

## **Barracuda Inc**

### **CBD Accounting - Compliance Risk Report**

For the year commencing 30 June 2020

#### **Entities Covered**

BARRACUDA INC.

A J MOORE & A M MOORE MRS

BRITNEY MOORE

MR ASHLEY MOORE

#### **Your Partner**

(multiple)

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## CBD Accounting Pty Ltd Protect

We're very pleased to be able to offer this exciting new service and thank you for taking it on. If there are any aspects of it that you would like to see changed over time, please don't hesitate to contact your Partner. We welcome feedback of any sort and will use client feedback to evolve the service over time.

If, after reading this report, you feel that you require a more complex level of service to address specific risks, please don't hesitate to contact us.

The purpose of this compliance risk report is to equip you with guidance on;

1. The Australian Taxation Office's Audit Process
2. How to efficiently deal with audits
3. Steps to take when you are chosen for audit
4. Our specific recommendations to you based on our knowledge of your tax affairs.

Please review this document and familiarise yourself with its content. It is necessarily extensive, and some parts may not be relevant to you now, but in our experience clients who have a better understanding of the review and audit processes experience fewer reviews and a faster review duration.

### 1. THE AUSTRALIAN TAXATION OFFICE'S AUDIT PROCESS

According to Australian Taxation Office (ATO) publications, a risk-management approach is taken to compliance. The ATO have an evolving number of methods to identify likely risk areas in taxpayers' tax affairs. These include;

- Sophisticated data matching with other organisations, such as banks, state revenue offices and other government departments, and
- Statistics applied to the massive volume of transaction and reporting data through their own general operations. This data comes from forms they receive, third parties, internal and external referrals and escalations and other information they hold, including through prior dealings with us or you.

This wealth of information helps them make decisions about tax and superannuation risks and where to devote their resources for maximum effectiveness.

This means that the ATO can identify a subset of taxpayers who, based on data they hold, appear different to a norm or to third-party information. In these cases, they may approach us, or you directly, to understand and work through any perceived issues.

Generally, when we identify a compliance risk we will review your tax affairs. This may result in an audit if we identify areas of concern requiring closer examination.



## 1.1. REVIEWS

The review process provides the ATO and the taxpayer with an opportunity to quickly and cooperatively resolve matters in a transparent way. Sometimes the ATO will contact us to resolve the matters directly, in which case we will likely require information from you.

In the case that you're required to be involved in a review, contact details of the ATO officer with whom we'll liaise will be provided to us both. The ATO generally request information from you on an informal basis without having to use the formal powers in an attempt to build a good working relationship, improve the resolution process and minimise costs.

The information they require along with their reasons for needing the information will be discussed at the outset and may include invoices, accounting system data files and/or access to online ledgers, financial statements, schedules, agreements and tax reconciliations.

The ATO will then review the information to clarify their understanding of risks within the context of your business and/or personal circumstances. Keeping good records will also help you with their enquiries.

The outcome of a review may be an "all clear" letter or proceeding to an audit where a more in-depth examination of the issue is required.

## 1.2. AUDITS

The ATO conduct audits where they consider a more in-depth examination of an issue is required. This could be a quick examination of source documents to a more intensive analysis of complex arrangements and transactions.

Most audits are escalated from a verification check or review. However, in some cases they may proceed directly to an audit without conducting a review. This may happen, for example, in cases involving less complex issues, or where they suspect fraud or evasion, or where an arrangement or transaction is considered high risk.

In our experience they will examine source documents to verify the accuracy of financial accounting information and the integrity of access controls within your systems.

As is the case with reviews, where their procedures are sufficient to explain their concerns, they will end the audit and advise you of the outcomes.

During the latter stages of an audit they usually provide you with a position paper that clearly explains their findings and gives you an opportunity to comment before they finalise the audit.

A position paper sets out:

- the available facts (which we will endeavour to agree with you first)
- the issue(s)
- your contention(s)
- our application of the relevant law to the facts
- details of any proposed assessments arising from the audit
- details of who to contact to discuss the matter.

In determining their position, they research the law, taking note of any pre-existing ATO views. They will consider your position and supporting arguments.

Where they disagree with you, they will explain why and whether an alternative dispute resolution (ADR) process may assist in resolving the dispute. To help determine their position, they sometimes engage external experts such as industry specialists, valuers, economists and legal counsel.

We will give you an opportunity to comment and we will consider your comments before making our final decision, including request for an independent review.

## **2. HOW TO EFFICIENTLY DEAL WITH AUDITS**

The largest cost of attending to an audit can be the time that a taxpayer spends distracted, hunting for information or trying to recall circumstances around a transaction or set of transactions that justify its treatment.

The aim for taxpayers and advisers should be to deal with tax reviews and audits as quickly and efficiently as possible.

In our experience, this is most easily achieved for clients who;

- Understand the review and audit process
- Are aware of the risk areas for their specific circumstances
- Keep good financial records, particularly around transactions or taxation treatment that are not simple and require some background explanation
- Answer queries promptly
- Keep their records in the cloud

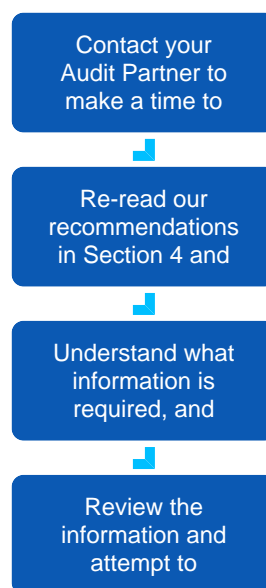
Australian tax and super laws require you to keep records to support your claims. These records include documents that evidence an intention, election, choice, estimate, determination or calculation. For these purposes 'documents' include computer files and other electronic information.

### **3. STEPS TO TAKE WHEN YOU ARE CHOSEN FOR AUDIT**

When the ATO select a taxpayer for audit, the first contact will likely be by phone to arrange an initial interview time.

In the case that they contact you before they contact us, you should **not agree** to a time to meet until you've spoken with your Partner to agree a timeframe that's acceptable to all parties and provides us with enough time to form a strategy for dealing with the audit.

Prior to the meeting, you will have an opportunity to review your records to identify any errors or omissions. Any penalties that apply may be reduced by 80% if you notify the ATO of the errors or omissions in advance.



### **4. OUR RECOMMENDATIONS TO YOU**

Based on your tax compliance profile, we believe the following areas of compliance risk are relevant to your situation. We recommend that you read the following sections and follow the simple steps therein.

#### **- General Record Keeping Requirements (Section 4.1)**

At this point in time we feel that the following sections are less relevant to your circumstances. If you are concerned that any of the areas below are in fact relevant to your circumstances, please contact your Partner to discuss further.

- Carrying on a business (Section 4.2)
- History of Poor Compliance / Long Outstanding Returns (Section 4.3)
- International Dealings (Section 4.4)
- Complex Tax Affairs (Section 4.5)
- Significant Lifestyle Assets used in Business (Section 4.6)
- Research and Development Tax Incentive (Section 4.7)

## 4.1. GENERAL RECORD KEEPING REQUIREMENTS

As discussed earlier, Australian tax and super laws require you to keep records to support your claims. The following information is an abridged version of the following link, which we encourage you to review in full. <https://www.ato.gov.au/Individuals/Income-and-deductions/In-detail/Keeping-your-tax-records/>

The Australian tax system relies on taxpayers self-assessing. This means you are responsible for working out how much you can declare and claim on your tax return. You also need to be able to show how you arrived at these figures – in some cases you may be required to provide written evidence.

Generally, you must keep your written evidence for five years from the date you lodge your tax return or if you:

- have claimed a deduction for decline in value (formerly known as depreciation) – five years from the date of your last claim for decline in value
- acquire or dispose of an asset – five years after it is certain that no capital gains tax (CGT) event can happen, so you know you don't need the records to work out a capital gain or loss
- are in dispute with the ATO – the later of five years from the date you lodge your tax return or when the dispute is finalised.

### *You should:*

- *Read this link: <https://www.ato.gov.au/Individuals/Income-and-deductions/In-detail/Keeping-your-tax-records/>*
- *Ensure that you understand what records you need to keep, and for how long they should be kept*
- *Get into the habit of filing important information in a secure location. We suggest that you consider appropriately secured cloud storage and can recommend specific services to you.*

## 4.2. CARRYING ON A BUSINESS

Taxpayers carrying on a business are exposed to a wide range of audit risks.

### 4.2.1. Activity Statements

Activity statements are constantly on ATO's radar. They can easily result in cash payments to taxpayers and are therefore a major fraud risk. In recent years, over 70% of activity statements selected for review by the ATO have led to adjustments in favour of the ATO.

The most common problems we've experienced with activity statements being modified because of an ATO review are:

- *Invoice date doesn't correspond with correct activity statement period (Often because of confusion with regards to cash vs non-cash treatment)*
- *Claiming entity has a different name to the name appearing on an invoice*
- *GST incorrectly claimed on non-GST transactions*

***You should ensure that you and anyone who is responsible in your business for categorising transactions understands;***

- *The way GST operates in Australia*
- *Appropriate GST treatment of regular business transactions*
- *Transactions that attract modified GST (eg. Insurance)*
- *The requirements for retaining valid tax invoices to be able to claim GST*
- *The importance of invoice dates and correct allocation between activity statement periods*

***Useful information can be found here:***

<https://www.ato.gov.au/business/gst/claiming-gst-credits/>

#### **4.2.2. The Cash Economy**

Businesses that deal in high volumes of cash are also likely targets for ATO audit. In the case of audit, the ATO concentrate on the accounting systems and controls employed by the business. If the systems and controls are weak, the ATO are likely to closely examine the industry norms for cash collection percentages. They may also wish to review the spending habits of the owners of the businesses. Retailers, especially tradesmen and restaurants are regularly in the ATO spotlight.

You can find out more about the way in which the ATO battles the cash economy here:

<https://www.ato.gov.au/general/gen/the-cash-and-hidden-economy/>

Here is a relevant extract:

*We use a range of tools to identify and take action against people and businesses that may not be correctly meeting their obligations.*

*Through data matching, we can identify businesses that don't have electronic payment facilities. These businesses often advertise as 'cash only' or mainly deal in cash transactions. When businesses do this, they are more likely to make mistakes or don't keep thorough records. Our 'protecting honest business' visits and contacts address this risk.*

***You should ensure that you have comprehensive systems and controls to record income and ensure all cash is promptly banked. If you require assistance with designing and implementing effective control systems, please contact us.***

#### **4.2.3. Trading Stock**

Trading stock is another focus for the ATO. Small businesses often do not have sophisticated systems for stock control, and the opportunity exists for taxpayers to manipulate tax liabilities by using an invalid or inaccurate accounting method for valuing stock. Specific rules exist around;

- What constitutes trading stock
- Acceptable methods for valuing trading stock
- Record keeping requirements

*You should ensure that you are familiar with the rules. We suggest that you start with the following link:*

<https://www.ato.gov.au/Business/Income-and-deductions-for-business/Reconciliation-activities/Accounting-for-trading-stock/>

#### 4.2.4. Private use of Business Assets

Where businesses provide employees or associates with cash or non-cash benefits, Fringe Benefits Tax must be considered.

The ATO provides some useful information here:

[https://www.ato.gov.au/General/Fringe-benefits-tax-\(FBT\)/](https://www.ato.gov.au/General/Fringe-benefits-tax-(FBT)/)

*The legislation around Fringe Benefits can be quite confusing given its breadth. You should ensure that;*

- *You understand the types of transactions that can attract Fringe Benefits tax or limit your ability to claim a tax deduction*
- *For transaction types that your business commonly experiences, you understand the specific requirements for valid claims*
- *You understand and adhere to the record keeping requirements, including retention periods*

#### 4.2.5. Motor Vehicles

We've included a special mention for motor vehicles because they are so commonly owned by businesses and almost invariably include a private use component. Record keeping requirements, in most cases, are stringent.

*You should review the following link and ensure that you take special note of the record keeping requirements;*

<https://www.ato.gov.au/Business/Income-and-deductions-for-business/Deductions/Motor-vehicle-expenses/>

You should also ensure that you're aware of motor vehicle cost limits for depreciation purposes, and maximum GST claims.

#### 4.2.6. Employee Superannuation

Businesses that employ individuals must adhere to the stringent and complex superannuation rules which dictate how much superannuation a business must pay and when it should be paid. Because of these complexities, and the cashflow pressures that small businesses can face, many employers have not paid adequate superannuation, or not paid it on time. Given this, and the sensitivity around protecting the retirement income of wage earners, Superannuation is often a focus for ATO audit of small businesses. Non-compliance can result in significant penalties to the business and Directors personally.

*You should;*

- *Familiarise yourself with this helpful page from the ATO: <https://www.ato.gov.au/Business/Super-for-employers/>*
- *Ensure that the person responsible for payroll is well versed in the superannuation requirements, including timeframes for superannuation payment*
- *Ensure that the person responsible for payroll has a way to remain informed as rules change over time*
- *Contact us if you and/or your payroll officer need assistance with Superannuation rules.*



#### 4.3. HISTORY OF POOR COMPLIANCE / LONG OUTSTANDING RETURNS

Clients with long outstanding tax reporting obligations are at a high risk of audit, default assessments and penalties. Late lodgement can lead to the ATO bringing forward future lodgement dates, compounding your issues.

*you should;*

- *Contact us to obtain a list of outstanding compliance reporting for your group*
- *Contact the ATO to provide a reason for the delay, and agree a date by which the reports will be lodged*
- *Attend to lodgement as a matter of priority. We're here to help.*

#### 4.4. INTERNATIONAL DEALINGS

Individuals and entities engaged in international dealings are ATO audit targets, particularly in relation to;

- Australian businesses engaging in offshore activities
- Australian residents with Investments in foreign entities
- Foreign residents disposing of Australian property
- Income or profits generated in Australia that are not being subjected to domestic tax due to non-arm's length conditions of international related party dealings
- International business restructures
- Interest or royalties paid to foreign entities
- Australian and foreign entities that have multinational investments and their debts exceed 60% of the net value of their Australian investments
- Australian entities that have dealings or relationships with secrecy and low tax jurisdictions and poor tax performance

The rules in relation to the above are complex, and taxpayers may inadvertently breach Australian tax laws.

**You should ensure that you have disclosed all international dealings with us in order that we can advise specifically on the rules you should understand.**

#### 4.5. COMPLEX TAX AFFAIRS

Clients with complex tax affairs are likely exposed to audit risk in a number of areas. Being prepared for an audit is the key to dealing with an ATO audit in a fast and efficient manner.

*You should;*

- *Ensure that your group structure is well documented, preferably in a visual manner*
- *Ensure that you properly understand the ways in which different entity types (eg. Companies, trusts, partnerships, individuals and self-managed superannuation funds) are taxed and relate to each other in your group*

*- Be aware of the likely audit risks particular to the complexities in your group*

*- Prepare documentation to justify your position with the ATO in advance. Remember, ATO audits can be years after the event due to the delayed reporting systems inherent in our tax system. It is invariably difficult to recall the reasoning for complex transactions or treatment of transactions years later without good documentation.*

*- Ask us to review this documentation to ensure it is compliant with the latest laws.*

#### 4.6. SIGNIFICANT LIFESTYLE ASSETS USED IN BUSINESS

The ATO focus on assets and private pursuits that generate tax deductions or are mischaracterised as business activities. In particular:

- private aircraft ownership or activities
- art ownership and dealings
- car or motor bike racing activities (refer to [ATO ID 2005/284](#))
- luxury and charter boat activities (refer to [TR 2003/4](#))
- enthusiast or luxury motor vehicles
- grape growing and other farming pursuits (refer to [TR 97/11](#))
- horse breeding, racing and training activities (refer to [TR 2008/2](#))
- holiday homes and luxury accommodation provision (refer to [Holiday homes](#) and [IT 2167](#))
- sporting clubs and other activities involving participation of the principals or associates of principals of private groups.

*You should contact us to discuss the treatment of any of the above that apply to you to ensure that:*

*The arrangements are documented and defensible, and that private usage is apportioned correctly*

*Fringe benefits tax has been considered and dealt with appropriately*

*GST has been correctly calculated*

#### 4.7. RESEARCH AND DEVELOPMENT TAX INCENTIVE

The ATO and AusIndustry (on behalf of Innovation and Science Australia) jointly administer the Research and Development (R&D) tax incentive which aims to give effect to the Australian Government objective to support companies that undertake eligible R&D activities. AusIndustry administers the registration and compliance of the R&D activities, and the ATO are responsible for the expenditure claimed on the tax return for eligible R&D activities.

Recent areas of concern according to the ATO include:

- claiming R&D tax offsets on business as usual expenses that are not covered by eligible R&D activities
- how entities apportion overheads between eligible R&D activities and other non-R&D activities
- payments to associates

- whether or not expenses have been incurred
- approaches taken by R&D consultants
- fraudulent claims
- failure to keep records.

*You should familiarise yourself with the following link:*

- **[Research and development tax incentive](#)**

*The ATO have also published the following taxpayer alerts that may be relevant to your industry, and we strongly recommend that you read any relevant links:*

- Broadacre farming activities [TA 2015/3](#)
- Construction activities [TA 2017/2](#)
- Claiming on ordinary business activities [TA 2017/3](#)
- Agricultural activities [TA 2017/4](#)
- Software development activities [TA 2017/5](#)