (or equity interest) in the company undertaking the project or venture. The share in the company will provide the contributor with certain rights including the right to participate in future profits (dividends), voting rights, and rights to returns of capital upon winding up.

At present, the government is in the process of consulting on the appropriate legislative framework for crowd-sourced equity funding by public companies, including whether the Corporations law should be changed to facilitate access to crowd-sourced equity funding by proprietary companies. The ATO says it will update its guidance for crowdfunding (including examples to assist promoters and contributors) once consultations conclude.

In **debt-based crowdfunding**, the contributor lends money to the promoter (or pool of promoters) who, in return, agrees to pay interest and repay the principal of the loan.

Income tax

A taxpayer who earns or receives any money through crowdfunding will generally find that the ATO will consider some or all of it to be assessable (therefore taxable) income, depending on the nature of the arrangement, the taxpayer's role in it and their circumstances. Naturally the ATO requires all assessable income to be declared on annual tax returns.

Of course if any amount is assessable income then some of the costs related to gaining or producing that income may be allowable deductions, providing the taxpayer has the appropriate records to substantiate any claims.

continued overleaf ⇨

Crowdfunding and tax continued

“A taxpayer who earns or receives any money through crowdfunding will generally find that the ATO will consider some or all of it to be assessable.”

In general terms, the ATO considers that the tax laws that apply to investment and financial activity undertaken in a conventional manner (for example, buying goods and services, buying shares, lending money) will apply in the same way to similar activities conducted under crowdfunding.

To play it safe, with any transaction that involves tax it is important to keep records — especially with crowdfunding arrangements which, as discussed, can result in grey areas in regard to tax treatment. Generally the ATO expects taxpayers to keep records of most transactions, in English, for five years. The five years starts from when a taxpayer prepared or obtained the records, or completed the transactions, whichever is the later.

Deciding factors

Determining if the income sourced through crowdfunding will be considered to be assessable can be boiled down to two questions:

- is the recipient carrying on a business?
- are they involved in a profit making scheme?

In business

The ATO is aware that not all promoters will be carrying on a business when they launch or even finish with a crowdfunding initiative. To be considered to be carrying on a business would mean a promoter would conduct activities for commercial reasons and in a commercially viable way.

The ATO will also consider that activities are conducted in a business-like manner, including preparing a business plan, acquiring capital assets or inventory in line with that plan, preparing accounting records and the marketing of a name or brand and its product. It is also considered that activities will generally be repeated in a regular

way (although the ATO has also considered one-off transactions to be a “business” in some cases).

If a taxpayer is indeed carrying on a business, when that enterprise commences is important. For example a taxpayer must have made the decision to start something and have done something about it. If they are still setting up or preparing, they may not yet be in business. Money received or property or assets given prior to a business being carried on may not generally be considered to be assessable income. Likewise, a taxpayer generally cannot claim deductions incurred prior to a business being carried on.

Profit-making

A crowdfunding project will be considered to be a profit-making scheme if it was launched with an intention to make a profit, and the project was entered into and profit made while carrying out a business operation or commercial transaction.

The ATO will generally disregard factors such as:

- a taxpayer is not already running a business
- the project is not part of their usual business activities
- they have no clear idea of how they will make the profit.

If a taxpayer expects to make a profit when they launch a project, and run the project in a businesslike way, any funds raised will be taken into account in determining profit. There may also be other tax consequences such as capital gains or dealing with the value of trading stock, depending on circumstances. ■

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.

Get a clear view with a private ruling



Photo by Ameen Fahmy on Unsplash

There have been cases where people believe the idle talk about being able to coerce a better tax outcome simply by applying for a private ruling from the ATO. But there are some sober facts that you may need to keep in mind if you have thought of it yourself.

Any taxpayer can apply for a private ruling where they have a concern that their circumstances may put them in an unusual position tax-wise. It may be that a particular transaction or event doesn't fit any known approach for tax purposes, for example, or the taxpayer may simply be looking to minimise the risk of an unanticipated tax outcome on the back of an out-of-the-ordinary financial arrangement.

For instance, asking for a private ruling can be a good way to "test-drive" a tax arrangement you may be considering, especially where the already existing information from the ATO does not seem to adequately cover all the bases.

But remember, these are one-off decisions, made only about a certain set of circumstances, and they set out how the ATO views that one particular situation. Each ruling is specific to whoever applied for it, and only to the situation considered by the ruling. Generally these can't be picked up as a standard by any other taxpayer.

By the same token, if you happen to find, say, a "private binding ruling" (they are, after all, publicly accessible on the ATO website) and decide this ruling sounds pretty much the same as your circumstances, you need to be aware you will not get any protection from using that ruling if the ATO decides that your situation should have a different outcome.

That the term used for these rulings has the word "binding" included is indicative. If a tax practitioner applies for and is granted a private ruling by the ATO on behalf of a taxpayer, the ATO is generally bound to administer the tax law as set out in that ruling.

But if in due course the ATO issues a "public ruling" (which applies to any taxpayer if their situation fits the ruling) and the tax outcome conflicts with the one in the private ruling, it may indeed be the case that there will be a choice of which one to apply (but we will need to check on your behalf).

The other side of that coin however is that if arrangements entered into differ materially in any way from the situation spelled out in your application for a private ruling, the ATO is not obliged to be bound by that ruling (although minor variations that don't affect the way the law applies are generally acceptable).

Private rulings can cover more than just income tax laws, and can also cover indirect taxes such as the luxury car or goods and services tax, but can also cover whether an activity is a hobby or a business, or decide the value of any item.

continued page 6 ➡

Changing details in your tax return after it's lodged



Say for example that we have already lodged your 2017-18 tax return and forwarded your notice of assessment to you saying that everything is as discussed, but you then realise that something has been left out of your return, or you accidentally included an extra deduction or doubled one up. There's no need to panic — an agent from the ATO won't be pounding on your door demanding that you pay a penalty.

The Australian tax system is based on "self assessment", which means the ATO generally takes your word, under our guidance, and bases its assessment on the information it has been provided. But if it subsequently becomes apparent that something is wrong, there is an option to make it right.

It is not all that uncommon for taxpayers to make a change to a tax return they have already lodged — often there can be a deduction that simply slipped your mind, or you realise that you received, say, foreign income that you forgot about. And then there are the straight-out mistakes that we all make from time to time, or you could have forgotten to tell us something about your tax affairs at our appointment.

If it involves an increase in the tax you should have paid, then it is highly advisable you take the bull by the horn and make a full confession. This will go a long way to prevent, or at least reduce, possible penalties that may apply if you realise that the oversight may actually have led to a "false" return (even if not intentionally lodged as such). The important thing is to make sure that as soon as you realise that the information you have reported to the ATO is incorrect or incomplete, that you ask us to take actions to correct it. And the way we can do this is to apply to make an amendment.

It is also possible that you or we simply disagree with an associated penalty issued in relation to timing of lodgement of your return or interest charged on a shortfall amount, or some other decision made about your tax affairs that you or we may want to take issue with.

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Changing details in your tax return after it's lodged *continued*

In this case, we would start by making an approach to the ATO via a phone call to try and remedy the situation before it gets out of hand. However, if the ATO digs its heels in over any of these sorts of matters, we can also help by lodging an objection.

If the amendment we prepare for you decreases the tax you owe, you will generally receive a refund (unless you have other tax debts) and may get some bonus interest to boot. If it increases the tax you owe, the ATO will generally treat it as a voluntary disclosure of unpaid tax. This means you are likely to receive concessional treatment for any penalties and interest charges that apply (in which case you'll still have to pay any outstanding tax, but we can ask on your behalf for concessional treatment of interest charges, or for a possible waiver altogether, depending on the amount).

There are time limits for making amendments to your tax return, generally two years for individuals and small businesses and four years for other taxpayers, including trust beneficiaries and members of partnerships.

For example, if you are a sole trader and receive a notice of assessment on September 7, 2018, your two-year amendment period will start the day after, and therefore end on September 8, 2020. A business that is not classified as a small business will have until September

8, 2022. We can submit on your behalf more than one amendment request within an amendment period.

(Note that if a shortfall of tax is due to fraud or evasion, the ATO has an unlimited time limit to amend.)

So if on current year discussions we identify something that we both didn't realise that we should have claimed in your previous year's tax return, then we can amend that year.

After the ATO processes our request for an amendment, a notice of amended assessment should be issued, showing the new amount payable or refundable. And if we submit a request for an amendment before your tax return has been processed, the ATO will generally process them together, so that a standard notice of assessment is issued, not a notice of amended assessment. Sometimes additional information is needed to properly re-assess a tax return, in which case the ATO should ask us for this information within 14 days of receiving the amendment request.

While ignoring an error may seem to be an easier option, the trouble with this is that future dealings with the ATO may be muddled. And as the process of asking for an amendment is fairly straightforward, and the fact that we are here to help, the better option is to make sure your tax affairs are in order sooner rather than later. ■

Get a clear view with a private ruling *continued from page 4*

You also need to be aware that a ruling made in respect of a particular tax law will be changed if that law is altered by legislation or by the result of a court decision. But it is also worthwhile to point out that if a ruling is followed, and that ruling is later found to not have applied the law correctly, there is generally some protection for you (or at least leaving you with a "reasonably arguable position") to make a request to not have to repay any tax that would have otherwise have been owed, as well as interest and penalties.

If a private ruling affects an earlier tax assessment, the ATO will not automatically amend that assessment unless you make a point of submitting a written request for an amendment.

We can apply for a private ruling on your behalf, or you can elect to do this yourself (search on the ATO website for an application form). For companies, a public officer can apply for a private ruling, or a partner of a partnership or a trustee of a trust estate.

One last thing that should be pointed out — you must understand that just because you ask for a private ruling doesn't automatically mean you are going to get one. The ATO can refuse if it thinks a ruling would prejudice or restrict the law. It can also refuse if you are being audited over the same issue, or if it deems your application to be "frivolous" or "vexatious". ■

Personal services income: An overview



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It is not uncommon for professional people who provide services to set up a separate entity to run their business, be it a trust, partnership or incorporated company. The allure of course is the lower tax rate that these can secure, rather than at the top marginal tax rate that an individual would generally wear.

Running a business through such a structure can also lead to a wider range of deductions being available, depending on circumstances. So to stop taxpayers dodging their full share of tax, the tax law has in place a set of rules for income derived in this way, which the ATO has dubbed “personal services income”.

The personal services income regime taxes individual contractors on a similar basis as employees where income is derived mainly from the individual’s own skills, expertise or the provision of personal services. As mentioned, this also applies to companies, trusts and partnerships where income is generated primarily as a result of an individual’s personal efforts or skills.

The personal services income (PSI) rules restrict:

- the availability of tax deductions to affected individuals over and above deductions ordinarily available to employees providing the same or similar services, and
- the “alienation” of PSI through an interposed entity to utilise lower tax rates by treating the relevant income as being earned by the individual from providing personal services. The individual is taxed on the attributed income at his or her marginal rates.

The provisions apply where the individual or interposed entity is deemed to be earning PSI. However, where the relevant individual or entity can meet one of a number of carve-out tests, the normal tax position of the taxpayer will be unaffected. That is, the PSI rules will have no adverse application (although ask us about “Part IVA”).

Those caught by the PSI rules are generally restricted in what can be claimed as a tax deduction. However, PAYG withholding obligations are imposed on any interposed entity that is subject to the rules.

Income derived mainly from the use of an asset may not be PSI. According to the ATO, income derived from the provision of personal services involving the use of some equipment may nevertheless be PSI. Where the substance of an agreement is the provision by an individual of his or her personal efforts or the exercise of his or her skills, or the production of a result from those efforts or skills, income may be regarded as PSI.

Income that is derived mainly from the use of assets and equipment, or for the sale and supply of goods or for granting a right to use property is generally not PSI.

The ATO states that when determining whether income is mainly a reward for the personal efforts or skills of an individual or from a business structure, consideration should be given to the relative values of the efforts or skills of the individual and other inputs, such as the efforts of other workers, and the use of plant and equipment, intellectual or other property and goodwill.

Factors relevant to making this determination include:

- the nature of the activities being conducted that generate the income
- the extent to which the amounts paid under an agreement (whether directly to an individual or to an interposed entity) is primarily for the personal efforts or skills of a particular individual
- the extent to which the contract price has been calculated having regard to the costs to be borne by an individual or entity in providing assets to use in the performance of contractual obligations

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Personal services income: An overview *continued*

- the market price of using any equipment, plant or tools as compared with the market price of hiring the relevant labour or skills for the same period
- the nature, size and significance of the assets used by the individual or entity in relation to the activity
- the value of the asset in relation to the total income generated under the agreement
- the uniqueness and degree to which an asset is specialised in the performance of a particular function
- the uniqueness, level of skill or degree of specialisation of an individual to provide the particular services contracted
- whether the payments made to an individual or an entity is for the transfer of the ownership or a right in respect of items produced by the individual or entity
- the existence of goodwill
- the existence of substantial income-producing assets
- the size of the business operation, and
- the contribution of other workers to the income-earning activities.

Some examples taken from ATO guidance on the matter are included in the panel below.

The ATO's PSI decision tool

To make things easier, and to help with your tax planning for the year ahead, the ATO has made available an online "decision tool" to assist you to work out whether you will or have earned PSI, and if the PSI rules will apply to that income. The tool however won't give an iron-clad result.

We can probably help you with a lot of the information required. To answer the questions in the PSI decision tool you may need:

- details of contracts or written agreements with your business's customers during the income year
- invoices from work performed during the income year
- records of payments to any employees or subcontractors.

After answering a series of questions, the tool will provide you with a report that gives you:

- guidance on whether your income is PSI and if the PSI rules apply to you
- a summary of the responses you have provided
- information about what your result means for your tax obligations.

We can discuss the outcomes with you to help you plan your tax affairs.

Examples

1. A taxpayer owns one semi trailer and he is the only person who drives it. The income derived from driving the truck is not PSI because it is mainly produced by the use of the truck and not mainly as a reward for the personal services of the taxpayer.
2. A taxpayer provides a computer programming service but she does all of the work involved in providing those services and uses the client's equipment and software to do the work. The income derived would be treated as PSI as it is a reward for her personal efforts or skills.
3. A taxpayer works as an accountant with a large accounting firm. None of the firm's ordinary or statutory income is PSI because it is produced mainly by the firm's structure and not mainly for his personal efforts or skills.