BAN TACS
National Accountants Group

NEWSFLASH BOOKLET

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Small Business

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Important

This booklet is simply a collection of Newsflash articles relevant to small business. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.

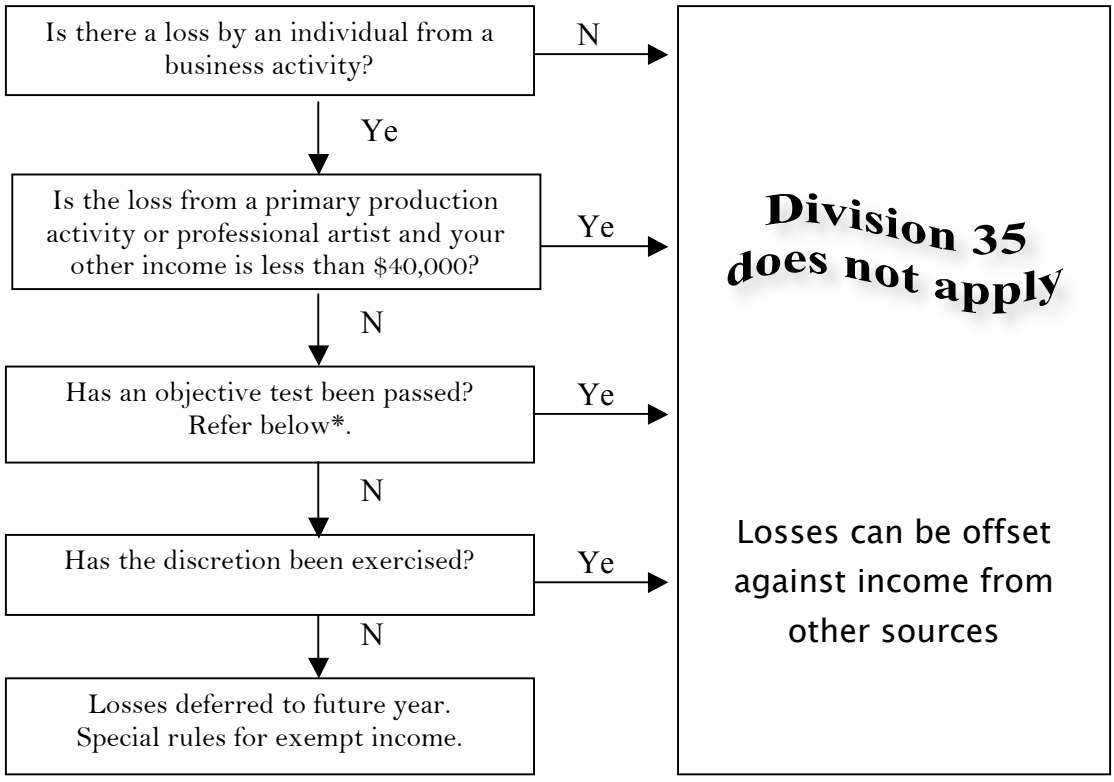
Recommended reading

We recommend that you read the KPI booklet to learn a few tools for managing your business.

Offsetting Business Losses Against Other Income

A bill has been introduced to Parliament that limits the circumstances where a taxpayer can offset business losses against his or her other income. Note this applies only to business losses, not passive income such as negatively geared rental property. This could apply to you if you receive a share of a loss from a partnership or operate a business at a loss. If caught by these provisions the losses can be held over to claim against future profits from the same business.

The following flow chart summaries the provisions: **For an income year:**



***Objective Test:**

To pass the objective test one of the following must be satisfied.

1) Turnover from the business activity is at least $20,000. .
2) The business has produced a taxable profit in at least 3 of the last 5 years including the current year. Note this is a profit before deducting any carried forward losses from previous years.
3) The value of real property used in carrying on the business is at least $500,000.
4) The value of other assets used in carrying on a business is at least $100,000.

Offsetting Non Commercial Losses Against Other Income

These provisions are explained above. Note the concessions for primary producers have been extended to Artists and Professional Sports People. If you fail the test above the losses are quarantined but can be offset against future profits from the business. In order to be able to claim these losses in future years they must be recorded in the income tax return for the year in which they are actually incurred even though they cannot be

claimed as a deduction. Accordingly, it is still necessary for you to bring in the information regarding these businesses.

Linking Programmers, Inventors, & Expanding Businesses to Investors & Government Grants

The Queensland Government Department of State Development has compiled a huge network for this purpose. You are no longer alone and the opportunities appear to be endless. For example:

Workshops to show you how to prepare your business and present your plan to investors.

Introductions to potential investors. For example Enterprise Angels is one of the many organisations that link businesses with investors. Their web site is www.enterpriseangels.com

Training to transform a technical person into a business person able to present their business to investors. This can be provided in Fortitude Valley by Achaeus Ltd., visit their web page at www.achaeus.com.au for more details. They provide training in preparing information about your business yourself, that would cost a fortune to have done professionally. Having prepared the plan yourself your personal presentation to potential investors will be much more professional.

Grants from ISUS up to $70,000 for start up at pre commercialisation stage. QIDS dollar for dollar assistance for business development e.g. business planning, trade shows etc. COMET for technology start-up grants. R & D Start grants and loans to assist research and development of innovation.

Mentors The Queensland Entrepreneurs Association provide mentors and network referrals.

Technical Assistance as well as funding is available through the Queensland Industry Development Scheme.
www.statedevelopment.qld.gov.au

Investors, these services provide a filtering system that helps ensure you make connections with legitimate businesses. For businesses this is an ideal method of funding before your business meets the criteria required by the banks. The first place to start looking is www.cbglobal.com

Employee Contributions for FBT and the BAS

On the 21st May, 2001 the Commissioner released GSTR 2001/3 which deals with employee contributions towards fringe benefits, being subject to GST. Unless the employee makes the contribution by way of paying the actual expenses associated with the benefit (such as fuel) and no input credit has been claimed on those expenses the taxable employee contribution is to appear in the BAS in the quarter in which it is received if the BAS is on a Cash basis. According to GSTR 2000/D17 paragraph 24, if the BAS is on an accruals or non cash basis all of the employee contribution is included in the BAS in which the first amount is received or when a bill is issued to an employee unless the full amount is not know then only the amount received is included. While the ruling doesn't address this I believe the legislation supports that the full amount of the contribution should be included when the supply is made if this is the first thing to happen and you are reporting on a non-cash basis. As the last FBT year started before the GST was introduced an amount paid for a benefit received over this particular FBT year 1st April 2000 to 31st March 2001 should be amortised over the period the benefit was provided to see if there is a pre GST portion on which no GST will be payable.

Unfortunately the ruling only looks at the limited circumstances of employees who are not owners of the company. Many of our clients own companies or trusts of which they are employees. They don't pay fringe benefits tax because they make employee contributions to cancel out the benefit. Many clients may not even be fully aware of this because until now the entry has been made by journal entry by the accountant when the tax return is done. This is permitted to be done retrospectively under ruling MT2050. GSTR2001/3 accepts that the employee can make a contribution after the end of the FBT year and have it apply to that year. So in order to be technically correct the journal, when made should not be back dated as it has been in the past but dated the date it is made. This way it can be correctly recorded in the BAS for the period when the accountant is doing the work. Just make sure you get this information for your BAS. We have had the above approach confirmed by the NTAA and ATO.

The above probably applies to you if your vehicle is owned by a trust or company and you are not in the maximum tax bracket, or if an employee makes contributions to you.

In short what to do now:

If you have employees who make actual contributions during the year and you prepare your BAS on a cash basis you will have to enter these amounts on the BAS for each period they are received. If you prepare your

BAS on a non-cash accruals basis you have to include all the future payments when the first one is received or you issue a bill or the goods are supplied unless the total amount is uncertain. This should not be a problem if the contribution is for goods as they have been supplied so the amount should have been set. The problem arises when a car is provided on an ongoing basis. There seems to be a good argument here that the total amount is not certain so the contribution only needs to be included when it is received or the journal entry made. In the latter case where you are at risk of missing this one off entry as it does not go through the cashbook. So if you are preparing your own BAS don't forget to ask you accountant for this amount when the business income tax return is done.

Some employees will be making an annual contribution in the June quarter as in most cases this is the quarter when the liability is calculated for the FBT return. The fringe benefit calculation for motor vehicles based on the formula method is reasonably simple. So once shown by your accountant you should be able to do it yourself in future years. But note when the car has been held for more than 4 years, at the beginning of the FBT year, the cost base in the formula is reduced to 2/3rds of the original cost. If you are accounting for the car on a log book basis the fringe benefit calculation is much more complex.

How a Discretionary Trust Works

Since the collapse of HIH many clients have decided to incorporate in order to put the corporate veil between themselves and their customers. The HIH catastrophe made people realise it was not enough to have paid the premium on an insurance policy, if the insurance company goes broke. The corporate veil enables them to put a barrier between the business and their personal assets providing they do not trade while insolvent or act illegally. In many cases we recommend placing a trust under the company to take advantage of the CGT concessions and more flexibility of profit distributions. On the other hand trading as a company does allow you to retain profits at the 30% but these profits, if kept in the trading entity, are venerable if the company is sued. If they are removed from the company they will probably be exposed to the higher marginal tax rates of the owners or fall foul of the many provisions designed to prevent the owners of companies from utilising the profits for personal purposes, such as Division 7A. The following article is intended to explain the basics to readers that are no doubt good at their trade but have a very limited understanding of business concepts.

A Trust is not a legal entity in its own right. In simple terms the law recognises, legal entities, such as sane people over 18 and companies as having the right to enter into binding contracts. Most readers are probably aware that a deceased estate is a trust. The deceased can no-longer enter into contracts on his or her own behalf but assets still need to be sold. An executor or trustee is appointed to enter into contracts on the deceased's behalf. When the executor or trustee enters into these contracts he or she is not binding his or herself but the deceased.

When a trading trust (as opposed to a deceased estate) is set up a company is normally appointed the trustee of the trust. This means that the effective owner of the trust can become a director of the company and control the trust but not have his or her personal assets responsible for the companies debts (unless they have given personal guarantees) providing they act honestly. The company does not trade and acts simply as a figurehead. Accordingly, it is not required to lodge income tax returns but annual returns to ASIC are required. The actual trading entity is the trust but as it is not a legal entity it enters into contracts under the company name with an additional notation that the company is trustee for the trust. The trust is the trading entity and as such is required to have an ABN, TFN and lodge tax returns. From this point onwards we only address the circumstances of a discretionary trust.

It is most important that the owners of the business remember that the trust is a separate legal entity from the owners themselves. This means that what belongs to the trust belongs only to the trust. Accordingly care should be exercised when using the trust's funds for personal purposes.

If any profits remain in the trust they will be taxed at the maximum tax bracket. Some of the circumstances when this is lower than the "owners" tax bracket are when the following are applicable to the "owner".

a) The "Owner" has a Child Support Liability.
b) The "Owner" has exceeded the Medicare levy threshold without appropriate health insurance cover.

While there are not any specific provision prohibiting trusts lending the profits it has retained back to the "owner" of the business, there are many traps. Therefore if you take profits from your trust without consulting your Accountant you should stick to the following methods.

1) **Wages** – Unlike a sole trader or partnership the trust being a separate legal entity from the owners allows the owners to become employees of the trust. Owners' wages should be treated exactly the same as those of other employees. For example superannuation contributions of 9% should be made; normal PAYG instalments should be deducted and included along with the wages on W1 and W2 of the Trust's BAS. If the "Owners" are not directors of the trustee company their wages should be included in workers' compensation calculation. Care should be taken to ensure these wages do not force the trust into a loss situation as this will result in the "group" paying more tax in the short term and relying on the trust to make profits before the extra tax can be recouped. As employees of the trust the "owners" can participate in fringe benefit arrangements.
2) **Profit Distribution** – Firstly ensure that there are profits to be distributed. Then create a minute declaring the profit distribution to the selected beneficiaries that are nominated either directly or indirectly by the trust deed.

   The minute should present as follows:

   Minute Of Meeting of Directors of _____ P/L as trustee for the _____ Family trust

   Date:

   Present:

   Resolution: It was declared that the _____ Family trust distribute the profits for the financial year ending 30th June, 2007 as follows

   _____ $

   _____ $

   Signed as a true and correct record:

3) **Repayment of a Loan** - The "Owners" of a business usually lend it money to get started. The trust can repay this without any complications. Make sure the loan does not topple over the other way so that the "Owners" owe the trust money without first consulting an accountant. As stated above profits left in the trust are taxed at the maximum tax bracket. Unless the trust has some tax-exempt income, it will need to retain profits in order to have the funds to repay the loan. So even if during the year the trust repays your loan, at the end of the year you may decide that it was really a distribution of profits because the owners are in a lower tax bracket.

The above should not be viewed as a comprehensive analysis of the law. It is too simplified for this and is merely intended to give the reader an easy method of understanding of the concepts.

When Do You Become an Employer?

A key case in this area is Hollis v Vabu Pty. Limited where the high court decided that a bicycle courier was an employee of the courier company. Note this case was not in regard to the superannuation guarantee. The contrast between this and another Vabu case gives you an idea of how unclear the area of employee or contractor is and how little this relies on outward appearances such as an ABN. The ATO has announced that it will rule on bicycle couriers to the full extent based on Hollis' case (2001 ATC 4508). In other words all bicycle couriers are now considered employees of their courier company. Accordingly, the ATO ruled that as at 1st July, 2002 all bicycle couriers with an ABN for that purpose only are to cancel their ABN and GST registration if applicable and Courier companies must treat their bicycle couriers as employees including deducting PAYG withholding from their payments, paying FBT on any benefits they receive and paying the 9% superannuation surcharge. Yet the very same courier company won the right not to include its Courier drivers who supplied a purpose built car as employees for the superannuation guarantee levy. Further in the Hollis case the judge said that it does not matter if the courier supplies a bicycle or a car they are still employees.

In view of the above please take the following as the best guideline we can give you but nothing is black and white. Please note that the alienation of personal services income rules (80/20 rule) do not apply to make contractors employees. These rules are only intended to control how contractors deal with the payments they receive.

For PAYG Withholding Purposes – Whether a person is an employee (and therefore the Payer is required to withhold PAYG) is an issue of common law. Therefore it is not specified in legislation but by various cases over the years. The ATO has outlined its opinion in TR 2000/14. This topic is full of fine lines for example the difference between an employee and an independent contract is whether the contract is a contract of service or a contract for services. Probably the strongest indicator is the control test. Years ago this used to be called the servant master relationship. The control test looks at how much the payer has a right to direct how, where and when the work is performed. This is where the question of, is the contractor employed to perform a specific task or to provide services as directed by the payer, comes from. If a contractor is paid on an hourly rate it strongly suggest that the payer has control over their efforts and so should be withholding PAYG Instalments. Having said that you should now be aware of some direct contradictions of this situation. Solicitors and accountants may charge on an hourly rate but be contractors because they have so many other clients. A salesperson who only receives commission, so is remunerated purely on a results basis is usually still considered to be an employee. Other tests include: does the contractor have the right to employ someone else to perform the work and does the contractor assume any risks that could result in he or she making a profit or loss on the job (payment for a result) rather than a guaranteed income. The more tools and materials the contractor provides the less likely the payer will have to withhold PAYG. The more payers the contractor has the less likely that PAYG Withholding Instalments need to be deducted. If the contractor is a partnership, company or a trust the payer does not have to withhold PAYG unless the set up is purely a sham, refer TR 1999/13 paragraphs 7 to 9. The provision by a contractor of an ABN will not automatically relieve the payer of the responsibility to deduct PAYG Withholding (TR 2000/14 Para 17). When the contract includes the payment of sick leave and/or annual leave the payee is most likely to be considered an employee. The higher the proportion of the gross income which the worker is required to expend in deriving that income, and the more substantial the assets which the worker brings to his or her tasks, the more likely it is that the contract is for services.

Simply writing in a contract that the payee is not an employee but a contractor will not automatically make that the case for tax law purposes. This clause is only effective if the contract has the elements of a sub contract relationship. The claim that it is not a contract of employment can only be used to clarify any ambiguity.

It helps to support the argument that the worker is a contractor if the relationship came into existence because of an advertisement by the contractor of his or her services to the public or if it was in response to a tender notice.

An oldie but a goodie in support of an independent contractor is the Worldbook Case where “Undertaking the production of a given result has been considered to be a mark, if not the mark, of an independent contractor". A major factor in this case was the contractor's right to employ others to do the work and the fact that payment was only by way of commission for actual sales made. Payment was not related to the amount of work done but to the result it produced. Though as you can see from TR 1999/13 paying commission alone is not sufficient argument that the payee is a contractor.

For Superannuation Guarantee Purposes – Common law employees as discussed above are caught by the guarantee but contracts with individuals that are principally for their labour are also caught. The most significant case here is Vabu's case, discussed above. The court found that a courier company was not required to pay superannuation under the guarantee where the courier drivers provided their own vehicle that was designed to carry parcels. SGD93/6 gives the ATO's opinion of when a courier driver is considered to be acting independently of its company and therefore the courier company is not liable for the guarantee. The more the arrangement becomes a payment for more than just the personal services of the worker the less likely the payer is to be liable for superannuation. For example a payment to the owner driver of a semi trailer is not subject to the superannuation guarantee because the majority of the payment would be for the provision of the truck.

The right to control is also a major determining factor. For example, family day care providers in their own home are not entitled to have superannuation contributions made for them because they have so much independence in their daily tasks (SGD94/4) yet family day care has a large amount of rules and guidelines this is not considered to be control. The right to refuse a child was also considered relevant. If a contract is

with a company, trust or partnership there is no requirement for the superannuation guarantee levy. If the payee is a sole trader and less than 50% of the payment received is for the sole trader's own labour there is no requirement to pay superannuation. Examples of this would be supplying and installing an air conditioner where the charge for the air conditioner was more than the installation charge. Of course if a sole trader provides you with the services of one of his or her employees you are not required to make a superannuation contribution for that employee the sole trader is.

If you are found to have not met the requirements of the Superannuation Guarantee you will be fined, required to pay the omitted superannuation and not receive a tax deduction for it. Therefore we recommend you error in favour of caution.

For Workers' Compensation Purposes – The workers' compensation rules vary from state to state. In Queensland if you subcontract to a company or a trust you are not required to cover it or its employees for workers compensation. However the employed company or trust is required to cover its employees and possibly subcontractors. If the contract is with a partnership but it is only really for the labour of one partner you will need to include that partner in your workers compensation cover. If your subcontractor is a sole trader and the contract is mainly (greater than 50%) for the labour of that subcontractor, they should be included in your workers compensation policy. The results test is also relevant. The Queensland workers compensation board have adopted the results test present in Alienation of Personal Services Income Legislation. Full details of this are available in our APIS booklet. Directors of companies do not have to cover themselves with workers compensation. More information can be found on the Queensland Workers Compensation Board' web site at www.workcoverqld.com.au.

Cashing in Leave

Annual Leave – Some Federal Awards allow employees to receive the cash value of their annual leave rather than taking the time off. In Western Australia employees can cash in up to 50% of the annual leave they have accrued. Employers in NSW are specifically prohibited from paying their employees for their annual leave rather than them taking it.

Long Service Leave – Some Federal Awards allow employees to receive the cash value of their long service leave rather than taking the time off. In Queensland, South Australia, Tasmania and Western Australia can cash in all or part of their long service leave entitlement.

FBT Return Preparation

How to account for those Christmas parties and gifts

Gifts that are not entertainment are fully tax deductible and a GST input credit is available but they are subject to FBT if they exceed $100 per employee ($300 after 1st April, 2007). If they are gifts to a customer they are fully deductible, a GST input tax credit is available and no FBT payable.

A Christmas party is considered entertainment so the following dissection needs to be made of those attending:

Family members etc of employees

FBT payable, tax deductible and input credit can be claimed. But if the total value to the family of the benefit received is under $100 ($300 after 1st April, 2007) no FBT, no GST input credit and no tax deduction. The employee himself or herself is included in the family total if the party is away from work or not on a normal working day.

Employees

on a normal working day at work no FBT, no tax deduction for the expense and no input credit can be claimed. If not at work or not on a normal working day FBT applies and a tax deduction and input credit is allowed if the benefit in total received by the employee and his or her family exceeds $100 ($300 after 1st April, 2007). If it does not exceed $100 ($300 after 1st April, 2007) no FBT is payable but no tax deduction or input credit.

Customers

No tax deduction, no GST input credit and no FBT payable.

There are 2 methods available for apportioning the costs between employees, family members and customers. One is a 12 week register which is not really appropriate for a one off Christmas party. The other is the 50/50 method which allows you to assume one half of the total expense is subject to FBT. Therefore only one half of the expense is deductible. But careful as, if the amount per employer qualifies as a minor benefit then no tax

deduction is permitted. If you use this method the other half of the expense that is not deemed to be a benefit is not tax deductible. The availability of the GST input credit is on the same basis as the tax deductibility. References – TR97/17, FBTAA 136(1) and 58P

What to put on group certificates

Fringe Benefits need only be included on group certificates if their value before grossing up exceeds $1,000. But if this is the case the whole amount including the first $1,000 is included. This $1,000 threshold changes to $2,000 from 1st April, 2007. The FBT year finishes on 31st March yet group certificates don't come out until 30th June. So the group certificates for the year ended 30th June, 2007 will show fringe benefits supplied from 1st April 2006 to 31st March 2007. Some fringe benefits such as meals and car parking are excluded from the $1,000 limit and excluded from the amount to appear on the group certificate. The gross up rate for reportable fringe benefits is 1.8692 regardless of whether GST applies to the benefit or not.

Employee contribution

The amount of the fringe benefit can be reduced by employee contributions but if these are made in cash, GST and income tax is payable on this amount by the employer. GST is not payable if the employee contribution is towards motel accommodation or a GST free expense such as health insurance.

Thresholds – GST Inclusive or GST Exclusive

1) The Minor Fringe Benefit limit of $100 is the GST inclusive price. The value of all fringe benefits is the GST inclusive price.
2) The $300 plant and equipment limit regarding immediate write off of the expense is the GST inclusive price.
3) The $20,000 income threshold (section 35-30) to allow the offset of a business loss against other income is the total sales after removing the GST. Note also the $20,000 total sales is per partnership not per partner providing all the partners are individuals (section 35-25).

Thank God our Government has tax simplification as a priority.

Concessions on Attribution Rules for PSI

At a meeting in July between the ATO and tax practitioners the following concessions were announced:

1) The complex PAYG withholding obligations have been abolished for the 2000/2001 year. While the income is still to be included in the personal income tax return of the person who earned it, there will be no penalties for the tax not being withheld. It can now simply be paid when the assessment notice is issued for the tax return. No penalties or interest charges will apply if the tax is paid by the due date of the 2000/2001 assessment. Which should be around two months after the tax return is lodged.

2) For the 2001/2002 year rather than companies, trusts and partnerships having to perform complex calculations each quarter to determine the attributed amount it can do an estimate based on either 70% of the gross personal services income or a percentage based on the entity's net personal services income for the previous year. If these options are used the tax must be withheld on the amount calculated as if it was paid as wages. The original attribution rules must be used for every year when calculating the amount that is actually entered into the income tax return. But no penalty or interest will apply to any differences between the estimate and actual.

Partnerships Registered for GST

The portion of partnership income a partner puts in the T1 box of his or her IAS is calculated using the following formula:

$$\frac{\textit{Your Share of Profit from the partnership as per the last tax return}}{\textit{Partnership's instalment income (turnover) as per the last tax return}}$$

As most people didn't understand this formula the percentage was probably given to you by a member of our team is based on the most recently lodged partnership income tax return. Since then the partnership has probably lodged another income tax return so this figure will have to change.

If the ATO has changed the amount shown in the T2 box on your IAS this is a sign that another partnership income tax return has been lodged. If you still receive partnership income you should contact the accountant for the partnership to find out the new percentage you are to apply to the partnership income to determine the amount you should include in T1.

Prepayments

When in Business: Before the 1st July 2001 many clients paid expenses in advance, usually in June, so that they could claim a larger tax deduction in the year the expense was paid. The most common method was paying lease payments on motor vehicles in advance. This strategy has now been severely restricted in that such prepayments have to be apportioned over the period they apply to unless:

1) They are for less than $1,000
2) Required by law
3) Salary or Wages
4) If you elect to enter the simplified tax system (refer Newsflash 23) you can continue to claim prepayments but only for up to 12 months in advance.

Non-Business such as rental properties: If the prepayment is made by an individual they can continue to claim a deduction for prepayments but only for up to 12 months in advance. Companies and trusts that are not in business must apportion all prepayments.

Deductibility of Interest

Interest on a loan is tax deductible when the money borrowed is used for income producing purposes. Case J54 (1958) 9 TBRD established the principle that interest is apportioned according to the ownership of the investment purchased. Accordingly, a couple can borrow money jointly for an investment that is held in the name of just one member. The whole amount of the interest attributable to the investment will be deductible to the partner in whose name the investment is held.

Courier Drivers

It has been a busy month in the game of spot the difference between the employee courier driver and the subcontractor. The ATO has done a back flip and decided that a courier operating under a contract to produce a result, supply equipment and fix mistakes at their own expense, will not be caught by the alienation of personal services income provisions. In other words the 80/20 rule will not apply to typical couriers.

In the same month the High Court decided, in Hollis v Vabu Pty. Limited, that a courier was an employee of the courier company. In this case Hollis was injured by one of the courier's contracting to Vabu Pty. Limited and the court decided that Vabu Pty. Limited was liable to pay damages because it considered the courier to be an employee of Vabu Pty. Limited. While the negligent "employee" was only on a bicycle the judge went further to say that the same would apply when the courier/employee provides a car.

The above case does not overturn the finding several years ago that couriers are not employees for superannuation guarantee purposes. Interestingly, the test case was on the same company, Vabu Pty. Limited, and the facts examined to determine whether the courier was an employee or independent contractor were the same.

As a result of the above both courier drivers and courier companies should carry public liability insurance. Courier companies are relatively safe in not deducting tax from their drivers and not paying superannuation for them. It would be worth getting a ruling from the workers' compensation board in your state as to whether the courier company should cover the drivers for personal injury. We are not yet confident that bicycle couriers will be able to avoid the alienation of personal services income legislation.

Primary Producers

As you are probably aware the government has introduced measures to prevent losses being offset against other income from 1st July, 2000 onwards. There are concessions available and in some cases these will take considerable tax planning.

Basically, the new law requires losses to be quarantined to be offset only against future profits from that particular business. This does not apply to negatively geared rental properties or share investments. In order to offset the loss against other current year income, **one** of the following conditions must be met:

- The activity produces an assessable income of at least $20,000; Or
- The particular activity has produced a taxable income in 3 out of the last 5 years; Or
- The reduced cost base or market value of land and buildings used in the business is at least $500,000; Or
- The total value of other assets, excluding motor vehicles, used in the business is at least $100,000; Or
- Apply to the ATO for permission to offset the losses because they arose from a business that has long lead times or a natural disaster; Or
- If the Primary Producer is trading as sole trader and has non primary production income of less than $40,000.

Wages, Commissions, Voluntary Agreements & the BAS

Voluntary Agreements – The gross amount is included at W1 and the tax withheld at W2. These amounts do not appear in any of the G boxes. Refer BAS Instruction book page 107.

Wages – This includes bonuses, leave payments, commissions, allowances etc paid to employees. Include the gross amount at W1 and the tax withheld at W2. This amount does not appear in any of the G boxes. Refer BAS Instruction book pages 107 and 50.

ABN Quoted but not registered for GST – If using the shortened BAS form described above you need only include this amount in G11 as G14 is not required to be filled out in the shortened version. But note it is not included in the calculation for G20. When entering this in Quickbooks the tax code will be NCF. Refer BAS Instruction book pages 50 and 55.

Registered for GST and Quoting ABN – Include the GST inclusive amount at G11. This amount is included in the calculation for G20. The QuickBooks tax code is NCG. Refer BAS Instruction book page 50.

PAYG Instalments on Cash or Accruals

PAYG Instalments are not tax on the wages you pay employees but the tax on your own profits and income. These instalments replace provisional tax. If you are a sole trader the instalments are part of the BAS, otherwise you will receive a separate income activity statement. Most clients in business prepare their income tax returns on an accruals basis as there are only limited circumstances when the Income Tax Assessment Act permits income tax to be reported on a cash basis. Your PAYG instalment is calculated by applying your instalment percentage to your total sales for the period or your share of the total sales in a trust or partnership (refer below). If you are reporting GST on a cash basis, as are most clients, the total sales for G1 will be different from the total sales to which you apply the instalment rate. If G1 is on a cash basis it will include only sales for which you have been paid, plus deposits. If the PAYG instalment income is calculated on an accruals basis it includes all sales that you have invoiced for the period, whether paid or not, and if a deposit has been received the whole amount of the order is included as income. Refer to the Quickbooks Handout for information on setting up QuickBooks to report on both a cash and accruals basis.

Partnership PAYG Instalment Rates

When this article appeared in the earlier editions of Newsflash 16 the commentary explaining the formula was incorrect. The formula was correct but the terminology difficult for the lay person to understand. Accordingly, the following is a corrected commentary and hopefully a more understandable formula. They both say the same thing - we are just giving two versions in the hope that at least one will be presented in a way you understand.

Partners apply only their instalment rate to the total gross income (turnover of the partnership) multiplied by the percentage their share of the profit was in the previous year of that years total turnover. This is the instalment amount to which the percentage you received from the ATO is applied.

In other words, the formula to calculate the instalment income to which you apply your percentage is:

$$\frac{\textit{Assessable income (Share of Profit) from the partnership for the last income year}}{\textit{Partnership's instalment income (turnover) for the last income year}} \; \boldsymbol{X} \; \textit{Partnership's instalment (turnover) income for the current period}$$

If your entitlement to a share of the profits has changed from last year you may wish to apply for a variation of your instalment percentage.

Another Way of Explaining the IAS T2 Percentage for Partners

Apparently I am still confusing people with the above two explanations so here is another example. Assuming a simple partnership where the partners split the profit equally:

Information from the last tax return lodged by the partnership:	
Partnership turnover or total income before deductions	$100,000.00
Less: Expenses of the partnership	60,000.00
Net Profit	40,000.00
	/2
Each Partner's share of the Profit	**20,000.00**

Therefore each partner received, as profit, 20% of the actual turnover of the partnership so when calculating their IAS their T2 percentage is applied to 20% of the partnership's turnover for the quarter. Note if you have income from other non-wages sources you will have to apply the T2 percentage to that but not the 20%.

Income Activity Statement – T1

T1 is not necessarily the same as G1. T1 usually includes income from business on an accruals basis yet in most cases G1 includes business income on a cash basis. Note you can elect to measure T1 on a cash basis. A simplified definition of income measured on a cash basis is all the actual cash, cheques and credit card transactions received in relation to the business during the period. Income measured on an accruals basis is the total of all invoices dated within the period but does not include loans to the business.

The business income included at T1 is only sales in the normal course of the business so (unlike G1) it does not include the proceeds from sale of equipment and motor vehicles. Further G1 is the GST inclusive value of sales whereas T1 is the net amount after deducting GST. But it does include the proceeds of the sales tax credit for trading stock. If any income has been subject to the ABN withholding rate of 48.5% the full gross amount must be included as T1 not just the net amount received. If you are a sole trader you also need to include income from outside the business such as interest, gross rent, dividends, royalties, your share of any other trust or partnership income. If you are a partner your share of income from the partnership is subject to the formula above "Partnership PAYG Instalment Rates" but, after calculating that amount, you must also include at T1 interest etc the same as sole traders. If you are a beneficiary of a trust get an accountant to calculate your T1.

Claiming Loan Interest After Business or Investment Sold

A reader has sold an investment property for less than the amount he borrowed. He wants to know if he can still continue to claim the interest on the balance of the loan. The ATO has lost a few cases in this regard lately so there is a good chance that the reader will qualify for a tax deduction. FC of T v Jones, 2002 ATC 4135 and FC of T v Brown, 1999 ATC 4600 and TR 2004/4 are the references. TD 95/27 has been amended as the ATO recognizes that an employee using a car for work purposes that sells for less than the outstanding loan can continue to claim the interest.

Everything you can do to bring yourself into line with the positive points of the cases mentioned above should be done. Some of the relevant facts that you may be in a position to do something about are:

1) All the proceeds of the sale should be used to repay as much of the loan as possible.

2) Endeavor to appear to be unable to repay the loan from other assets other than the family home. This may mean as a couple if only one member owned the property sold at a loss the other member should hold any further investments.
3) Don't refinance the loan to extend its term or increase the interest rate. You must appear to be doing all that is possible to eliminate the loan. So refinancing to reduce the interest rate is ok. On the other hand if you have to change the loan from principle and interest to interest only because that is the only way you can afford the repayments you may be able to justify changing the loan.
4) If the loan is already fixed at the time the investment is sold, then you have an argument that you could not pay it out. This is a factor to consider if you are refinancing before the sale.

The above also applies if the investment was shares or if a business was sold for less than what is owing on it. In the case of a business the ATO has issued a statement that division 35 cannot work to quarantine the interest in these circumstances as the taxpayer is no longer in business. Division 35 is discussed in Non Commercial Business booklet. But all you really need to know is that Division 35 will not stop you claiming the interest.

Methods of Finance and GST

If you are reporting for GST on a cash basis and purchase an item under hire purchase you can only claim the GST input credit on the principle portion of each repayment when it is made. A better scenario is to borrow the money under a normal loan agreement or chattel mortgage so you can claim the full input credit for the acquisition at the time you take out the loan.

Business Structures Comparison

Sole traders and partnerships have always provided a cheap and simple means of being in business. But the collapse of HIH and the volatility of the public liability arena have caused concern for these sorts of businesses. If you operate your business as a sole trader or partnership it is simply you who operates that business, so if something goes wrong it is you personally who will be sued or held liable. Partners are joint and severally liable for each other. This is why we are all careful to cover ourselves with public liability insurance no matter how simple a business because someone could simply trip over you, sue you and you could lose your house. The trouble is that if your public liability insurer goes broke you could still lose your house. Accordingly, the protection of a corporate veil is becoming more and more necessary. By setting up a company you become merely an employee who is not normally liable for his or her actions while working. Note you are still responsible for your actions if you act improperly i.e. trade while insolvent, misappropriate funds, operate the company vehicle while drunk etc. But if you behave properly only your employer namely the company is liable and only the company's assets are up for grabs. But there are many disadvantages in owning a company i.e.:

1) Cost at least $1,000 to set up with additional running costs compared with a sole trader of about $500 p.a..
2) Wages paid to family members must be justified by hours worked.
3) Passive income can only be distributed by dividends (assuming Alienation of Personal Services. Income provisions do not apply) but dividends can only be received by shareholders so flexibility of distribution of income is not available and the same amount must be paid on each share. Changing shareholders will normally create a capital gains tax problem. On the other hand ownership rights are very well defined and enforceable.
4) Does not qualify for the Capital Gains Tax 50% discount. The active asset discount and rollover relief are quarantined within the company unless it is liquidated. The retirement CGT exemption is available if the requirements of a controlling individual can be met.
5) Most creditors will require Directors guarantees so only protection is from people suing the business and some sub contractors who do not have Directors guarantees. Some protection from the ATO if you have been up front with them right from the start.
6) Subject to company law rules as well as normal business and tax law.

Points 3, 4, & 6 can be minimized by putting a discretionary trust under the company.
There are two disadvantages of a trust rather than a company:

1) Difficulty in carrying losses forward so make sure you don't make a loss.
2) Any profits retained by the trust will be taxed at the maximum tax bracket. So another entity such as a company or superannuation fund may be needed to store retained profits in. This has another advantage in that anyone suing the trading trust cannot touch the assets in another trust or superannuation fund.

A discretionary trust has far more flexibility as to who it can distribute income to as long as it is not APSI but the ownership of the underlying assets is not as clearly defined. A unit trust has clearly defined ownership but has many of the problems associated with companies. If two families are going into business together, and clearly defined ownership of assets is important, consider a partnership of discretionary trusts, one for each family. The partnership agreement would define exactly what percentage of the business each trust owned and what each trust's entitlement to profits is. The individual trusts are then free to distribute that profit amongst family members as suits them personally on a year by year basis. This also allows each family trust to choose a different approach to the capital gains tax concessions available to it.

A trust is not a legal entity in its own right so cannot enter into contracts etc. Accordingly, it needs a legal entity to act on its behalf. This is where the company comes in. It holds no assets and is not the trading entity it is just the figure head but if someone sues the trading entity namely the trust they can get at only the trusts assets but they can't go any further unless the directors have acted illegally. Ideally the assets of the business should be held in a superannuation fund or an entity other than the trading trust so those assets will be safe too.

Black Hole Expenditure

Due to the new capital allowance provisions, expenditure on the following will be able to be written off over 5 years if it was incurred after 1st July 2001:

1) Business Establishment Costs
2) Costs of Changing Business Structure
3) Costs of Raising Equity for the Business
4) Costs of Defending a Business Against a Takeover
5) Costs of Launching an Unsuccessful Takeover
6) A Shareholder's cost of Liquidating a Company
7) The Costs of closing down a Business

A full 20% of the amount incurred is claimable in the first year the expense is incurred. For example $1,000 of the above expenditure incurred on the 30th June 2002. The deduction in the 2001/2002 tax return is $200. The above does not include expenditure on land, already deductible as expenditure for plant and equipment or already deductible under other provisions. In other words if you buy a piece of equipment that the ATO deems to be depreciable over 20 years you cannot claim that it is a business establishment cost and reduce the write off to over 5 years.

Motor Vehicle Purchases & GST

Please make sure when purchasing a motor vehicle that you obtain a Tax Invoice if you wish to claim back the GST for business purposes. The Purchase Contract does not constitute a Tax Invoice.

The Simplified Tax System

From 1st July, 2006 small businesses with an average turnover of less than $2million will have the option of using a simplified tax system. The following outline of the system should help you decide if it could be of benefit to your business. The primary features of the simplified tax system are covered in the following 3 points but note you cannot pick and choose. If you decide to use the simplified tax system you must make all 3 changes listed below:

1) Accrual Accounting – Changes to the rules in 2004 now mean that cash accounting cannot be used in the STS system unless you were already in STS before that date.
2) Simplified Depreciation – Items of plant costing less than $1,000 can be written off immediately. Items costing over $1,000 are pooled. Items already in the pool at the start of the year are depreciated at 30%. Items joining the pool during the year are depreciated at 15% for that year. But if the item of plant has an

expected life of more than 25 years the rate applied to the opening balance is 5% and 2.5% for new items to the pool.

3) Trading Stock Changes – Stocktakes are not necessary if change in stock held is less than $5,000.
4) Access to the small business CGT concessions even if your net assets are more than $6 million

Once you have elected to prepare your income tax return under the simplified tax system there are restrictions to changing back to the old system unless your business grows to the extent that you no-longer meet the under $2million turnover test. If you do not meet these requirements and you choose to discontinue to use the simplified tax system you cannot return to this system for 5 years.

Note grouping rules apply to the $2million threshold. In summary these grouping rules group together business that share an influence. If the Chief Executive Officer of the Commonwealth Bank had a small business on the side that small business would not qualify because the group's combined turnover exceeded the threshold.

Book Review

Quote from The E Myth Revisited by Michael Gerber:

> " In a business that depends on you, on your style, on your personality, on your presence, on your talent and willingness to do the work, if you're not there why, of course, your customers would go someplace else! Wouldn't you? Because in a business like that, what your customers are buying is not your business's ability to give them what they want, but your ability to give them what they want. And that's what's wrong with it! What if you don't want to be there? What if you'd like to be Someplace else? On a vacation? Or at home? Reading a book? Working in the garden? Or on a sabbatical, for God's sake? Isn't there any place you would rather be at times than in your business, filling the needs of your customers who need you so badly because you're the only one who can do it? What if you're sick, or feel like being sick? Or what if you just feel lazy? Don't you see? If your business depends on you, you don't own a business – you have a job. And it's the worst job in the world because you're working for a lunatic!"

I know there is a lot for me (Julia) to learn here but when reading this passage my heart went out to many of my clients who are in the same boat.

Medicare Levy Surcharge and Child Maintenance

Many taxpayers are being charged the Medicare levy surcharge incorrectly. The surcharge applies if you do not have private hospital insurance with a low or no excess and your income is more than $50,000 for singles or $100,000 for families. The threshold includes taxable income and fringe benefits. The definition of family is based on whether you have dependants i.e. contribute to a spouse or child's (under 16 or full time student under 25) maintenance. Spouses are automatically considered dependants of each other. In the case of separated couples the normal Medicare levy only entitles you to consider a child your dependant if you would be entitled to claim Part A benefit from Centrelink in other words you shared custody of the child. But for surcharge purposes this area is widened and a child would be considered a dependant even if he or she does not live with you but you contribute to his or her maintenance. In particular a single person without private hospital insurance who earns more than $50,000 but less than $100,000 is not liable for the 1% surcharge if they pay child maintenance. Reference ITAA1936 Section 251V.

Diaries and Home Office Expenses

The ATO has released practice statement PS2001/6 which reinforces the importance of keeping diaries to substantiate claims, whether you are a wage earner or in business. Diaries should be kept for one month **every year**. They are necessary when an item has both business and private use. The diary must record both the business and private use. Examples of expenses that this ruling could apply to are telephones, computers, photocopiers, etc. A record should also be kept as to the number of hours an office is used for business.

The ruling points out that a deduction is allowable only where additional running costs are incurred. For example if the family room is also used as an office there would be no deduction for the electricity to light the room if the room was also being used, at the same time, by family members to watch TV.

Claims for non variable expenses such as rent, mortgage interest and rates are only deductible if you business fits the definition of a place of business. Due to a recent case one of the main deciding factors is whether clients or customers regularly visit the premises. Note this is not decisive as you home can still be a

place of business without seeing clients or customers there but you would have to be strong on the other points which are:

- Whether the area is clearly identifiable as a place of business
- Whether the area is not readily suitable or adaptable or use for private or domestic purposes
- Whether the area is used exclusively or almost exclusively for business purposes
- The essential nature of the area and the nature of the taxpayer's business

A more detailed discussion on this matter can be found in TR 93/30.

Note you may not wish to have your home considered a place of business, as this will make it subject to capital gains tax. So this is only beneficial if you are renting or purchased the house before 19th September, 1985. Claiming electricity, depreciation of equipment and telephone will not trigger capital gains tax.

Business Name Registration

Under current law the fine for using an unregistered business name is only $300. The state government is proposing to change this fine to $3,000. So now is the time to register your business name if you haven't already.

The new proposals include a change to the test as to whether a business name is the same as one already registered. Currently the test excludes similar names. The proposed new test will allow any name as long as it is not identical to one already registered.

The main objective of the business name legislation is to give the public details of who owns the name. It is not intended to protect your exclusive right to use that name. If you want to ensure your business name can only be used by you, you should consider registering a Trade Mark.

Privacy Rules

The new privacy legislation does not apply to your business if you have a turnover of under $3 million unless any one of the following applies to you:

1) You are related to a larger organisation.
2) You use the information you collect for any benefit, service or advantage.
3) You handle personal health information.
4) You are contracted as a government service provider.

If you are caught by these rules you must apply the following to information you collected after 21st December, 2001.

1) Take reasonable steps to protect personal information you hold from misuse, loss and unauthorised access or modifications.
2) Only collect information that is necessary and by fair and lawful means.
3) Allow individuals access to their personal information and make corrections.
4) Remove names from mailing list if requested.
5) Notify customers what the information is going to be used for, whom the information will be disclosed to, how they can access the information and the consequences if they do not supply the information.
6) Only use the information in a way that the giver would reasonably expect or has given permission. More information is available at www.privacy.gov.au

Salary Packaging

If your salary package reduces your gross pay to less than $150,000 you can improve your take home pay at the ATO's expense by making employee contributions. Fringe benefits tax is based on the assumption that if you received the money for the benefit in your pay packet all of it will be taxed at the maximum bracket. So if your salary package before the sacrifice is over $150,000 but under $150,000 once the sacrifice is deducted please contact our office and we will calculate the optimal employee contribution you should make as the formula is too complicated to explain here.

Note there are special concessions for employees of hospitals and public benevolent institutions which make salary sacrificing attractive no matter what your income as long as the package is within the limits of the concessions. This issue will be addressed in another article.

If your package is under $150,000 before deducting the salary sacrifice you should make employee contributions to reduce the "taxable value" of the benefit to zero. An employee contribution is not necessary

with exempt fringe benefits that are salary sacrificed such as superannuation, laptops, mobile phones, minor benefits etc. because their taxable value is already zero. The "taxable value" is normally the market value of the benefit you receive, so, if your package is under $150,000, the only items worth salary sacrificing are the exempt benefits or in most cases a car (providing it is unlikely to have much business use and it will travel a reasonable amount of kilometres).

This also applies to the self-employed that operate through a company or trust. The employee contribution is normally done by journal entry when the tax returns are done. Note you will not be able to claim a tax deduction in your personal income tax return for the cost of using a salary sacrificed car for your work.

Reminder About Increased Late Lodgement Penalties

Since the 1st July 2000 the ATO has had the power to fine taxpayer $110 for every 28 days you are late in reporting your tax obligations. This is a $110 for each type of tax. For example if your BAS reports your GST obligations, your PAYG withholding obligations and your PAYG installment obligations the total fine for each 28 days the BAS form is late will be $330 with a limit of up to 5 lots of 28 days. The penalty also applies to income tax returns for the 2001 year and following years. However, the ATO has made a concession for this years income tax returns. The penalty will only apply if you owe the ATO.

Until recently the ATO has rarely enforced the $110 fines on the BAS but it has now announced it is getting tough. Accordingly, we ask you to bring your work in with enough time available to lodge it on time.

Companies, Trusts and the Building Services Authority

We have been checking up on some of our clients and found at least two that are operating as a company or trust but only the business owner is registered with the BSA. For example a carpenter sets up a company so he/she is covered by limited liability should someone sue the business. But as he or she is the only one registered with the BSA and uses that number on contracts effectively he or she is personally liable under that contract. This means the company or trust is a complete waste of time. Secondly, the company or trust is trading in the building industry without a licence. The BSA can fine an unlicensed company or trust up to $75,000. This applies to all companies and trusts engaging in building work where the contract price exceeds $1,100 including labour and materials. A company will also need to employ a licensed supervisor to comply with BSA regulations. Depending on the amount of turnover of the company it will need to have a certain amount of assets to qualify for BSA registration or someone will have to give a deed of assurance on its behalf.

If this article has got you worried, good, because we are very concerned that more clients may be effected. If you are in the building industry and operate through a company or trust please contact Cathy in our office. She can check your registration and if necessary, advise you of the steps you need to take.

Super

Superannuation and Death and Disability Insurance

Reference Part IX of the Income Tax Assessment Act 1936 (ITAA36)

Self Managed Funds

Under Subsection 279(2) of ITAA36 a tax deduction is available to a superannuation fund for the full notional cost of a death and disability insurance policy to cover the life of a member even if the fund elects to only partially insure for its liability under a superannuation policy. That is, the fund can claim a deduction for insurance it has decided not to take out because the assets of the fund will cover the risk anyway. Note an actuarial certificate must be obtained (279(3)) but the cost of this is also tax deductible.

In the year a member dies or is disabled it may not be advantageous to claim this deduction or a deduction for any actual premium paid refer 279B. The advantage gain depends on the future of the fund after the member's death. If this is the case, an election can be made under 279(4). This election can be made on a member basis and does not have to be done until after the relevant financial year.

Members of Superannuation Funds

Section 279D of ITAA36 allows a superannuation fund to, in the event of the death of a member, claim back the tax paid on contributions and pay it to the estate or dependants as part of a death benefit. Note this applies only to amounts that have been taxed in the hands of the fund - not undeducted contributions or proceeds of an insurance policy. It is unusual for a public superannuation fund to apply this so it is worth

checking that their deed allows you to claim this entitlement and that they do apply it. Note a fund cannot use 279B and 279D in the same year so the benefits must be compared.

Life insurance is not a tax deduction to an individual but it can be a tax deduction to a superannuation fund and your contributions to that fund can be fully tax deductible if you are self employed or effectively tax deductible if funded through salary sacrifice. So a considerable saving on life insurance premiums can be obtained by simply including it in your superannuation policy.

Claiming Meals as a Tax Deduction

How employers can claim

IT2675 – "Providing morning and afternoon tea to employees (and associates of employees) on a working day either on the employer's premises or at a work site of the employer is not the provision of entertainment. The cost of providing these refreshments is therefore not excluded as a deduction by subsection 51AE(4) of the ITAA. In most cases, an income tax deduction is allowable under subsection 51(1) of the ITAA. However, it is necessary that the requirements of subsection 51(1) be met in each particular case for the cost of providing the morning or afternoon tea to be deductible. Broadly stated, the requirements are that the expenditure be incurred in the course of gaining assessable income (or carrying on business for this purpose) and that it not be of a capital, private or domestic nature. If an employer (including a partner in a partnership) provides morning and afternoon tea to employees on a working day, and consumes morning or afternoon tea from the same source available to employees, the additional costs for the morning or afternoon tea consumed by the employer is not denied deductibility under the ITAA. The provision of morning and afternoon teas to visitors to the taxpayer's premises or work site is not the provision of entertainment if it is provided on the same basis as employees. Morning and afternoon tea includes light refreshments such as tea, coffee, fruit drinks, cakes and biscuits etc but does not include alcohol. Light meals are treated in the same way as morning and afternoon tea. It is not the provision of entertainment to provide sandwiches and other hand food, salads, orange juices etc that are intended to and can be consumed on the taxpayer's premises or work site. As light meals become more elaborate, they take on more of the characteristics of entertainment. There is no particular point at which this will become obvious.

Normal business practice

Normal business practice will be the yardstick. If alcohol is provided at a morning or afternoon tea or at a light meal this constitutes the provision of entertainment in terms of subsection 51AE(4) of the ITAA and unless one of the exemptions set out in subsection 51AE(5) applies, expenses incurred on the food and drink (including the alcohol) are denied deductibility. The provision of morning and afternoon tea and light meals to employees is an exempt benefit under section 41 of the FBTAA."

Travel Allowance

TR 2000/13, the ruling that deals with the current year's reasonable travel allowances, actually states that you can claim a deduction, against a travel allowance that you receive, in excess of that allowance, if the allowance is under the amount the Commissioner considers reasonable. At paragraph 21 the ruling states: "A domestic or overseas travel allowance expenses claim is considered to be reasonable if the amount of the claim covered by the allowance received by an employee, does not exceed the relevant reasonable amount shown in the Ruling."

To further emphasise this point, at paragraph 105 the ruling gives an example of an employee travelling overseas who is paid $100 per day for meals when TR2000/13 states that $141.99 per day is reasonable. The employee incurs $120 per day in meal expenses. As the $120 per day is under the reasonable amount of $141.99 the employee is entitled to claim this amount i.e. $20 per day in excess of the allowance paid, without the need to keep any written evidence, providing any other requirements such as a travel diary are met.

Note there may be other prerequisites to qualify for a travel allowance claim without substantiation. The above is just highlighting a point in those rules that is not often realised.

Kilometre Method

The cents per kilometre method of motor vehicle substantiation is only limited to 5,000km per car per owner. In other words, a taxpayer can claim for more than one car if he or she is the owner of more than one car and uses it for deductible purposes. Further, if two taxpayers own the same car they can claim 5,000km each providing they are not the same 5,000kms. For example:

A and B are brother and sister and both are required to carry bulky tools to and from work each day because there is no secure storage provided by either of their respective employers. A and B buy two cars each car in both their names. Both of them travel 10,000km per year to and from work. If they swap cars half way through the year they will each be able to claim 10,000km at the 5,000km rate. If the cars have an engine capacity exceeding 2.6 litre that is a tax deduction (based on 1999 rates) of $5,380 each.

On a related issue, Case S29 states that tools weighing more than 20kg are considered bulky. Therefore, transporting them to and from work, if there is no secure storage at work, is deductible. Weight is not the only determinate of bulky. Difficultly in carrying on public transport is also relevant. For example two light but large boxes of say

How to Pay Your Home Off Sooner

The following is only written for Companies, Trusts and Partnerships in business whose owners have personal debt. As Noel Whittaker is constantly reminding us there is good debt and bad debt. Good debt is borrowed to acquire income producing assets and is therefore tax deductible. If you are in the maximum tax bracket and want to pay $1,000 off a loan for your own home you have to:

- earn $1,869.16 – even more if you have a child support liability
- have passed the threshold for the Superannuation surcharge or Medicare surcharge.

So one of the most tax effective tools is to change your non deductible debt to tax deductible debt.

Roberts and Smiths case in July 1992 Federal Court. The ATO interpretation of this is in TR95/25. Basically if your business owes you money (i.e. the working capital you initially put into it) and you are not operating as a sole trader the business can borrow money to pay you back and claim the interest on the new loan as a business expense. If you are operating as a company make sure the loan is debt not equity.

Save Yourself a Fortune in Accounting Fees

Despite warnings in previous issues of Newsflash we are still finding many of our clients are making entries dated before their last BAS or Income Tax Return. This creates a lot of extra work for us when we try to reconcile your file, which means a lot of extra cost to you. It is easy enough to do. For example simply dating an invoice the date of the delivery without considering that that particular date has been closed off by the last BAS or Tax Return. Please date all entries within the current quarter or month, whichever your accounting periods are. If you find this is not possible due to your particular circumstances please give us a ring, we might have an idea or at least we can make a note in our records rather than go looking through all your entries next time we try to reconcile the file.

How to Claim a Tax Deduction for Life Insurance

Normally life insurance premiums are not tax deductible. If your income insurance does provide life insurance as well you are required to dissect the premium and not claim the portion applicable to life insurance. This requirement to dissect the premium does not apply if it is through a superannuation policy. So if you qualify to claim a deduction for your superannuation contributions i.e. you are self employed you can ask your superannuation fund to provide you with life insurance and the increase in premium is just as deductible as the superannuation contribution.

If you are an employee you could salary sacrifice into superannuation to cover yourself for life insurance. If you are a low income wage earner you won't get a tax deduction for your superannuation contributions but you will get up to $1,500 co contribution from the government.

There are superannuation funds that will permit you to make superannuation contributions small enough just to cover your life insurance. So you don't even need to invest extra into superannuation to get life cover.

Tony Townsend Registered Life Broker has offered to review all our clients insurance needs free of charge. He provides a detailed evaluation of all your insurance needs and can see you in your home or our office. Refer the advertisement at the end of this Newsflash.

Bicycle Couriers

The ATO has announced that it will rule on bicycle couriers to the full extent based on Hollis' case (2001 ATC 4508). In other words all bicycle couriers are now considered employees of their courier company. Accordingly, the ATO requires the following by 1st July, 2002.

1) All bicycle couriers with an ABN for that purpose only are to cancel their ABN and GST registration if applicable.
2) Courier companies must treat their bicycle couriers as employees including deducting PAYG withholding from their payments, paying FBT on any benefits they receive and paying the 9% superannuation surcharge.

Consider STS if Purchasing Assets Under $1,000

If you have made a large asset purchase, purchased a lot of assets under $1,000 (which are not part of a set) or, if you have purchased identical assets that combined are under $1,000, there may be considerable tax advantages in switching to the simplified tax system to claim a far greater write off or depreciation. In the year you switch you will have to abide by the other conditions but in the following year you can elect to remove your business from the simplified tax system and return to normal but all the concessions you gain in regard to plant and equipment continue with you. For example you do not have to reverse the write offs and anything that started being depreciated at the concessional accelerated rates for members of the simplified tax system can continue on that rate after you leave. But note you cannot rejoin the simplified tax system for 5 years after you leave it voluntarily. If you leave it because you no longer qualify you can return as soon as you do qualify i.e turnover increases beyond $2million must leave STS.

Doctors etc – Protecting Their Assets

With insurance companies collapsing and public indemnity premiums going through the roof many professionals are wanting to diverse themselves of all their assets including the family home. There are two major barriers with transferring your home to another entity or person:

1) If that person is not your spouse you will lose your principle place of residence exemption for CGT purposes. As indexing no longer applies this will be very expensive when you decide to move. For example even if your property only increases in value by the inflation rate you will have to pay tax on half the gain on the sale of your home. Therefore you will not be able to buy a similar one as they would have all gone up by a similar amount. Note if the property is owned by a company or held for less than 12 months tax will be payable on the whole gain. With the principle place of residence exemption the whole gain would be tax free.
2) The stamp duty cost of transferring the deed.

There is another option, simply gifting the dollar value of your equity in your home to a trust, then the trust lends you back the money taking a second mortgage on the home so you have very little equity. The banks will normally co-operate with a round robin of cheques in their office. Most importantly the house remains in your name but there is nothing left for a creditor to touch. It is too late if action against you has started or starts in the next four years.

Deferred Losses and Separate Net Income

The amount of a person's separate income determines how much spouse rebate their partner is entitled to. Just because a deduction for a loss is deferred by Division 35 it is not prevented for reducing the separate net income calculation. Of course this can't be counted twice so if a spouse claims these losses in a later year they will not reduce the separate net income for that year.

Trusts and Capital Gains Tax Concessions

There are many capital gains concessions (see reader's question below for example) for businesses whose "combined assets" are less than $6 million. The problem lies with the definition of "combined assets" as these include the assets of associates. If you are operating your business as a trust then all the beneficiaries of your trust that are entitled to 40% or more of the profits are associates of your business. Traditionally trust deeds have endeavoured to define beneficiaries as widely as possible to cover all possible future events. The

trouble is that the total of all these possible beneficiaries assets could easily reach $6 million. So it is important to have a clause in your trust deed that any beneficiaries other than the immediate family members are only entitled to a maximum of 39% of the profits in any given year. This ensures their assets are not taken into account when determining whether the assets of the trust and its associates does not exceed $6m.

If you are operating through a trust but the business is so personalised that there is no chance of selling it to someone else, and there are no significant assets, the above should not be of concern to you as you will not be subject to capital gains tax unless you can sell the business for more than it cost you.

This is a relatively new issue so please don't assume that if you organised your trust through BAN TACS that this issue has been addressed. All clients, with trusts, should check their trust deed.

Readers Questions – Selling Business Premises

A reader has been operating a business from premises they own. They have sold the business and are now considering what to do with the premises. As it turns out asking this question before 12 months has elapsed since the sale of the business has halved their capital gains tax bill.

The following exemptions, except point (a)- the 50% capital gains tax discount, are conditional upon the small business test being met i.e. Under $6million in net assets or have elected to enter the simplified tax system.. The definition of net assets includes the assets of all associates.

Capital gains tax will apply to any increase in the value of the premises since purchase (less purchasing costs and selling costs). Note: in some cases indexing may apply but it is rare that this is an option as using it prevents you from using the 50% capital gain discount. The following concessions are permitted regarding capital gains made on assets held for more than 12 months.

a) The 50% capital gains discount - only half of the gain is included in your taxable income. This concession is not available if the asset is owned by a company.
b) The 15 year ownership exemption. This requires you to have held the asset for more than 15 years. The asset must be an active asset. You need to satisfy the controlling individual test if the asset is owned by a company or trust. The taxpayer or the controlling individual, if a company or trust, must also be over 55 and retire or be permanently incapacitated.
c) Retirement exemption – can only apply to an active asset and the taxpayer or controlling individual must retire or put the funds into a superannuation fund. The gain is not taxed when it goes into the superannuation fund and the only limit is that you can only put $500,000 into superannuation this way, in your lifetime. When you retire the money comes to you tax free.
d) 50% discount for active business assets – can only apply to an active asset.
e) Rollover relief where an active asset can be sold and another active asset purchased within two years.

More than one of the above can be used if you qualify. It is not that difficult to meet the retirement condition but if that is the case you would not be looking to use the rollover relief. You can use the 50% capital gain discount together with the 50% active asset discount to only pay tax on only 25% of the gain.

An asset is not an active asset if it is held merely for the purpose of earning rental income. Section 152-35 states that to qualify as an active asset the asset must be held as an active asset just before the sale or within the 12 months before the sale if the business has ceased. In addition to this, the asset must also have been an active asset for at least half the period of ownership. So our reader will need to sell the asset before 12 months has expired from the business ceasing, to be able to claim the 50% active asset discount. Though the Government is looking at making this condition more lenient.

There are problems if the asset is held in a company. Firstly, the 50% CGT discount is not available. The controlling individual test cannot be met in many circumstances so the 15 year ownership or the retirement exemption may not be available. The active asset discount stays within the company. If you try and get the money out of the company (without putting it into a superannuation fund) every dollar you receive, including the dollars that the company did not have to pay tax on because of the discount, will be fully taxable as a dividend in your hands. Using the rollover relief provisions is only useful if you are buying another business but it will force you to continue to use the company, continuing the problem next time you sell.

The GST ramifications of selling the building should also be considered. De-registering for GST is a consideration if you purchased the building before GST came in and the margin scheme will help. Refer our GST booklet for more details.

Tax Minimisation Schemes Alert – Internet Marketing

The ATO has issued TD2002/D5 on internet marketing schemes. The scheme involves an up-front fee for a year of services developing, managing and promoting the taxpayers web site. The scheme marketer guarantees the taxpayer a return equal to the amount invested but in a later year. The real benefit to the taxpayer is income shifting. The catch is the actual web site created is not adequate and the taxpayers involved are claiming to have started up a business at the end of the financial year just for the deduction. They get around Division 35 on the basis that if it had traded for a full year the income would be greater than $20,000. Basically, the ATO is claiming that there is no real intention to enter into the business promoted on the internet it is simply a scheme to increase deductions in the current year. This should not discourage businesses from entering into a legitimate web page arrangement if they are legitimately in business.

Income Protection and Workers Compensation

Income protection offers financial security to those who are not considered to be a worker for the purpose of workers compensation. You are **not** considered to be a worker if you are one of the following:

- ◊ Company Director
- ◊ Trustee
- ◊ Partner of a firm or organization
- ◊ Self-employed
- ◊ Contractor

Workers compensation will **only** cover you if you sustain a work related injury. **Income protection** will cover you if you become ill or sustain an injury twenty four hours per day, seven days per week world wide (that is, also for any non-work related incident).

PLEASE NOTE:
Premiums for income protection policies are fully tax deductible.

FACT:
80% of claims against policies are for males and 70% of those are long term illness.

EXAMPLE OF BENEFITS OF SOME INCOME PROTECTION POLICIES:

- ◊ Allow you to work up to 10 hours per week
- ◊ Offer Day 1 Accident cover
- ◊ Offer a daily benefit if you are hospitalized during the waiting period
- ◊ Provide for a reversionary benefit to your spouse\partner should you die
- ◊ Offer the option of extending cover to include a benefit payment for home duties based spouse/partner

DID YOU KNOW ……..

ON A TYPICAL DAY IN AUSTRALIA –

- ◊ 214 people will be diagnosed with cancer
- ◊ 35 people between the age of 35 and 69 will survive a heart attack
- ◊ 38 people under the age of 75 will have their first stroke
- ◊ 41 people will undergo Coronary Artery By-pass surgery.

And many more victims of unexpected accidents!!

Thanks to Tony Townsend for contributing this article. Tony offers our clients a free full needs assessment. He can be contacted on – 07-5443 3209.

Income Insurance When on a Low Income

Low Income earners can have a problem with insuring their income with an income protection policy as most companies will only cover up to 75% of Taxable Income (for a self employed person this is their Gross Income less expenses incurred).

For self-employed people there is an option available called business expenses Insurance. This enables them to insure critical business expenses under a separate cover. Business Expense items are fixed expenses which will continue regardless of whether a person is working or not, as a consequence of disability caused by injury or illness. E.g. lease payments, rent, administration staff, interest on loans, accounting fees, insurances, some vehicle costs, just to name a few.
Any person in business whose business income is based on their personal efforts and whose business expenses are predominantly met by this personal exertion revenue, could qualify for this type of cover.

Drawing Money From Your Company

The following is written only for Pty Limited Companies. If you operate your business as a trust, partnership or sole trader ignore this article as while some points may be relevant it is not written with these other business entities in mind.

There are four ways in which you can draw money from your company. Each has its areas of concern as follows:

Drawing Money as Wages or Directors' Fees – The tax will need to be paid on these wages in the next BAS. The wages are tax deductible to the company so care should be taken to ensure you do not draw so much that the company will run at a loss. This would effectively mean paying tax on income that has never really been earned. On the other hand if you are going to have taxable income for that year of more than $75,000, you don't really need the cash and the company may need you to lend it money in the future, say to buy capital equipment, consider leaving the money in the company. If it goes to you it will be taxed at the very least at 41.5% and possibly as high as 46.5% whereas the company tax rate is only 30%. If you do leave it in the company and decide to take it out in a future year, maybe because your income is lower, you can still do this as a franked dividend and get the 30% tax the company has paid as a credit towards the tax you will have to pay.

Drawing Money as a Dividend – This can only be done if the company has retained earnings. A minute will have to be made approving the distribution of a dividend and the ATO will need to be advised of each recipient and their TFN. All the holders of a particular class of share must, on a per share basis, receive exactly the same amount and franking credit, if applicable. Make sure you have sufficient franking credits available when you declare the dividend. Franking credits are basically the amount of tax the company has paid (assuming the company has not itself received franked dividends) right up to the last BAS installment. If you do over frank the dividend you can pay a franking deficit tax which is simply tax paid in advance. You can choose how much of the dividend is franked, up to a limit of 42.8% of the amount of actual cash dividend paid, but it must be the same for all shares in that class. The dividend plus any franking credits are included in your tax return as your taxable income the franking credit also reduces the tax payable by you. This strategy is particularly useful in a year when you need money, will be in a low tax bracket and the company is not trading as well as in past years.

Borrowing Money from the Company – Careful here. You can have a loan account, from the company, during the year provided that at the 30th June each year there is nothing owed by you, to the company. It is extremely important that you take the care to adhere to this or the amount outstanding at the 30th June could be effectively taxed at 62.5% unless your accountant organises a loan agreement before lodging the tax return. If you have no alternative but to owe you company money at the 30th June it is important that you execute the appropriate loan documents and offer the necessary security as follows:

1) A written loan agreement must be in place. This loan agreement should be written in such a way that will enable the shareholder to draw more than one loan during the tax year but a new loan agreement will have to be made for each tax year a loan is drawn. The agreement may be subject to stamp duty in some states.
2) At least the FBT benchmark interest rate must be charged on the loan. For the year ending 31st March 2002 this rate was 7.55%.
3) If the loan is unsecured it must not be for more than 7 years and if it is secured, not for more than 25 years.
4) There is a formula in section 109E of the ITAA for calculating the minimum principle and interest repayments.
5) Note repayments do not have to be made in the financial year that the loan starts and interest does not have to be charged in that year but if it is not, FBT may apply. After that, proper repayments must be made.

Getting the Company to Repay its debt to you – This has no tax consequences for you providing you do not reduce the loan to the extent that you end up owing the company money and the point above applies. But note

for the company to retain enough capital to repay your loan it must first be taxed on that money at 30% so this is not a tax efficient strategy if you are earning less than $25,000 in wages.

Tax Minimisation Schemes Alert – Mutual Funds

The ATO is currently investigating a scheme being promoted to retailers by wholesalers or an associate of the wholesaler. The arrangement is for the retailer to buy stock from the wholesaler but instead of receiving a volume discount an amount is redirected into a mutual fund. Mutual funds enjoy tax concessions on income from members. The mutual fund then directs this amount back to the retailer as tax free proceeds from members.

Smart Start for Business

A government agency called IP Australia has produced a booklet called Smart Start – Your First Steps to Managing Intellectual Property in a New Business. This booklet covers Business Names, Domain Names, Confidentiality Agreements, Trade Secrets, Franchising, Trade marks, Patents and Designs. The booklet is available by ringing 1300 651 010 or e-mailing them on assist@ipaustralia.gov.au or visiting their web site at www.ipaustralia.gov.au.

Eleven Keys to Prompt Payment in Service Industries

1. Be up front, explain "how we do it here".
2. Quantify fees in advance.
3. Bill regularly.
4. Bill as near as possible to the conclusion of work segments.
5. Where practical present the account to the client.
6. Provide payment alternatives.
7. Consider fixed fees.
8. Follow up debts systematically and frequently.
9. Explain the value of the work.
10. Build a relationship and demonstrate your value.
11. Consider the fee issue in your client selection criteria.

Division 35 Secret Plans and Clever Tricks

From other articles in Newsflash you are probably well aware that Division 35 prevents business losses being claimed unless one of the following points are met but there is opportunity in the detail:

a) If the loss is primary production and the total gross assessable non primary production income is less than $40,000 the loss maybe offset against other income. This concession also applies to a professional arts business and sports people. Note the $40,000 does not include capital gains or fringe benefits. If the other income is from a partnership, it is only your share of the net profit of the partnership that is added to your assessable income if the partners are natural persons. This makes forming a partnership a very attractive option even if APSI requires you to return the net profit as 100% yours. If you were a sole trader your assessable income would be the total sales of the business before deductions rather than the net profit in the case of a partnership. If you are a wage earner, a partnership will not solve your problem therefore salary sacrificing may be the solution if you are just over the $40,000 limit. But note fringe benefits are effectively taxed at the 46.5% rate. If your income is $40,000 each extra dollar is taxed at 31.5% until you reach 75,000 when it is taxed at 41.5% until $150,000 where it is taxed at 46.5%. So you need to consider the cost of the effective tax rate against the potential gain of offsetting the losses. There may also be benefits of salary sacrificing a vehicle and taking advantage of the formula method if the car does higher than average kilometres

b) The assessable income from the business activity is at least $20,000. The assessable income is sales plus the increase in stock i.e. closing stock less opening stock. Therefore if you purchase more trading stock you will increase the closing stock and therefore increase the assessable income. Note the trading stock has to be on hand for it to be included in closing stock (Section 70-15 ITAA97). So you cannot just order it and bring it into account as a creditor. References Section 35-30 and 70-40 to 70-45. Buying and selling will also increase assessable income so there are plenty of ideas to work with here. There is also a concession for the first year of trading. If a "reasonable estimate" would conclude that had you been

trading for the full year you would have made $20,000 worth of sales plus closing stock (no opening stock in first year) then you are considered to have turned over the $20,000. This also applies to the last year of trading but in that year there will be opening stock.

c) The business has produced a taxable profit in at least 3 of the last 5 years including the current year. Note this is a profit before deducting any carried forward losses from previous years.
d) The value of real property used in carrying on the business is at least $500,000. **or**
e) The value of other assets used in carrying on a business is at least $100,000.

ATO Benchmarks on Cash Businesses

The ATO collects data on businesses in many different industries so it can benchmark taxpayers to consider the risk that they are not reporting all their cash transactions. For example, if you are in the restaurant industry they would look at the margin between your sales and food purchases, compare this with other restaurants to consider whether the amount of food purchased should have produced more income. The margins for 518 industries are available on the ATO web site. If you would like to see how your figures compare with the industry average visit www.ato.gov.au/content/business/downloads

What to do When the ATO Walks in the Door

The ATO has begun what they call "Walk Ins". Their objective is to find businesses operating outside the PAYG or GST systems by going to an area or a particular industry and checking every business. The typical questions they will ask during these "Walk Ins" is:

1) Your ABN?
2) Are you registered and charging for GST?
3) How many employees do your have?
4) Are your Activity Statements (BAS & IAS) up to date?

They will not ask you to prove your answers but will take the information back to their office and check it against the information you have been supplying on your BAS. This will not just catch out those not registered for GST. Imagine if they walk into your premises while you have staff working yet you have not registered for PAYG withholding (deducting tax from employees wages). We have long been advising clients that paying cash wages is not worth the risk and only benefits employees not the employer. These "Walk Ins" are just another reason to be up front with the ATO from the minute you start to employ.

Don't feel pressured to respond to these "Walk Ins" they do not have the right to disrupt your business. If you are busy simply ask them to come back at a more convenient time. The information you provide is voluntary so don't feel obligated but obviously if you don't eventually provide the information they will use their stronger powers to gain all the information they require. You also have a right to have your accountant present when they ask the questions. Clients doing the right thing should not need an accountant to answer the basic questions listed above but if they go further than this and you are concerned, you can halt the whole process until you seek advice.

ATO staff performing the "Walk Ins" have been trained that they must not be intrusive. The ball is in the taxpayer's court, don't be intimidated but realise that you must answer their questions eventually. If you are unsure of the answer you are allowed a lifeline. Call your accountant or arrange for them to come back at a more convenient time.

Of course they will be targeting low compliance areas such as markets and the construction industry.

Careful if you Have a Company as Beneficiary of Your Trust

Division 7A can deem an unfranked dividend to have been paid if a company makes a loan to shareholders. This means that, unless the company has some tax exempt earnings retained, the money would have already been taxed at 30% in the company but the shareholder will still have to pay tax on the full amount received at his or her marginal tax rate with no franking credit. The effective tax rate could be as high as 62.5%. Even if the company has some tax-exempt earnings the whole amount of the loan will still be fully taxable at the shareholder's marginal tax rate. The deemed amount is limited to retained profits and can be avoided by entering into a qualifying loan agreement before the amount is borrowed. But the loan agreement is no protection if the company loaning the money is a beneficiary of a trust which has made a distribution to it that has not yet been paid by the trust and the borrower is associated with the trust. This law considerably limits

the use of bucket companies. These are companies that trust distribute profits to when other adult beneficiaries already have more than $75,000 in taxable income, to keep the profits within the 30% tax bracket. That is ok but if the funds are then on lent to you by the trust you risk effective tax of 62.5% for every dollar your loan account, with the trust is in debit, up to the amount of undistributed profits to the company.

In short where you have a trust distributing profit to a company, don't borrow money from your trust or don't borrow money from your trust or company without checking with your accountant and gone are the days of using the trust or company's funds as your own and sorting it out at 30th June.

Web Site for Demographics & Other Business Information

Go to www.sd.qld.gov.au for lots of useful information on the area you are considering buying or setting up a business in. For a small fee they can provide you with statistics on the households in your area as well as information about other businesses in the area in the same industry as you are considering. When you get to the site select the Starting A Business icon then Products And Services and then the Business Resource Centre.

Transferring a Business on Divorce

Refer our CGT Booklet for details of the rollover relief that is available to assets transferred on the breakdown of a marriage. In short these provisions allow assets to be transferred between spouses without any CGT consequences. The following only addresses the issues that are unique to businesses.

Depreciating Assets – Generally the rollover relief under section 40-340(1) would apply. This would result in the transferring spouse not incurring any tax liability whether the asset's market value is more or less than the written down value for depreciation purposes, section 40-345. The spouse receiving the asset would continue depreciating the asset on the same basis and from the same written down value as the transferring spouse. If the transferee spouse later sold the asset the difference between the written down value and the selling price would either be his or her ordinary income or a deduction for income tax purposes.

Trading Stock – Rollover Relief is not available for trading stock but in a partnership if at least 25% of the ownership remains the same the trading stock can be transferred at cost price rather than market value but an election to do so must be made, section 70-100.

Bad Debts – In the case where a sole trader or partnership transfers the business to a spouse being the other partner or a total transfer of the business ownership from one spouse to the other, the right to recover the debts of the business should not be transferred. As a deduction for bad debts is not permitted to the new owner should any of those debts go bad.

Companies and the ASIC

New Annual Statements

Company annual returns have been replaced by annual statements. These statements are now due within 28 days of the anniversary of the company being incorporated. The company's registered office should receive the annual statement around the date of its anniversary.

Deregistering a Company

You can apply to deregister a company if:

1) All members of the company agree to deregister
2) The company is not carrying on business
3) The company's assets are worth less than $1000
4) The company has paid all fees and penalties payable under the Corporations Act 2001
5) The company has no outstanding liabilities or charges
6) The company is not a party to any legal proceedings.

You must use Form 6010 and you must include the $30 application fee. You should ensure that all outstanding documents (including annual returns) have been lodged with the ASIC. The ASIC will reject your application and we will not refund your $30 unless all outstanding:

- ASIC fees have been paid; and
- charges (loans) against the company have been satisfied.

So you should make sure of this before applying for deregistration.
Timing - To avoid the annual ASIC fee you will need to deregister the company before its next anniversary date. To avoid lodging a tax return for the company it must not have traded since the end of its last financial year, usually 30th June. In other words if you have lodged a tax return for the most recent year before deregistering the company and the company has not traded since the end of the period that tax return was for, no further returns will need to be lodged.

Employee Super Contributions Now Required Quarterly

From 1st July 2003 superannuation contributions under the guarantee scheme are required to be made quarterly. For the 2003/2004 financial year the rate is 9% and the contribution must be made by the 28th day of the month following the end of the relevant quarter. You are now also required to present each employee, each quarter, a report stating the amount you have contributed and the name of the fund. The report must be provided to employees within 30 days of making the final contribution, for the relevant quarter. You should keep a copy of this report.

Superannuation contributions are required to be made for all employees who earn more than $450 per month unless they are under 18 and work less than 30 hours per week. You are not required to make contributions for employees who are 70 years of age and over.

If you are operating as a Company or Trust and you are paying yourself a wage you are considered an employee of the company or trust. Accordingly, you must also make contributions for owners working in the business, each quarter.

Director's Bona Fide Redundancy and Closing a Company

In Super Update December 2002, the ATO advised taxpayers who are employees of their own business that they must apply to the ATO for approval if they pay themselves a tax exempt bona fide redundancy payment. This is another example of the ATO making up its own rules without going before Parliament. Hopefully this stand will soon be challenged and the ATO forced to back down.

A bona fide redundancy payment is not always the best option if the directors are likely to be in a low tax bracket in the future, due to retirement, and the company has franking credits. It may be more appropriate to take the assets out of the company as a fully franked dividend and possibly get some of the franking credits refunded because the taxpayer's average marginal rate on all the dividend income is less than 30%. Once the company is closed the franking credits will be lost forever.

Business Owners' Protection

Did you know there is insurance available that will protect all owners of a business in the event of premature death or permanent disability of one of the business owners?
The insurance can be structured to cover buying the deceased's share of the business from the deceased's estate and /or paying out existing business debts. This is the ideal way of ensuring you do not end up in business with the beneficiaries of your business partner's estate. It also protects the business if the remaining partners do not have enough collateral between them to support the current business debt without the personal assets of the deceased. This is achieved by a mixture of Term Life Insurance, Total & Permanent Disability Insurance and Trauma Cover. These policies should not be entered into without sound legal advice to protect all the business owners' interests.

Important points to consider when organizing this are:

1) The age limits of any Term Life Insurance cover i.e. some policies will not cover a business partner past the age of 65 years, but some contracts will extend cover to 99 years of age.
2) All Total & Permanent Disability and Trauma Cover will cover you up to 65 years of age. Some contracts will provide a modified version of Total & Permanent Disability cover past the age of 65 years, up to 99 years of age.
3) There are many companies providing this cover so shop around.
4) Is there a ***buy back*** option on the TPD and Trauma?
5) Make sure any Income Protection contracts are ***agreed value***.
6) Does the company have professional underwriters that understand this type of cover?

7) Can the policies compliment your personal insurance?
8) Make sure you are aware of the capital gains tax consequences of the arrangement and take enough insurance to cover the CGT bill on transferring the business. Don't let the insurance company tell you CGT does not apply. It may not apply to the insurance payout but the business is still considered to have transferred at market value so that will generate at CGT liability.

For professional guidance and assistance during the whole term of the insurance including any claims contact **Tony Townsend on (07) 54433209**. He deals with many companies that provide this cover so he can help you select the best policy for your needs. There is no charge for his services to provide you with a risk analysis report.

Professional Practices - Service Trusts and Companies

The ATO has included in its audit target for this year service companies and trusts. These entities have traditionally been used by professionals such as Doctors who are not permitted to go into business with their spouse unless the spouse has similar qualifications. The primary objective of a service entity is to stream some of the income the Professional earns into an entity where it can be distributed to family members in a lower tax bracket. Personal services income such as Medicare fees cannot be distributed to family members. Income from a business structure can. Examples of income from a business structure include sale of goods or the provision of services by just as many or more employees as principles. In the latter case there are many cases, rulings and legislation that set out when a business is of the size that the income stream is considered to be more than primarily from the services of the business owners.

A landmark case in regard to service entities was Phillips case in 1977. Some of the relevant points include:

1) The Court found that the fees charged by the service entity were commercially realistic.
2) The service entity was set up with the predominant purpose of keeping assets out of the hands of anyone suing the professionals. This is necessary to argue against Part IVA which voids for tax purposes any arrangement with the predominant purpose of minimising tax.
3) The service entity took over, all aspects of the practice that were not required to be carried out by a suitably qualified professional and was run by a company whose directors were not professionals in practice or an associate of the professional. This was clearly done in every practical way, such as, a written agreement regarding the provision of services, independent records and issuing of invoices.
4) The firm provided accounting and auditing services and had 31 partners and 300 staff.
5) None of the partners were directors of the service entity but they were potential beneficiaries of the underlying trust. The partners did not lend the service entity any money.
6) Services provided included lending the Professional partnership money, providing clerical staff, office equipment, furniture and share registry services The markup was 50% on wages. (Another acceptable way of determining the charge rate for wages is to collect some information on what the labour hire firms are charging.) Interest on the loan was 10% (commercially realistic in the 70s) and the furniture and equipment was provided at a mark up of 6 to 8% which was considered by the judge to be commercially realistic
7) The furniture and equipment that was originally owned by the accounting firm was sold to the service entity at arms length values. Existing staff were terminated and employed by the new service entity.
8) The practice didn't try to mark up services where the service company did not value add. For example phone, rent and electricity should only be charged to the practice at the actual cost.

As a result of losing Phillips case the ATO issued IT 276 which states that payments to service trusts that are commercially realistic will not be challenged. The ATO accepts that the service entity is not set up primarily to avoid tax, if there is also an asset protection objective and a cash flow benefit to the practice of not having to purchase equipment. The ruling also states that if the service fees are excessive the presumption will be made that the payments are not just for the provision of the services and will need to be apportioned.

Even when you fit within the commercially realistic guidelines above care should be taken to ensure the service fees are not out of proportion to the income earned. Fletcher v FCT 1991 173 CLR "it is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income but only how much he has spent ….. If however, that consideration reveals that the disproportion between the outgoing and the relevant assessable income is essentially to be explained by reference to the independent pursuit of some other objective and that partly of the outgoing can be characterized by reference to the actual or expected

production of assessable income, apportionment of the outgoing between the pursuit of assessable income and the pursuit of that other objective will be necessary."

A service company set up right at the start of the practice's business operations is more reliable than one put in place later.

ATO ruling IT 2494 states that it is not acceptable for the Service Entity to provide cars as a fringe benefit to the practitioners but it does concede that the service entity can purchase cars and lease them to the practice. Note if the practice is operating as a partnership then it cannot utilise the Fringe Benefit's Tax formula to provide the cars to the partners. This means that in most cases a log book will be required. Note if the service entity leases a vehicle on lease to the practice it cannot justify a mark up as there is no real value add. Further as a lease of a vehicle is not ownership involving the service entity cannot be justified under asset protection or improved cash flow.

IT 2494 also discusses administration entities or service entities, employing the professionals so that they can make employer supported superannuation contributions. The ATO accepts this arrangement providing the services the professionals provide to the practice are charged at only the amount that is either paid to the professional or contributed to superannuation for him or her, there should be no mark up. Further the actual salary, if any, received should be commensurable with the work performed.

In TR 2006/2 the ATO introduced a ruling and guidelines that reduced the markup that service companies could charge to the extent that in many cases it was not worth setting one up. I have a lot of problems with this ruling as it diverts from Phillips Case and is just ATO opinion. Further the markups are so low that if an arms length business charged such a small amount the ATO's statistics say it should be audited under suspicion of tax avoidance. So despite what the ATO are making a lot of noise about the issue, it is far from resolved and lets hope a case goes to the courts soon to push the wave back the other way. In the meantime it is probably not practical to incur the cost of setting up a service entity.

Happy Days – ATO Finally Compensating Taxpayers

The ATO has issued a draft paper regarding taxpayers' and tax agents' rights to compensation if the ATO has been negligent or their defective administration has caused the taxpayer loss. The definition of negligence is a complex legal matter so for small claims taxpayers should concentrate on the definition of defective administration causing the taxpayer loss. The loss would normally be the value of time spent by either the taxpayer or their tax agent. Defective administration would include:

a) Failure to provide accurate, appropriate or unambiguous advice.
b) Unreasonable time delays.
c) Unreasonable lack of administrative procedures.

Note normally documentary evidence will be required though for very small claims under $50 the evidence requirement may be waived. Claims can be made by all taxpayers including individuals, companies, trusts, incorporated associations etc.

The compensation is available through the Compensation for Detriment Caused By Defective Administration (CDDA) scheme. It is early days yet the paper is only a draft. Contact details are:

ATO Solicitor
Australian Taxation Office
National Office
Civic ACT 2600

Telephone: 1800 005 172
Facsimile: 1800 005 173
Email: compensation.application.ato.gov.au

Claiming Company and Trust Losses in Your Personal Tax Return

The trick here is to find a way of failing the APSI test. Shouldn't be too hard seeing as the legislation was designed to catch you anyway.

Finally, something positive for taxpayers out of the APSI legislation. If your company or trust made a loss you will be permitted to offset the loss against your personal income if the loss is in regard to personal services income caught by the APSI legislation. This initiative was announced in the May 2003 budget. It effectively gives taxpayers caught by APSI an advantage over other taxpayers operating through a company or trust as other taxpayers' losses are quarantined until that company or trust makes a profit and satisfies other

requirements. The new concession will be backdated to losses generated in the 2000/2001 financial years and all following years. Tax returns can be amended for up to four years back from the date of their original assessment.

ATO Changes its Mind on Unearned Income

The primary purpose of printing this article is because we have advised clients on the basis of the ATO's view to date and now it has changed its mind refer TD 2003/25. So if the following seems to be a contradiction of how we have told you to prepare your BASs you are absolutely right, it is! Fortunately this change of mind only applies from 1st July, 2003.

The principle is based on the Arthur Murray dance school case. Lessons were paid for in advance. The taxpayer won the right not to include in his tax return the funds received for lessons yet to be given. This principle would apply to taxpayers regardless of whether they were on an accruals or cash basis. But now if you are in the STS system and operating under the cash basis you do have to include this unearned income in your taxable income.

ATO's More Reasonable Approach to Small Equipment

Most business owners may not have realised this but since the 1st July, 2001 businesses, other than those in the simplified tax system, have not been allowed to write off any equipment purchases no matter how small. This means that if you buy a stapler or hole punch for the office a new Philips head screw driver to replace the one you lost etc they have to be depreciated over their life even if they cost less than a dollar. The only concession has been that if they cost less than $1,000 they could be placed into a low value pool rather than depreciated individually. Nevertheless, you are required to segregate your stationary bill etc to find these small items and they can only be depreciated at the rate of 18.75% in the first year and 37.5% after that.

The ATO has released PS LA 2003/8 which recognises the administrative nightmare this has created for businesses and offers a more reasonable approach. Please note that practice statements such as this do not have the force of law but are merely an undertaking that the ATO will be more reasonable than the legislation. Note this Practice Statement cannot be used with composite assets that exceed $100 (GST inclusive) in total. It only applies to individual and independent items.

The Practice Statement allows business to claim an outright deduction for expenditure that is capital in nature, not part of a composite asset and under $100 (GST inclusive). The ruling also allows businesses to use a sample of transactions to determine the ratio of purchases that are under $100 (GST inclusive) and apply this to the whole amount expended but this method is not available if the records or the business are sufficient to determine the precise amount.

While this ruling was released in the 2003 year it can be applied as far back as 1st July, 2000.

Nasty Sting for Legitimate Business Expenses

If you are caught by the APSI rules you cannot claim a deduction for payments made to associates unless the work they perform directly relates to the principal work provided to customers or clients. An example of this is if I charged my brother for preparing the income tax return for his tutoring business he would not be able to claim the fee paid to me as a tax deduction, despite the size of my business. Naturally enough I don't charge him. Nevertheless, under GST legislation I am required to remit to the ATO the amount of GST that would have been applicable had I charged him! In an even further development of this double standard the ATO has taken the approach that the rules on payments to associates include payments for goods. Accordingly, if your spouse owns the business from which you purchase your stationery and your income is from personal services you cannot claim a deduction for the stationery.

The legislation states:

SECTION 85-20 Deductions for payments to associates etc.

85-20(1) You cannot deduct under this Act:

(a) any payment you make to your associate; or

(b) any amount you incur arising from an obligation you have to your associate; to the extent that the payment or amount relates to gaining or producing your personal services income.

85-20(2) Subsection (1) does not stop you deducting a payment or amount to the extent that it relates to engaging your associate to perform work that forms part of the principal work for which you gain or produce your personal services income.
85-20(3) An amount or payment that you cannot deduct because of this section is neither assessable income nor exempt income of your associate.

Makes you wonder if any of our highly paid politicians read the legislation before they vote on it, doesn't it.

E-record

In the past we have tried to accommodate our clients using e-record because it is available free from the ATO. Unfortunately, we have found over and over again that it allows clients to make critical errors, which end up costing many hundreds of dollars in accounting fees to reconcile. For example if a client goes back and edits an entry but does not post the revised transaction the monthly totals will not reconcile with the annual totals and the presentation of the information makes it difficult to find where the error has been made.

We now recommend that all our e-record clients change to a more professional pacakage as the one off purchase price in most cases will be less than the annual increase in accounting fees if you forget to post an entry.

STS When are Wages Paid

Employers in the Simplified Tax System (STS), who are still operating under the old cash basis, can only claim expenses when they have actually been paid. The ATO has issued TD 2003/26. It addresses when amounts withheld from wages are considered to be paid. For example the tax withheld on wages during the last week of June will not be paid to the ATO until July. The ruling says that this tax is still deductible in the year the wages are paid as it has been "dealt with on the employees behalf" by then. This principle would apply to other amounts withheld from wages at the employees request such as health insurance contributions.

Cash Economy Audits

The ATO has released a report called *The Cash Economy Under The New Tax System*. In annexure 1 it sets out the procedures it will be using to detect unreported cash income. The full text is available on the ATO web site. A few items that may interest readers are:

1) The ATO considers the high risk industries to be Building & Construction, Cafes, Restaurants & Takeaways, Cleaning, Hairdressing & Beauty, Trucks, Smash Repairers and Taxis.

2) Audit activity will include
   (a) Walk ins – Intended to catch traders not registered for GST or employees who are not on the books.
   (b) Top Down – Tracing the records of major firms down through to the contractors they pay and the contractors that the contractors pay to make sure all income has been correctly recorded.
   (c) Statistical Norms – The ATO will be comparing each business against the average for its industry. For example they will be looking at gross margins assuming goods have been marked up at the industry average. If the margin is less they will be suspicious that the income from some of the goods sold has not been declared. Over the last year, when we have prepared a business tax return, we have provided our clients with a letter which among other things discusses how their figures compare with the ATO industry average. So for further information on your industry please refer to this letter or contact us.
   (d) Cash Ratio – According to the ATO's research Cafes and Restaurants receive 68% of their income as cash. In other words if credit card transactions account for more than 32% of the takings the ATO will assume some cash has not been recorded. Sound a bit extreme? Tell that to the Restaurateur who was sentenced to 3 years and 4 months jail for keeping two sets of books, non-lodgment of company tax returns and paying untaxed cash wages.

3) Other Areas The ATO Will Be Looking At:
   (a) Whether GST has been remitted to the ATO when equipment or a vehicle used in the business, is sold, even if the business use is only minor.

(b) Checking for a tax invoice for expenses where the invoice amount exceeds $55 (GST inclusive). A tax invoice needs to include the supplier's ABN, the words Tax Invoice, the date, the name of the supplier, a brief description of the goods, the tax inclusive price and if the invoice is for over $1,000 it must also include the quantity or the extent of the services provided and your ABN or name and address. Surprisingly, it is the purchase of vehicles that is most likely not to be supported by a tax invoice.
(c) Forgetting to apportion payments between private and business use. If such a payment is over $1,000 you need to review the portion claimed as business each adjustment period.
(d) Not paying GST on cash contributions employees make to reduce their fringe benefits.
(e) An up front GST input credit is not available on items purchased under a Hire Purchase agreement if GST is reported on a cash basis, you can only claim the GST portion of each payment made under the HP agreement when that actual payment is made.
(f) A GST input credit can not be claimed for land purchased under the margin scheme.
(g) Barter Transactions must be included.

Balancing Life and Business

Joan Marie Johnson has been helping Julia deal with the insane demands of such a rapidly growing business. She has some interesting material on her web site www.joanmariejohnson.com. Joan has kindly allowed us to reprint the following:

How to Enforce Boundaries:

After you have decided on boundaries that are bigger than you need, and you have clearly communicated what they are to everyone who might approach them, here is what you do if someone steps over the boundary:

4 Step Plan of Action:

1) Inform them of what they are doing that steps over your boundary then, if they don't stop,
2) Request that they stop immediately then, if they don't stop,
3) Demand that they stop the, if they don't stop,
4) Walk away without any snappy or get-even comments

This plan can be adapted to personal and business related situations. Most people will respond to steps 1 and 2. Hard cases will respond to step 3. True abusers may require step 4, which may range from walking away or hanging up to end a conversation, all the way to severing the relationship.

Arranging to Make Interest Payments in Advance

Investors who pay the bank next year's interest before 30th June can claim the amount as a tax deduction this financial year.

The deductibility of prepaid interest, paid by an individual taxpayer in respect of a rental property for a period not exceeding 12 months is not subject to special timing rules under section 82 KZM of the ITAA 1936 according to ID2002/939.

Taxpayers who have a loan for a rental property or shares can make up to 12 months interest payments in advance and qualify for a tax deduction at the time the repayments are made. Be careful that the ATO cannot argue that it was really a repayment of capital. Make sure the arrangement with the bank is that the payment is interest. Simply putting the money into the loan account will not work as the bank will treat that as a repayment of capital. You must not make an advance payment for a period in excess of 12 months or the whole amount will only be able to be claimed in the period the interest is applicable to not when paid. Businesses do not qualify for this concession unless they elect to enter the simplified tax system. If your business is in the simplified tax system you may want to consider making 12 months lease payments in advance also.

As this arrangement is only moving tax deductions from next year into this year it could work against you if you are in a higher tax bracket next year than this year.

Year End Tax Planning for Small Business

Take the speedo reading, for each car you want to claim under the log book method, as at 30th June.

Trusts

Be very careful not to make a loss i.e. draw out more wages than profit made. Otherwise you will end up paying tax on income your group as a whole has not yet received. This is also important if the trust will be

distributing franked dividends. In order for a Discretionary Trust to be able to pass on its imputation credits to beneficiaries (assuming the beneficiaries are claiming less than $5,000 in imputation credits each) the trust must have at least $1 in taxable income (profit).

Make a minute before 30th June, 2003 declaring how the profit for that year will be distributed.

Companies

Consider paying a fully franked dividend if all the shareholders' taxable incomes are under $150,000, even if cashflow restrictions means the money must be loaned back to the company. If the business is looking to do well in the future this may be your last chance to get the money out at a tax bracket lower than 46.5%.

Sole Traders and Partnerships

Non Commercial Losses (Div 35)

Division 35 prevents business losses being claimed against other income unless certain conditions are met but there is opportunity in the detail with some of these conditions, for example:

a) If the loss is primary production and the total gross assessable non primary production income is less than $40,000 the loss maybe offset against other income. This concession also applies to a professional arts business. Note the $40,000 does not include capital gains or fringe benefits. If the other income is from a partnership, it is only your share of the net profit of the partnership that is added to your assessable income if the partners are natural persons. This makes forming a partnership a very attractive option even if APSI requires you to return the net profit as 100% yours because if you were a sole trader your assessable income would be the total sales of the business before deductions. If you are a wage earner, a partnership will not solve your problem therefore salary sacrificing may be the solution if you are just over the $40,000 limit, but mainly exempt benefits or concessionaly treated car benefits. Otherwise the FBT payable at 15% more than your marginal tax rate would erode the advantages of being able to offset the losses.

b) Losses can also be offset against other income if the assessable income from the business activity is at least $20,000. The assessable income is sales plus the increase in stock i.e. closing stock less opening stock. Therefore if you purchase more trading stock you will increase the closing stock and therefore increase the assessable income. Note the trading stock has to be on hand for it to be included in closing stock. So you cannot just order it and bring it into account as a creditor. Buying and selling will also increase assessable income so there are plenty of ideas to work with here. There is also a concession for the first year of trading. If a "reasonable estimate" would conclude that had you been trading for the full year you would have made $20,000 worth of sales plus closing stock (no opening stock in first year) then you are considered to have turned over the $20,000. This also applies to the last year of trading but in that year there will be opening stock.

Levelling Your Income Over the Years

One of the most effective tax planning strategies is to level out your income over each year and each member of your financially dependant family over 18. It does not particularly matter that the amount of income is the same each year and for each family member it is more important that the tax bracket is the same. For example a husband and wife with a combined income of $70,000 will pay exactly the same amount of combined tax if they have $35,000 each or one has an income of $25,000 and the other an income of $45,000.

In line with this method of thinking is making sure you are in the same tax bracket each year rather than pulling all your tax deductions into this year when you are taxed at 31.5% when next year you will not be able to avoid the 46.5% bracket.

The following strategies can be used to move deductions from one year to another but should only be used to move deductions into a year where your tax bracket is the same or higher than the year you are pulling them from.

1) Consider purchasing stationery and other deductible consumables that will be used up within the next 3 months (IT333).
2) Consider entering the Simplified Tax System (STS) if your turnover is less than $2 million. This will allow you to claim a deduction for expenses you have paid up to 12 months in advance. For example a vehicle lease. But you will need to consider if you have the cash flow to afford this. Businesses in the Simplified Tax System are also entitled to concessional rates of depreciation so consider purchasing

equipment costing less than $1,000 (GST exclusive) for an immediate write off. Equipment costing more than $1,000 is still entitled to 15% depreciation even if purchased on 30th June.

3) Ask your Accountant, Solicitor etc to bill you for any work in progress to date.
4) If you are not reporting your income on a cash basis write off bad debts. If you have a loan for the business ask the bank for a statement of your interest liability for the period from the last time it appeared on your bank statement until 30th June. If cash flow permits buy equipment under $1,000 and prepay expenses up to a limit of $1,000 per expense. Calculate wages up to the 30th June even if the last pay date is before then as these will still be tax deductible even if not paid. This extra amount does not need to appear on the group certificates so it is suspended for this tax year. Organise repairs as long as the work is committed to the unpaid cost of the work is still deductible. Make sure you include all amounts you owe as long as the services or goods are provided you can claim the expense even if it is not paid. Exclude from your income any invoices you have issued for goods or work you have not supplied.

Regardless of whether you are STS or not, if you are considering selling off plant and equipment that is worth less than its written down value do so before 30th June. On the other hand if it is likely to fetch more than its written down value delay the sale until after 30th June.

When Triggering CGT is Good For Business

Small businesses are entitled to considerable CGT concessions such as a 50% active asset discount and tax free rollovers into a super fund. If properly structured they can make a capital gain of over $3 million tax free. Usually these concessions are utilised when the business is finally sold. It is worth considering taking advantage of these concessions sooner than later. This can be done by selling the business to a related entity. The idea is to create a capital gains tax event so the new entity acquires the business at today's market value as its cost base. True this does generate a capital gain for the current owner of the business but if the tax can be reduced to zero through the concessions the net result is simply an increase in the cost base of the business when it is eventually sold to a third party. This may be worthwhile for any of the following reasons:

1) Tax law is always changing so you may want to take advantage of the CGT concessions while they are available to at least increase the cost base you can apply if the concessions are one day removed. As the concessions can reduce the CGT to zero it is fair to assume there will never be a better option than what is currently available.
2) The Small business CGT concessions can only be utilised if the business' and associates' assets are less than $6 million or qualify to enter STS because their turnover is less than $2million. If your business is approaching that threshold, triggering a CGT event now, may be the only chance you get at the concessions. For example a business started from scratch eventually sells for $8 million with $5 million in goodwill. The other $3 million being the written down value of equipment and stock:

Normal Circumstances

Profit on Sale	5 million
Less 50% CGT Discount	2.5 million
Amount Subject to Tax	**$2.5 million**

CGT Event Triggered when worth half the above ie small business concession apply

Profit on Trigger Sale	$2.5 million
Less 50% CGT Discount	1.25 million
	$1.25 million
Less 50% Active Asset Discount	625,000
Placed into Super for both the Husband and Wife who own the Business	625,000

Therefore no CGT payable and no tax payable by the super fund. The new entity that owns the business has now purchased the goodwill for $2.5 million. When this entity sells this goodwill for double the amount the small business concessions will not be available because the $6million threshold is exceeded but the profit is reduced by the $2.5 million cost base. Therefore the amount subject to tax will be:

Selling price of Goodwill	$5 million

Less: Purchase Price cost base	2 .5 million
	2.5 million
Less: 50% CGT discount	1.25 million
Amount Subject to Tax	**1.25 million**

The above has effectively halved the CGT applicable.

You may regret the business structure you have chosen for the business. The sooner you change the less the impact. For example if you are operating in a company you will not qualify for the 50% CGT discount. Obviously the sooner you cut your losses and move the business out of that entity into a better option the lesser the amount of CGT discount you miss out on. Note using a company as a business structure does have other advantages so look at the whole picture and the CGT problem can be solved by liquidating the company.

On the down side is the cost of setting up new structure and possible stamp duty. It is important that you do actually trigger the CGT event so make sure you do not qualify for any of the CGT rollover concessions.

The best CGT concession is the 15 year rule. No capital gains tax is applicable to the sale of a small business that has been owned for more than 15 years. If you trigger a CGT event, as per point 2 above, the 15 year clock starts back at zero. Accordingly, you may regret doing this if you end up owning the business for more than 15 years, the law does not change in the meantime and the business' and associates' assets do not grow beyond $6 million.

Making the Most of Allowance Concessions

This article is for the benefit of both employers and employees. By making the most of the ATO concessions for reasonable allowances employers can increase their employees' tax deductions for food that they are probably not claiming at the moment. Organising salary packages around these concessions can increase employee loyalty at no extra cost to the employer.

If an employee receives a travel allowance or overtime meal allowance under an award, the employee is entitled to claim a tax deduction without receipts providing they have some method of showing that the amount was incurred. Further the employee is entitled to claim more than the actual allowance received providing they do not exceed what the ATO considers reasonable.

Full details of what the ATO considers reasonable are available each year from the ATO web site. In TD 2004/19 for examples it allows $20.55 for an overtime meal, $67.55 for meals for a truck driver who sleeps in his truck and earns less than $78,750 per year. Employees, that are not truck drivers and are earning less than $78,750 per year are entitled to $245.55 per night to cover meals and accommodation while travelling to Sydney. Not only are employee truck drivers not permitted the concession for accommodation because it is assumed they will sleep in their truck they are allowed considerably less than other employees for the food component of their allowance. If a truck driver wishes to claim a tax deduction for accommodation they must provide receipts.

In TD 2004/19 the ATO states that neither the allowance nor the expenses need to be shown in the employees tax return if the allowance does not exceed the reasonable amount and it was fully expended. Both the allowance and the expenses need to be included if the allowance is more than the reasonable amount or more than the amount expended. If the amount expended exceeds the allowance received but the claim is limited to the amount that the ATO considers reasonable both the allowance and the expenses need to be included in the employees tax return.

The employer does not have to pay the actual amounts the ATO consider reasonable but they must pay a "bona fide amount". For example the ATO tried to argue that a truck driver who only received $39 per night was not actually in receipt of a bona fide travel allowance because the amount was not enough to cover the cost. The ATO lost this argument in the courts but we recommend that the allowance received should be at least half of the amount the ATO states as reasonable in TD 2004/19.

Employees required to work overtime and who are entitled to a meal allowance under their award do not need to sleep away from home or eat the meal while working. They can stop at a restaurant on the way home from working overtime and spend the money then. They do not need to keep a receipt but it is advisable that on at least one occasion they get a receipt as evidence of the amount normally spent.

The employer needs to show the allowance clearly on the employee's PAYG Summary to assist in the calculation of the claim. It is important that the employee knows how many days the allowance was paid for and what type of allowance was paid. The employee will need to keep a travel diary if they are away for more

than 5 nights in a row. The employee must keep a record to show he or she has incurred expenses. Don't try and claim you stayed in a Motel if you didn't. The Motel register can be easily checked. The ATO will not accept a flat claim that the allowance is fully expended, you will have to show how you worked out the claim. For example an employee truck driver who is required to sleep away from home and receives an allowance, in 2004, was entitled to a claim of $67.55 per day. Ideally the truck driver should have receipts for one day showing that such an amount is normally expended but a detailed estimate such as the following will suffice.

Breakfast Mixed Grill with Eggs, Toast & Coffee	$ 18.00
Coke and Mars Bar for the Road	5.00
Burger and Chips & Coke for Lunch	10.00
Coke and Mars Bar for the Road	5.00
Dinner Steak & Salad	16.00
Desert & a Beer	7.00
Two Cokes and Mars Bar for Midnight snack	7.00
	68.00

Providing the truck driver reduces his or her claim to $67.55 per day he or she can claim this amount, without receipts, for each day he or she sleeps away from home. Note sleeping away from home would include truck drivers who leave home in the afternoon and drive to the markets early so they are at the start of the queue to be unloaded and then sleep while they are waiting. They may be home again in less that 24 hours but nevertheless they are entitled to the meal allowance concessions.

Tax Strategy Change as Part B Threshold Increases

Part B is a Centrelink payment to sole parents and the low income earner of a two parent family. In the case of a two parent family the high income earner's income is not taken into account to determine eligibility. The payment is only effected by the low income earner's income. The low income earner can have income to up to $4,234 (current December 2006) and still receive full Part B after that it is only reduced by 20 cents in the dollar after that. The tax thresholds have also increased, for example the high income earner can have an income of $75,000 per year and still only pay 31.5% tax. This can mean income splitting is counter productive for many families.

For example a family has business income of $60,000 which could be split between spouses:

Split only $4,234 -	Tax on $55,766 to high income earner $12,916	Netting	$42,850
	No tax on $4,234 to low income earner	Netting	$4,234
	Part B Payment received as one child under 5 years of age		$3,468
	Disposable Income		$50,552

Split $30,000 each - Tax on $30,000 is $4,800 Netting 25,200 x 2 = 50,400 Disposable Income

If your taxable income is less than $10,000 you pay no income tax so the best outcome is to move $10,000 across to the low income earner as he or she will only lose 20 cents in the dollar from Centrelink on $10,000 - 4,234 = 5,766 of it instead of the 31.5 cents in the dollar the high income earner would lose in tax. But once the low income earner's income exceeds $10,000 they will lose at least 15 cents in tax and 20 cents in the dollar from Centrelink compared with the high income earner losing 31.5 cents in tax.

It is time to rethink your tax strategy if you are income splitting and this should not be left until you do your next tax return.

Subdividing Land you Purchased to Run a Business On

Careful planning to make the most of the Active Asset Concession can make the gain on the sale of the individual lots income tax free. Though you will probably have to charge GST on the blocks but at least you can claim input credits on the development cost and the margin scheme may help you reduce the GST applicable. This article is directed at the income tax consequences. For information about the GST ramifications visit our web site and down load the How Not To Be A Developer booklet which is under free publications.

With the possibility of the whole project being income tax free it would be a major tax blunder to take the development too far or be found to have transferred the property into a business of developing land and end up paying normal tax on all the profit so make sure you get the right advice.

To qualify for the small business concessions you need yours' and associates' assets to be less than $6 million and in some cases satisfy a controlling individual test. The following only addresses the ramifications for the land and buildings not the plant and equipment on it.

The property also needs to pass the active asset test and this is littered with traps. The property must be used in the business up to the day of sale and for at least half of the time it was owned. If the business ceases before the sale the asset must have been used in the business up to the time it ceased (note the ATO is taking a very strict view here it means right up to the last day) and then must be sold within one year of the business ceasing. Make no mistake here take one day more than a year from the date you ceased business to the date you sold the land (either subdivided or only with Council approval) and you will go from possibly paying no tax on the whole project to paying tax on half the profits on the blocks. A property would not be an active asset if it was used to derive rental income.

Section 152 covers the active asset rules. The best concession is the 15 year exemption. If you purchased the property over 15 years ago, you do not have to offset the gain against your capital losses first so they are still there for your future benefit. The owner or owners must also retire (a state of mind) then the profits are completely tax free and does not count towards your RBL.

If you miss out of the 15 years do not despair, a careful combination of the remaining small business exemptions will give you almost as good a result. For example combine the retirement exemption with the 50% CGT discount and the 50% active asset discount and you will pay no tax but 25% of the profit may need to be contributed to super if you are under 55 years of age. This will not be taxed in the hands of the superannuation fund.

The active asset concessions are far too valuable to risk, your first step should be professional advice.
You also need to be careful that the development is not so elaborate that you are considered to be in the business of developing land.

Business CGT Concessions

When you sell a small business you should expect to pay little or no capital gains tax. If you have a tax bill you are not utilising the business CGT concessions to the optimum. The concessions only apply to active assets that have been held for more than 12 months. Active assets normally refers to Goodwill and buildings. Plant and equipment do not qualify as active assets nor is any profit made on them subject to CGT. Any profit made on the sale of plant and equipment over and above its depreciation value is taxed at normal rates.

Individuals, Partnerships and Discretionary Trusts qualify for more concessions than Companies. Companies are not entitled to the 50% CGT discount and there are difficulties involved in getting the tax free portion of the active asset concession out of the company. You would have to look into liquidating a company to get the best CGT outcome.

To qualify for the small business concessions the business and associates net assets have to be less than $6 million or elect to enter the simplified tax system which requires the turnover to be less than $2 million. Trusts and companies also have to pass a controlling individual test.

Concessions if held for more than 12 months:

a) The 50% capital gains discount - only half of the gain is included in your taxable income. This concession is not available if the asset is owned by a company. Must use the capital gain to reduce any carried forward capital losses before applying the discount.
b) The 15 year ownership exemption. This requires you to have held the asset for more than 15 years. The asset must be an active asset. You need to satisfy the controlling individual test if the asset is owned by a company or trust. The taxpayer or the controlling individual, if a company or trust, must also be over 55 and retire or be permanently incapacitated. Not only is the amount CGT free but it does not count towards the owner's RBL and does not reduce any capital losses you may be carrying forward.
c) Retirement exemption – can only apply to an active asset and the taxpayer or controlling individual must retire or put the funds into a superannuation fund. The gain is not taxed when it goes into the superannuation fund and the only limit is that you can only put $500,000 into superannuation this way, in your lifetime. The contribution to superannuation counts towards your RBL and when you retire the money comes to you tax free.
d) 50% discount for active business assets – can only apply to an active asset.
e) Rollover relief where an active asset can be sold and another active asset purchased up to a year before the sale or 2 years afterwards.

These concessions can be used in conjunction with each other, for example:

Gain of	$100,000
Less 50% CGT Disc	50,000
	50,000
Less 50% Active Asset Disc	25,000
	25,000
Purchase A New Active Asset	25,000
Amount subject to CGT	0

The best strategy depends on the type of business entity and the owners future plans.

Stock Takes

Many months ago we warned readers that the ATO required retailers and wholesalers to use absorption costing when performing their stock take. Absorption costing among other things requires you to apportion rent, electricity, wages etc that relate to the storing of the stock. This amount then has to be apportioned over each item of stock. This was the case even for small retailers such as takeaways.

As a result of lobbying from the accounting profession the ATO has now limited the use of absorption costing to businesses with a turnover of more than $10 million.

Ryan's Case - Superannuation for Employee Spouses

Ryan's case decided in July 2004 gave us a glimmer of hope for self employed professionals with a spouse on a lower income. The trouble was this case was heard before the AAT so there were plenty of courts the ATO could appeal to and we were all waiting expectantly. Not only didn't this happen but the ATO has now issued a draft ruling conceding the point.

Dr Ryan ran a computer consulting company that employed him and his wife. The court accepted that the company was not set up for tax purposed but that the dominant purpose was for asset protection and because clients generally preferred to consult with companies rather than individuals. Ryan's wife only performed secretarial work for his company. She was paid at commercial rates for the amount of time she spent on company business. This was a relatively small amount but much, much more was contributed to superannuation on her behalf.

The ATO argued that this was simply a scheme to reduce tax and was caught under Part IVA. The court found that since amendments to legislation effective on 1st July, 1994, the only restriction on the amount of money Dr Ryan could contribute to superannuation for his wife, and claim a full tax deduction was the age base limit. Further the arrangement did not meet the main criteria of a scheme to reduce tax (Part IVA) because if the superannuation contribution had not been made in his wife's name it would have been made in his name, so Dr Ryan's tax situation would remain exactly the same.

I would like to point out that the years the case applied to were before the Alienation of Personal Services Income (APSI) rules were introduced. So the scenario will appear to contradict the law as we now understand it. The APSI rules did not override any existing law. Therefore the circumstances of this case will apply to you if you manage to avoid being caught by the APSI rules. On the other hand if you are caught by the APSI rules you cannot claim a deduction for superannuation contributions for your spouse unless they perform work that the client is directly charged for. Full details of the APSI rules are available in a booklet on the free publications section of our web site. Basically you will be caught by the APSI rules if you are providing personal services rather than providing goods or a significant asset. Unless one of the following exemptions applies to you:

a) The contract is to produce a result, supply plant and equipment or tools of trade (if it is normal in your industry to have tools) and liability for the cost of rectifying defective work or liability for damages remains with you; or
b) Non associated entities, or individuals (or if in partnership other partners in that partnership) perform at least 20% of the market value of the work in a normal year. or
c) Normally you would have at least two unrelated clients sourced through advertising to the public and no one client pays you more than 80% of your income. or
d) You employ an apprentice for at least half the year. or
e) Have business premises separate from your home or your client's premises. or
f) You receive income for a large number of clients but through one principal and you fit into **all** the following categories:
    (i) No one actual customer generates 80% or more of your income.

(ii) At least 75% of your income is from commission i.e. small or no retainer.
(iii) You actively seek out the customers i.e. advertising. And
(iv) You do not use the principal's premises except on arms length rental. Note this means you can never see a client on your principal's premises.

Examples of the type of people this concession will apply to include Doctors who receive all their income through Medicare but in relation to many patients. Financial Planners and Insurance Brokers who might receive all their income through AMP but have many clients. Network marketers and Party Plan sellers who might receive all their income from Tupperware but have many customers. Franchisees who may supply many customers but are only paid by the franchiser.

If you cannot find an exemption above then section 86-75(2) of the APSI Act will deny you a tax deduction for superannuation contributions for a spouse beyond 9% of their wage that can be justified in relation to actual chargeable work, not administration. But if your spouse performs at least 20% of the actual chargeable work for clients you are not caught by the APSI rules.

The principles in Ryan's case are not needed to justify paying superannuation for a spouse from the profits of a service trust. The point of Ryan's case was it allows the Doctor to claim a deduction for the superannuation contribution indirectly increasing the portion of income he or she can divert to other family members. Be careful here, for the Doctor to qualify for the tax deduction, the superannuation contribution must be made in relation to an employee, so the Doctor will have to directly employ his or her spouse though this does not have to be on a full time basis, he or she can still also work for the service trust. Doctors wanting to use this strategy will have to register as an employer in their own right or in the company through which they practice. The superannuation contributions and wages will need to be paid before 30th June and the spouse will have to have actually worked to earn the wage though the wage does not have to be significant.

Employees earning commission can also utilise this if there spouse helps them. The APSI rules specifically exclude bona fide employment arrangements. TR 98/6 recognises that employees whose wage is based on commission are entitled to claim a tax deduction for paying their family to help them. While the wage must be on a market hourly rate, records need to be kept and the work done must be more than just answering the phone the trick here is not just getting a deduction for the family members wage but also getting a deduction for any superannuation contribution you make for them up to their age base limit.

Writing off Bad Debts in MYOB

GST has made even a simple entry like writing off bad debts much more complicated. The correct strategy for writing off bad debts in MYOB is:

1) Create an expense called Bad Debts if this does not already exist.
2) Do a negative invoice to the customer for the Bad amount including the original GST code and amount. Instead of selecting an income account select the expense account Bad Debts. MYOB will suggest you use an income account, ignore this warning.
3) Go to 'Returns and Credits' in the sales register and apply the adjustment note to the original invoice.
4) Make sure both the negative invoice and the appropriation are dated within the date range of the next BAS you are due to lodge.

Small Business 25% Tax Discount Through Parliament

It's called the Entrepreneur's tax discount but it works best if you don't leave your day job. The main requirement to qualify for a 25% discount on your taxable business income is that you are in the simplified tax system and that your business turnover is under $50,000. Though you still get some discount if your business turnover is between $50,000 and $75,000. Note this is turnover not profit and there are not many people who can live on the net profit from a business if its turnover (total sales before deductions) is less than $50,000. It is no good having several businesses as their turnovers will be added together. The discount applies to businesses trading as a company, sole trader, partnership or trust. In reality it would only be of benefit for people who have a small business on the side.

If the business owner has a wages job as well, the wages income they receive does not count towards the business turnover. So a tax trick is to apply for an ABN and earn some of the income you would normally earn as wages, under the ABN instead. As a result this profit from the income earned under the ABN would qualify for the discount.

GST and Selling a Business

If a business is sold as a going concern it is exempt from GST providing both the buyer and seller are registered. There are many other conditions including a requirement that all things necessary to carry on the business are included in the contract. Wide statements such as this give the ATO a field day to nit pick. It is the seller who will ultimately have to pay the GST if the ATO decides it is applicable. A clause in the contract saying the purchaser will reimburse the seller if GST applies will not help you if the purchaser does not have the money or has disappeared. The ATO is only interested in getting the seller to pay. We believe it is not worth the risk.

If you charge GST on the sale you just increase the price by the amount of the GST and the purchaser claims it back as an input credit. If cashflow is an issue with the purchaser and they can't afford to wait to lodge their BAS consider offering vendor finance. It is only for a few months at the most.

Buying Equipment to Reduce Tax

If the equipment is going to be depreciated under normal circumstances there is not much benefit in buying it at the year end because the depreciation claimable is apportioned over the year and life of the item so the deduction would be minimal.

It would be different if you leased the equipment, elected to be in the Simplified Tax System and made 12 months lease payments in advance. You would get a full deduction for those prepayments.

There are **concessions for small purchases**. If items are under a threshold they can be written off immediately:

Non STS Businesses - $100 GST exclusive if registered.

STS Businesses - $1,000 (net of GST if claimable) if the item is part of a set the whole set must be under $1,000.

Wage Earners - $300 (GST Inclusive) but all items that are identical must be added together for the $300 test. If an item is part of a set the set must be under $300.

Rental Properties - $300 (GST Inclusive) Identical items or part of a set must be added together.

Some items **purchased in June** will get more than just a few days depreciation if they meet certain criteria.

Non STS Businesses - that buy a piece of equipment for less than $1,000 they can write 18.75% of the purchase price off in the year of purchase regardless of when it is bought.

STS Business - can write off 15% of any equipment in the year it is purchased if the life expectancy is less than 25 years.

Wage Earners and Rental Property Owners – Can claim 18.75% in the first year, on equipment less than $1,000 regardless of when purchase. The threshold for rental property owners is actually $1,000 per owner.

Tax Concessions for Charity Auctions and Dinners

Fund raising events should have even greater appeal now that payments for goods, entertainment and/or meals, in excess of their value, can be claimed as a tax deduction.

Previously the rule was, if you received some benefit for a contribution you made to a charity it was not considered a donation so no deduction was available for any portion of the amount even if all you received was a pen. The new concessions are directed at charity auctions and gala dinners where the true value of the benefit received is less than $100 (GST Inclusive), less than 10% of the amount paid and the amount paid exceeds $250. Of course the event has to be held by a charity that is registered as tax deductible. The deductible portion of the amount contributed is the difference between that and the market value of the benefit actually received. The organisers of such events are required to provide you with the market value of the benefit on their receipt.

Tax Minimisation Between Spouses

Before entering into an arrangement that effectively shifts income from one partner to the other or deciding whose name in which to buy an income producing asset, check the need for this considering the new tax brackets.

The way for a couple to minimise their overall tax is to arrange their affairs so that they are both in the same tax bracket. They do not need to have the same taxable income. Their combined tax bill will not benefit from any income shifting arrangement if they are already in the same tax bracket. Even if one is at the higher end and the other the lower end.

In the 2007 financial year the government expects that only 2% of the population will be in the maximum tax bracket due to the new tax rates. The 31.5% bracket is so wide that a taxpayer only working part time may well be in the same bracket as his or her spouse who is working full time.

For example in 2006/07
0-6,0000 **0%** 6,001- 25,000 **15%** 25,001 – 75,000 **30%** 75,001 – 150,000 **40%** 150,001 + **45%**

Note the above does not take into account the low income rebate of $600 which starts to shade out after $25,000in taxable income.

You need to have gone well into the next bracket above your low income spouse before any tax arrangement that shifts income to them is worth your while.

Subdividing the Farm

Just being a farmer does not automatically mean developing the land is capital rather than revenue in nature. In Crow v FC of T 88 ATC 4620 the profit a farmer received on selling 51 portions of land was assessable as revenue because his intention when buying the property was to make a profit.

It is extremely important that the subdivision be considered capital in nature rather than revenue. The difference is, the profit on the sale of the blocks could be completely free of income tax, if the sale is capital in nature and you take advantage of all the CGT concessions.

Out of all possible reasons for purchasing a property you are subdividing, using it as a farm is the most tax advantageous.

Even if your assets are more than $6 million, providing you have held the property for more than 12 months, there are still tax concessions in the sale being considered capital rather than revenue. But to get all the concessions you will need your assets to be less than $6 million or elect to enter the simplified tax system if your turnover is less than $2 million. The property must also be an Active Asset – Section 152, that is used in the business, up to just before sale and for at least half of the time it was owned. If the business ceases before the sale the asset must have been used in the business up to the time it ceased (note the ATO is taking a very strict view here it means right up to the last day) and then must be sold within one year of the business ceasing. The property would not be an active asset if it was used to derive rental income. The following only addresses the ramifications for the land not the plant and equipment on it.

a) If you purchased the property over 15 years ago, farmed it for at least 15 years and the development is not so elaborate that you are considered to be in the business of developing land (see below), you are home and hosed you don't need to pay any CGT. Another advantage of the 15 year concession is you do not have to offset the gain against your capital losses first so they are still there for your future benefit. The owner or owners must retire (a state of mind). This would certainly be worth it for the profits to be completely tax free. Lastly if you qualify under this concession it does not effect your superannuation reasonable benefits limit.
b) If you miss out on the 15 years do not despair a careful combination of the remaining small business exemptions will give you almost as good a result. For example combine the retirement exemption with the 50% CGT discount and the 50% active asset discount and you will pay no tax but 25% of the profit may need to be contributed to superannuation if you are under 55 years of age. It will not be taxed in the hands of the superannuation fund. Despite its name you do not need to retire to utilise the retirement exemption. Assume the gain on the property was $100,000 the 50% CGT discount would reduce this to $50,000 and the 50% active asset discount would further reduce this to $25,000. Placing the remaining $25,000 into superannuation would mean that the whole $100,000 is received tax free. The $25,000 is not taxed in the hands of the superannuation fund but you will have to be at least 55 before you can touch it. Companies are not entitled to the 50% CGT Discount and the use of the 50% Active Asset Discount creates problems when the asset is owned by a Company. In Discretionary Trusts the CGT flows through to the beneficiaries so is treated the same as an individual. Though both companies and trust have to satisfy a controlling individual test.

All the benefits in a) and b) above are only available if you stay within the CGT provisions rather than enter into the business of property developing. As these effectively mean that you will pay no tax on the profit it is worth dotting your i's and crossing your t's and seeking professional advice to ensure you don't miss a trick.

Most farmers would already be registered for GST for the farming enterprise so they will have to charge GST when they sell the lots though the margin scheme may minimise the impact of GST. Details of the margin scheme are in our How Not To Be A Developer booklet. If you were not registered for GST when farming, you need to make sure you do not fit the definition of enterprise when developing the blocks. In other words don't be too business like. .

An idea maybe to reduce the farming business down to where it has a turnover of less than $50,000 so the farmer can de register for GST, but still be in business so be entitled to the active asset concessions outlined above. You could also consider ceasing the business in order to deregister but you must be careful to sell all the blocks within 12 months in order to keep the active asset concessions.

There are further concessions that allow farmers to sell their farm as a going concern or to an associate or another farmer with no GST being applicable.

If you purchased the property with the intention of reselling it at a profit none of these concessions apply. But even if you didn't, you still need to be careful not to cross the line of later applying that property for a business making purpose. If you are considered to have changed the property to the business of selling it for a profit you will be taxed as normal income on any profit made between the market value at the time of change of purpose and eventual selling price. You will also be up for capital gains tax on the capital gain made on the market value at the time the property became part of the business of property development. Accordingly, the property will be introduced to the business as a cost at the market value at the time. The actual calculation of the tax is far more complex than this if you do not change entities when committing the land to development. It is also date sensitive and is affected by whether the property is an isolated transaction or trading stock of a developer. Details are not included here as it is not within the scope of this article. This is just a warning not to crunch your numbers without having a professional calculate the tax considerations. The actual committing of the land to a business or the subdivision do not trigger a CGT event ie generate a tax liability. So the CGT is not payable until the land is actually sold. But if you transfer the land to another entity for development CGT will be payable in the year of transfer.

If you want to be completely sure the transaction will only be treated as a mere realisation of an asset and you can prove the purchase was not for profit making by resale, don't turn a grain of soil until you have received council approval for the sub division and then sell the land for its market value to another entity. Note if you take this line of action the new entity will have buckly's of arguing it was merely realising an asset and will pay full tax on all future profits because they are revenue in nature. Professional advice should be sought on the nature of this new entity to minimise the tax consequences, depending on your particular circumstances. If the council require you to undertake work before the subdivision will be approved you have a real problem getting the market value to a decent figure. In Case W59 89 ATC 538 it was decided that the property became part of the business when these works started so market value at this time could not include the fact it was subdividable but there is hope in TD 97/1 which says the market value should include the highest and best use including the potential of consent being given for subdivision.

Factors that suggest you are merely realising an asset rather than operating a business include:

1) Whether there is another valid purpose such as rental or farming that was viable at the time and that this was actually carried out.
2) How quickly you resell the property. The longer you own the property the more likely it is that you held it as an investment rather than for use in the business of property development.
3) A valid reason for changing the use of the land, ie being too ill to continue to farm it.
4) Attempts to sell the land undeveloped that had failed.
5) The owner of the property is not a developer, real estate agent or builder by occupation.
6) Don't go transferring the property to a new entity for the development.
7) Many factors inherent in the development itself such as:
    a) The significance of the development costs compared with the value of the undeveloped land. The more money borrowed to finance the development the more likely it is to be a business.
    b) The size of the development.
    c) The business like nature of the activities, avoid letterheads and employing staff.

d) How involved the land owner is in the process. For example the difference between Cassimaty's case and Stevenson's case (refer below) could be summed up by the fact that Stevenson made the mistake of being actively involved in selling the lots where as Cassimaty left the job to a real estate agent.
e) The more stages the development is done in the more it will appear to be a business. This can be countered by developing on the basis of need to repay debt or finance living expenses.
f) The amount of works required for the land to be subdivided. To this end it may be more advantageous to pay a contribution to council to put in kerb and channelling rather than undertake the work yourself. Or paying a developer to take responsibility for all of the works.
g) Don't quit your day job.
h) Don't estoppel yourself by trying to claim a tax deduction for expenses such as interest and rates while the development is taking place.

Examples of the points made above can be found in:

Stevenson v Com. of Taxation 1991 29 FCR 282 – Profit on Subdivision of Farm Taxed as Normal Income 446 acre farm owned by family since 1904. 26 acre single block sold 1965. 360 acre block sold 1971. Another 35 acres sold when taxpayer reached 70. The balance was later subdivided and attempts made to sell it with development potential. Council required water and Sewerage. 180 blocks subdivided finance by considerable borrowings. Development done in 8 stages. The taxpayer was very involved in the development right down to selling the land himself rather than appointing an agent. The taxpayer had no previous development experience.

George Casimaty v Com. of Taxation 1997 1388 FCA 10-12-97 – Profit on Subdivision of Farm Capital Purchased 988 acre farm from father in 1955 and father forgave obligation to pay for the land. 1956 purchased 40 adjoining acres to build a house. 1963 could not sell the property for enough to cover debts. In 1965 diary farming became uneconomical. 1967 to 1969 drought effected. 1972 tried to sell the whole property to state housing department. Rural market depressed so continued farming. Ill-health and high interest payments forced taxpayer to sell off 3 lots in 1975. More financial problems lead to second subdivision of 10 lots in 1977 for which Council required roads, water and fencing. More financial problems in 1983 so 9 lots subdivided included water, roads and fencing. 1988 13 lots roads plus gift of 2 hectares to son. Council required roads, water, fencing and draining a creek. 1992 16 lots water, fencing and roads. 1993 19 lots. Ill-health suffered from early 1970s but continued to live on the property and farm it a third remained un-subdivided. Properties were sold by a real estate agent.

ID 2002/483 – Is an interesting example of when the ATO wanted to argue the other way because the property was sold at a loss. The taxpayer's spouse completed a Real Estate course and they claimed that the property was purchased for development. Meetings were held with real estate agents and project builders but the local council was not consulted regarding any restrictions effecting the viability of the project nor was a costing analysis done before purchase. When the costing was done afterwards it indicated the project was not going to be profitable so the taxpayer sold the land unimproved. The ATO concluded a profit motive could not be readily drawn from the facts and that the project was approached in a haphazard way with little activity from the taxpayer.

Update re Service Entities Draft Ruling

Many professional practices use service entities to run their office. The advantage being the mark up on services provided to the practice can be distributed to other family members. Asset protection is another benefit if the equipment and premises used in the practice are owned by the service entity

The ATO has released a draft ruling and a guidance booklet on the sort of arrangements they consider acceptable. The guidance booklet discusses in detail what items can be marked up and by how much. There are two main tests. Firstly, is the service entity bona fide? If so is the amount the professional entity is paying for the services commercially realistic.

Is the Service Entity Bona Fide?: The services provided must have a commercial purposes and the service entity must operate independently of the professional firm. I quite accept the points on having separate management and the professionals not working in the service entity but the guidance booklet tries to make quite a big deal about separate premises. In one of the examples the wages show there are only 4 or 5 staff in the service entity but it is paying $80,000 a year in rent for separate premises. I think this is over the top, not practical or realistic and not supported by the leading cases on the topic. Though it is important that staff

clearly know who they are working for and that the service entity's office area and administration is separated from the professional firm both in action and in the layout. The ATO is threatening to use Part IVA if the service entity does not have a bona fide purpose in the business. It is saying that asset protection is not sufficient justification on its own (TR 2005/D5 para 39). This is in conflict with statements from the decision in Phillips Case.

There also needs to be ample documentation such as contracts and regular invoices.

Are the Fees Commercially Realistic?: The rate charged not only has to be similar to what arms length entities are charging for those services or goods but also the net profit on that section of the service entities business must be similar to others in the industry. The Guidance booklet gives the following examples:

1) No markup should be added to items where no value is added – for example if the service entity pays the professional entity's electricity bill they should be simply charged the amount of the bill, that is assuming the staff member paying the bill is already being contracted to the professional firm by the service entity. If that is not the case a fee can be charged for the administration time but not a percentage mark up just an amount based on time spent.
2) Prices charged for casual staff can be similar to labour hire firms but permanent staff (longer than 12 months) must be charged out at a much lower rate. The guidance booklet recommends that the profit made on hiring temporary staff should only be 5% on top of their wages, superannuation, insurance and their share admin costs and overheads of the service entity. With permanent staff this should only be 3.5% net profit. Note the 5% & 3.5% is if you went though and dissected all expenses in the Profit and Loss Statement against the income it earned the net profit for each section should only be 5 or 3.5%. I think the ATO would like to confuse taxpayers into thinking this is the gross mark up. Examples put the gross margin at around 35% on the wages of the staff member hired out plus their superannuation and Workcover but the booklet clearly places more emphasis on the net profit percentage. As the ATO is looking at the net profit it is important that family members take every cent they are entitled to as wages rather than profit distribution. To maximise this a diary needs to be kept of hours worked and the hourly rate needs to be commercially realistic. Note in Phillips case the court accepted a mark up of 50% on wages. The net profit margins quoted by the ATO are less than the benchmarks they use to test whether employment agencies are understating their profit. According to the ATO's contradicting figures if you get the service entities net profit down low enough to fit within the guidelines in the booklet you will trigger an ATO audit for understating your income.
3) Don't double dip. If the professional firm is paying an hourly rate for you to provide them with clerical staff, then the work that staff member does can not in anyway be charged to the professional firm nor can they be attending to the administration of the service entity. The guidance booklet also expects the person attending to the administration of the service entity not to be on hired to the professional firm in anyway.
4) Equipment hire should be marked up at 9% of the depreciation and administration costs of holding the equipment.
5) Rent charged by the service entity for the practice's premises must be market value so if the premises are rented from a third party the amount can not be marked up. If the service entity owns the premises then a market rent or less must be charged.

In its guidance booklet the ATO says it is giving most service entities 12 months to correct their margins. But during that 12 months they will be auditing high risk entities. These are ones where no real services are provided and those that pay over $1million in service fees and that $1million represents more than 50% of the gross fees earned by the professional firm.

Generally the guidance booklet tries to suggest that service entities that are not large enough to require several full time staff members just to manage them, will not qualify. The size of the entity is just not relevant. I feel the statements made in the guidance booklet will have to be watered down or the professions will fund another test case and based on previous cases they will make a lot of ground. The ATO must realise that by specifically stating in its ruling that it is mainly concerned with Solicitors and Accountants that they will wind up in court if they try to push beyond the current position in case law.

In the current climate clients who are not yet operating a service entity may have to wait and see whether it is worth the set up costs. If the ATO is successful in enforcing the small margins the tax saved may not be worth the extra operating costs. The main area that they are attacking is the on hiring of staff. A simple and cheap solution for a sole practitioner maybe to have his or her spouse own the equipment and premises and simply pay rent to the spouse as well as employing him or her on wages to do the clerical work and keeping a

diary of work performed. If the couple are nearing retirement with independent children it may be better to rely on Ryan's case and make a large superannuation contribution for the spouse. If the couple have young children the children are only allowed to receive $1,325, each year, in passive income before they are pushed into the maximum tax bracket. If the children over 18 and still financially dependant there may be some advantage in having a trust but this is not necessary if they can work in the business anyway.

References: TR 2005/D5 & ATO Booklet N13085 May, 2005,
Phillips v FCT Supreme Court 1977 original case
FCT v Phillips Federal Court 1978 appeal by ATO dismissed

Directors of Trustees of Family Trusts

Most of our clients that have discretionary trusts have a company as the trustee and they are a director of that company. The use of the company as trustee is to provide the director with some personal protection should the trust become insolvent.

Clients following the Hanel v O'Neill case may now be a little concerned. In this case the director was held personally liable for tax withheld from wages even though he had followed correct procedures.

On the 18th November 2005 changes to the law improving the protection of directors of trustees were passed, so this case should no longer be relevant.

Overloaded Utes Insurance Risk

The payload on most utes includes the tray, bull bar, passengers, accessories, canopy and sometimes even fuel. So having a one tonne ute does not mean that you can put one tonne in the back. After allowing for all the above you may only be able to legally carry half a tonne. If it is shown that being overloaded contributed to the accident your insurance company may not pay the claim. The answer to this problem is a lazy axle that can add another metre to your tray and up to one tonne to your payload. An extra axle can change a Landcruiser or Patrol into a dual cab with a tray area larger than the standard ute. The extra space provided by the 6 wheel conversion gives you twice as much space as a standard ute at a lot less cost.

Having found myself overloaded by one tonne I found that the best people in the country for this type of conversion are at Dalby in Queensland. Six Wheeler Conversions Pty. Limited. They have found a solution for every problem I have thrown at them. They custom build anything and make any size trailer, even tipper trailers. They also build tipper trays for utes.

When is a Choice Not Really a Choice?

When one looks at the amount of exemptions from the choice of superannuation fund legislation you really have to wonder why the government is spending so much money on advertising it to the public. The sceptical amongst us would say they were really just spending taxpayers' money promoting the Federal Government.

After years of waiting finally on 1st July, 2005 employees were going to be able to direct their employers to make their superannuation contributions to the fund the employee chose. But this is not possible if the employee is caught within one of the many exemptions from the legislation. In fact some employers may be mislead into thinking they can offer a choice when they are really breaching the award by doing so.

Your employer is not required to allow you to choose your superannuation fund if your employer makes superannuation contributions for you under:

- A certified agreement
- An Australian Workplace Agreement.
- A state award or industrial agreement.
- The Coal and Oil Share Mine Workers Superannuation Act
- A Local Government Act
- Most Defined Benefits Plans
- Most Public Service agreements

Makes you start to wonder who on earth will qualify. Basically employees who are likely to qualify are those that are employed under a Federal award yet are not public servants. Also employees who are not employed under an award or one that does not address superannuation.

If you want to get into the nitty gritty go to www.superchoice.gov.au/employers/eligibility or as the site suggests ask your employer!

So what was all the noise about again? Better to ask what they were trying to divert our attention from at the time.

If you would like to check if you have any unclaimed superannuation benefits go to www.ato.gov.au or ring 131020. You will need your tax file number. **Note** if you have reached 65 years of age your unclaimed superannuation contributions will be transferred to the Unclaimed Moneys Register. If you would like more information about your award you are employed under go to www.wagenet.gov.au

Interesting ATO Rulings for Partnerships

GSTA TPP 086 & 87 - A partnership can claim the input credit for a tax invoice in the name of an individual partner or even an employee.

GSTA TPP 089 – If you receive a tax invoice after you have cancelled your registration you are not entitled to an input credit and you cannot claim that input credit before you cancel your registration because you do not have a tax invoice.

ATO Guide - Part IVA – General anti-avoidance rule - Principles about how and when it applies – traditional husband and wife partnership not caught if no unusual or contrived features. Accepts that profits can be distributed equally even though only one partner performs most of the work. Though if the business of the partnership is simply providing one partner's personal services the alienation of personal services income rules may apply.

Labour Hire Arrangements

Due to the amount of radio advertising about the pit falls of being an employer compared with using a Labour Hire firm I thought the following case relevant reading.

In Damevski v Giudice (2003) FCAFC 252 the full Federal Court found a cleaner provided in a labour hire arrangement was really an employee of the person for which they did the cleaning (principle) not the Labour Hire firm. As it was the principle that set the conditions under which the cleaner worked, the Labour Hire company was merely an administrator.

Note that the question of whether you are still liable as an employer is really an issue for a solicitor and you should consult one before shelling out higher labour rates to a Labour Hire company. Some of the important factors are whether the contractor provides their own tools, whether they are paid by the hour or by result, whether they contract to other businesses as well, whether there is any allowance in the agreement for holiday pay and whether the principle deducts tax from the contractors pay.

Who or What Should Own Business Premises

Section 152-40 makes the active asset discount available to assets owned by a non business entity providing they were used in the business of their small business CGT affiliate or another connected entity.

Your Small Business CGT affiliate according to section 152-25 is your spouse or child under 18 years or a person who acts in accordance with your directions. Your partner in a business partnership is not your small business CGT affiliate. Section 152-30 describes a connected entity as one where you control 40% or more of the rights either directly or through control of another entity that has that control.

These definitions are also used to define whose assets are added to yours for the 6 million dollar asset test to qualify for the CGT small business concessions. So on the one hand being a CGT affiliate or connected entity is good as assets owned by these entities and used in your business can qualify for the active asset discount even though the owner of the asset is not in business. On the other hand to qualify for any of the small business CGT concessions you and your CGT affiliates and connected entities must have less than $6,000,000 in net assets. Superannuation and personal assets such as homes are not counted, section 152-20 (b).

This is just another one of the many issues that should be taken into account when establishing your business. The trouble is no one really expects to get to the $6,000,000 threshold so it doesn't get a lot of thought. But the active asset side should always be considered as it is important for asset protection purposes that the assets are owned separately from the business but without losing the small business CGT concessions. Note the CGT concessions do not apply to plant and equipment. In the case of most small businesses the two assets that the CGT concessions are likely to apply to are Goodwill and the premises the business operates from. The Goodwill by definition will always be owned by the same entity as the business so usually it is

only the business premises that need to be held in a different entity from the business but still connected with the business so that the active asset concession is available.

So who or what should own the business premises? If you are looking to make the most of the CGT concessions the premises should be owned by you, your CGT affiliate or a connected entity. Owning the building in the name of a child under 18 would result in penalty tax and once they reach 18 they would not be your affiliate so this leaves you, your spouse or an entity you control more than 40% of. A company, while qualifying to the CGT small business concession, will not be able to distribute the tax free profits to you without triggering tax at your normal tax bracket or being liquidated and it does not get the 50% CGT discount. This means the only suitable non human entity to hold the premises in is a trust.

If you want to have flexibility on how the profits are distributed and/or you are concerned that you or your spouse may one day be sued the cost of setting up a discretionary trust is well worth it.

Now the next question is would you be better giving up the CGT discount so that you could hold the premises in your self managed super fund? About 90% of the time, yes. Super funds are only taxed at 10% on capital gains and once they are in the pension stage they are not taxed at all. Careful use of the CGT concessions can reduce the tax to zero as well but there is a risk that you may lose your qualification for the CGT concessions. This is easy enough to do by simply selling the premises more than 12 months after the business has ceased or turning the premises into domestic accommodation or not using the premises in the business right up to and including the day the business is sold. The down side for super is the super fund cannot borrow to buy the building. On the up side having the building in the superannuation fund will exclude it from the $6,000,000 asset test so that you are more likely to qualify for the CGT concessions on your goodwill. If this has provoked you to change your circumstances, a super fund can buy the business premises from a related entity.

Hybrid Trusts

A hybrid trust is a variation on the traditional fixed and discretionary trusts. In fixed trusts (sometimes called unit trusts) the beneficiaries are entitled to an exact portion of the profit and capital distributions based on the number of units they hold. In discretionary trust (sometimes called family trusts) it is up to the trustee, each year, to decide who receives the profit or any distributions of capital. This is very useful in a family situation where each member's tax position changes over time but not normally used by parties trying to deal with each other at arms length.

If you borrow money to invest in a discretionary trust the interest is not tax deductible unless the trust pays you interest equal to or exceeding the amount you are paying the bank. Interest can not be deductible simply because you might receive a distribution of profits as this is up to the trustee's discretion. On the otherhand in a fixed trust money borrowed to buy units in the trust has a defined link to the income it will produce so the interest is tax deductible.

The most common use of a Hybrid Trust is to sell the high income earner units which he or she borrows money to purchase. The proceeds from the sale of the units are used by the trust to purchase an investment. The income from this investment is intended to initially be less than the interest on the loan. This income is distributed to the high income earner who includes it in his or her tax return as income but with a negative result after claiming the interest. Over time the investment is intended to become positively geared at which stage the units are redeemed by the trust and the profits or capital gains on sale of the investment are then distributed to the discretionary beneficiaries which are usually the taxpayer's family.

Until now BAN TACS has stayed clear of Hybid trusts on the basis that no other purpose could justify their existence other than a tax benefit and so they should be caught by Part IVA. A highly respected tax training and research organisation call the NTAA has openly approved these arrangements and stated that the ATO is not objecting to them. Accordingly, we now withdraw our hesitation and are able to assist our clients should they wish to enter into such arrangements. Though taxpayers should be aware Hybrid trusts have not been tested through the courts so we can not be absolutely certain they will stand up. We would also prefer clients to allow the high income earner to receive the profits in the first year the investment becomes positively geared.

It should be noted that a Hybrid Trust is not a suitable vehicle for a business entity as it would fail the controlling individual test and therefore not be entitled to some of the small business CGT exemptions. Taxpayers considering a Hybrid Trust should also think about our rental property salary sacrifice kit as another and cheaper method of achieving the same result. There is also a version of the kit available for investments in shares. The kit is not caught by Part IVA as the ATO has stated it will not use Part IVA

against a simple choice permitted under tax laws such as arranging part of your salary package to include a fringe benefit.

Interesting ATO Interpretive Decisions

ID 2005/147 – The lease payment to the government for a 50 year taxi licence where the payment is due in full at the start of the 50 year period is not tax deductible because it is considered capital in nature.

Payments in Advance

Making payments in advance will move deductions from next year into this year, if you are an investor, wage earner or business in the simplified tax system. Don't pay more than a year in advance. Expenses a business could consider are rent, lease payments, advertising etc. Investors and businesses paying interest in advance must make sure it is treated as such by the bank. If you simply pay an amount into the loan account it will be treated as a repayment of principle and not tax deductible. All taxpayers should consider tax-deductible repairs, stock up on office supplies and generally make sure all your bills are paid before 30th June. Businesses not in the simplified tax system can only prepay expenses less than $1,000 (net of GST if registered), wages and payments required by law to be paid 12 months in advance ie vehicle registration.

Wage earners may also consider buying before the 30th June items they will need for work in the following year.

For example protective items such as sunscreen. Basically you can claim for a protective item if, by its nature, it would be reasonable to conclude that it will protect you from the risk of injury or illness in your workplace and that risk is not remote or negligible. This is unlikely to apply to items of clothing that are conventional in nature though if it is used principally for your protection it would qualify as a deduction. An example of this would be moisturiser with sunscreen included. This also opens up the opportunities to claim special non-slip shoes if they are required for your work. Conventional clothing such as raincoats, woollen underwear and jumpers are protective if your job exposes you to water or extreme temperatures whether mechanical or climatic.

Long sleeve shirts and jeans are not considered protective but this would change if they had reflective stripes, a UV rating or the material was heavy duty and your job necessitated that protection.

Prescription sunglasses are claimable if you need protection from the sun. If the protective item is also used for private purposes, such as sunglasses, a diary should be kept for 1 month so that the cost can be apportioned between business and private use on a time basis.

Changes to the Simplified Tax System

The government is going all out to encourage businesses to use the simplified tax system (STS). One of the most significant changes relates to the small business capital gains tax concessions. These concessions are very lucrative and used correctly can mean a business owner pays no tax on the sale of a business. There are conditions including a $6million asset test. But now this test has been abolished if the business qualifies for and elects to be in the simplified tax system. The budget also announced that the asset test to enter the STS had been abolished and the turnover threshold increased. Accordingly, the only requirement a business needs to meet to enter the STS is to have a turnover (total sales) of less than $2million. It may well be time to reconsider this option.

Other than the CGT concessions the other main advantage of being in the STS is accelerated depreciation. For example assets costing less than $1,000 (net of GST if claimable) can be (optional) written off immediately. Note if they are part of a set the whole set must cost less than $1,000. Assets costing more than $1,000 but with a life expectancy of less than 25 years are placed in a pool and depreciated at a rate of 15% in the first year and 30% there after. Further if the business ceases and there is still a balance in the pool this amount can continue to be depreciated against other income without having to apply the non commercial loss rules (ID 2003/389). This applies even if the assets are now used for private purposes providing they have been held for more than 3 years. If the pool balance ever falls below $1,000 it can be written off completely (Section 328-210). Note where a car is claimed under the 12% of cost method or the kilometre method it cannot be placed in a low value pool but if you change to one of these methods after the car has been in the pool for 3 years you do not have to remove it.

PAYG Summaries and Annual Report due on the 14th August

Unless you meet the criteria below all employers must sent your 2006 PAYG summaries and an annual report to the ATO by 14th August, 2006. Very small businesses are allowed to delay this until the lodgement date of their business' 2006 income tax return if the following is applicable:

1) You have lodged your 2005 income tax return and PAYG annual report on time and
2) All employees must be family members, directors or shareholders of the company or a trust beneficiary, and
3) Your tax agent notifies the tax office that you have elected to receive this extension.

Accordingly, we ask all clients wishing to take advantage of this concession to contact us before the deadline for notifications which is 15th September, 2006. If you meet points 1) and 2) but do not notify us you must send all your PAYG summaries and the annual report to the ATO by 30th September, 2006.

More Workers Allowed a Choice of Superannuation Fund

Many workers missed out on being given a choice of which fund the superannuation paid under the guarantee, by their employer, was paid into, because they were covered by state awards. Employees covered by state awards were not effected by the Federal Governments choice of superannuation fund rules. This changed on 1st July, 2006 when the new Federal workplace relations system was introduced. Now employers that are companies may have to allow their employees a choice.

To find out if you or your employees now have a right to choose their superannuation fund go to www.workchoices.gov.au or ring 1300 363 264.

Micro Business - Entrepreneur's 25% Tax Offset

That's right the ATO will reduce the tax payable on your business income by 25% if you qualify as a small business entrepreneur. It is call the Entrepreneur's Tax Offset (ETO) and is intended to encourage people to start up small businesses on the side. As a bare basic you must meet the following criteria

1) Elect to join the simplified tax system
2) Have a turnover of less than $75,000 – This excludes rent and dividend income if that is not really part of the business and excludes interest income earned on non business bank accounts.
3) The business must have made a profit on the difference between the turnover in 2) and expenses related to earning it. Note if a company is providing personal services that are attributed to the person providing the services, the company will not have any tax payable to utilize the offset unless it has income from other sources.
4) Have enough taxable income for the year that you have a tax liability, as the offset can only be used to reduce your tax liability, it is not payable to you if the tax on your income from all sources is less than the offset.
5) You include all or part of the business profit in your income tax return.

Note if you are involved in multiple businesses their turnover, applicable to point 2) above, may be added together if they are part of a group. To be part of the same group the following must apply – **note**: entity includes you:

1) Either entity controls the other
2) Both entities are controlled by the same third entity – ie 40% ownership or more

or

3) The entities are STS affiliates of each other – STS affiliates are other entities that can be expected to act in accordance with the first entities wishes in relation to all or a substantial part of the entities business (TR 2002/6). But partners in a partnership are not usually each other's STS affiliates. Likewise a husband and wife are not consider to be STS affiliates if they run separate businesses. The clause is intended to catch artificial ways of getting around point 1) and 2).

As you can see from the above a taxpayer can be a partner in a partnership and a sole trader and qualify for the ETO for both providing each businesses individual turnovers are less than $75,000 even if combined they exceed it. On the other hand the total turnover of the partnership counts for each partner. For example if the partnership turnover is $80,000 no matter how many partners there are they will not qualify for the ETO on their partnership income.

This offset is another nail in the coffin of forming a company compared with a discretionary trust which gives you the same asset protection if it has a corporate trustee but better access to the ETO. While companies are technically entitled to receive the offset it will only reduce the tax payable by the company not the owners of the company. So when these profits are eventually distributed to the owners of the company they are either received as wages which reduce the amount of the offset that is applicable to the company because wages reduce the company's profit. Yet the owner is not entitled to an offset on the wages because it is not business income in his or her return. Nor is the owner entitled to receive the offset on dividend income received from the company. This dividend income may not be able to be fully franked because of the reduction in the company tax payable due to the offset, so effectively the offset benefit is paid back when the owner receives the dividend. The only other way an owner of the business can receive the income from the company is by it being attributed to him or her by the personal services income rules. ID2006/28 states that the offset is not available in these circumstances.

On the other hand a trust would be able to effectively pass the offset onto a beneficiary but not if it paid the income out as wages. The personal services income rules requiring the profits of the business or a partnership or trust to be attributed to the tax return of the person who earned the income would not prevent that person claiming the offset in their personal return as the originating entities are still considered to have made a net profit (ID 2006/227).

To calculate the amount of ETO you are entitled to simply calculate the following in regard to each business that qualifies then add the offsets together to get the total tax reduction:

1) Divide the total turnover from the STS business by your total taxable income to calculate the percentage of your taxable income it represents
2) Multiply the total tax payable on your taxable income (before the offset) by 25%
3) If the turnover in 1) was more than $50,000 subtract the turnover from $75,000 and divide it by $25,000.
4) Multiply the figure in 2) above by the percentage in 1) above and 3) above, if applicable, for the amount of offset you are entitled to.

Secret Plans and Clever Tricks

The higher the business profit the higher the Entrepreneurs Tax Offset with the only negative element being the turnover of the business. Accordingly, if you are limited in a claim it is better to claim it against your income, rather than the business. For example if you can only claim 5,000kms for your motor vehicle and you have already done that in relation to your wages income, don't apportion between wages and business use. Claim it all against your wages income thus shifting profit from wages to the business.

New ATO Data Matching on Retailers

The ATO has started writing to shopping centre operators requiring them to provide the following information in relation to all the stores in their centre.

1) The name, location and ABN of each store
2) The tenant's phone number and contact address
3) The gross sales reported to the centre operator and the amount of rent paid
4) The date the tenant first started to operate the store.

Not only is this an easy way for them to find businesses that are not registered but it also utilises the shopping centre operators to make sure income is not under stated. Most centres base their rent on the turnover of the store and have methods of keeping the store owner honest. The ATO will now be very economical utilising these methods to keep the store owner honest in their BAS and income tax return as well.

Not all shopping centres are involved at the moment the ATO is only contacting the seven major operators:

Westfield Management Limited
Colonial First State Property Management P/L
Lend Lease Property Management (Aust) P/L
General Property Trust.
Stockland Property Management P/L
AMP Capital Investors Limited
Centro Properties Group

Who Should Pay Black Hole Expenditure

Examples of Black Hole Expenditure are the set up cost for a trust or company or a feasibility study before starting a business. These costs can be written off over 5 years by the entity or person who incurred the expenses. The 5 years is in equal instalments so even if the expenses were incurred in June and the business started to trade before the end of the financial year you would be able to claim a full 20% in that financial year. The 5 year period does not start until the business starts to operate.

It is important to note that the deduction is only available to the entity or person who incurred the expense. The person setting up a company or trust is entitled to claim the deduction in their personal tax return if they are connected to the business ie will receive income from it. Having the new entity reimburse you for the costs of setting up the entity will eliminate the tax deduction completely. The new entity will not be entitled to a tax deduction because it did not incur the expenditure and the reimbursement would be taxable income to you so cancelling out the benefit of the tax deduction.

It's Never Safe to Dispose of Records

In March the ATO released TD 2007/2, stating that in the case of carried forward losses records need to be kept for a lot longer than the record retention period prescribed under income tax law. This applies whether the losses are from normal income or capital in nature. This may surprise property investors who have carried forward capital losses and businesses with carried forward revenue losses.

Losses are included in the income tax return for the year they are incurred and carried forward until offset. In the case of business losses it may not be long before the losses are offset but capital losses require future capital gains to be offset so this may take quite a long time. TD 2007/2 states that records must be kept until the expiry of the review period (up to 4 years) from the last tax return when the losses are fully absorbed and even then it warns that "where a formal dispute arises in relation to a loss a taxpayer should retain relevant records until any objection or appeal in relation to a loss has been finally determined". The ruling goes on to point out that the ATO has the power to go beyond the time limits, make a new assessment and put the onus of proof back on to the taxpayer to prove the assessment is excessive. So the real advice is you can never be safe. Ignore what you read in Taxpack, about only needing to keep records for 5 years, you can't rely on that or any other statement by the ATO because, the ruling says: Taxpayers should have regard to their own particular circumstances in making any decision whether or not to retain documents for longer periods.

No this is not an April Fool's Joke.

Claiming Your Lunches When you Work From Home

The ATO NTLG FBT sub-committee minutes for 22nd May 2003 contain some very interesting discussions on when food eaten in your home office would be tax deductible and not subject to FBT. The NTAA put forward an example of Michael who was employed by his company Michael Widgets P/L. The company's business was conducted from an office in Michael's home. The question put to the ATO was if each working day Michael purchased sandwiches and juice from the local deli and ate it in his home office while he was working would the meal be deductible and not subject to FBT. Further, what about a two to three course meal from the local restaurant purchased as a takeaway and eaten in the home office? The relevant section is 41 of the FBTAA which covers meals provided on business premises.

The ATO did its usual cop out and stated each case would depend on its particular facts and each person should apply for a ruling on their particular circumstances. But they did concede that there are times when such an arrangement would result in a tax deduction. Their main area of concern was whether the office was bona fide business premises. Details of when part of your home is considered a place of business are set out in TR 93/30 and TR 2000/4 covers the definition of business premises for FBT purposes.

TR 93/30, at paragraphs 4 and 5, lists the following factors as relevant when considering if part of your home is considered business premises.

1) Part of the residence is set aside exclusively for the carrying on of a business by a self employed person, for example a doctors surgery. Or Part of the home is used as a taxpayer's sole base of operations for income producing activities for example where no other work location is provided to an employee by an employer.
2) The area is clearly identifiable as a place of residence
3) The area is not readily suitable or adaptable for use for private or domestic purposes in association with the home generally

4) The area is used regularly for visits of clients or customers.

Warning if you meet the requirements above, so part of your home is considered business premises and you purchased your home after 19th September, 1985 then your home will be subject to CGT because part of it is income producing. While only part of the gain will be taxable you need to first calculate the gain for all of the property and then apportion it. So you now have a massive record keeping responsibility that is unavoidable whether you eat your lunch in the office or not. If the house was first used to produce income after 20th August, 1996 your cost base for the whole house will be reset at the market value at that time. If you purchased the house after 20th August, 1991 you are permitted to increase your cost base by the holding costs that you have not otherwise been able to claim a tax deduction for. The holding cost for the part of the house you use for private purposes can be used to reduce the gain on the business portion. This is because the holding costs, not previously claimed as a tax deduction, are taken into account to calculate the whole gain made on the property then this figure is multiplied by the percentage applicable to the business use. Holding costs are interest, rates, land tax, insurance, repairs and maintenance costs. This means even keeping receipts for light globes, mower fuel etc.

On the up side, if your home is considered a place of business you can claim a portion of the interest, rates, insurance, repairs and maintenance costs as a tax deduction. The portion is normally based on floor area and is also used when calculating what portion of the gain on the sale is subject to CGT.

Note it is fatal to your claim if you eat the meal anywhere else in the house other than the office.
Subsection 136(1) of the FBTAA states that business premises "do not include premises, or a part of premises, used as a place of residence of an employee of the person or an employee of an associate of the person". At first glance this may seem that home offices are excluded . But the NTAA took the view that as long as the part of the home that was being used as business premises was not in anyway used as part of the residence then it passed the test. The ATO didn't contradict this but did do a lot of talking about the definition of business premises in TR 2000/4 and TR 93/30.

Business Owners Reducing Non Deductible Debt

Here is an interesting titbit for business owners that realise that with careful planning they could use some of their business liquidity to reduce the non deductible debt on their home. As discussed in earlier edition as long as it is not a scheme to reduce tax you can capitalise interest on borrowings for deductible purposes. This means if you have some spare cash in your business account you can use it to reduce your home loan. If at a later date the business needs the cash back you can draw it back off your home loan but as that draw is used for business purposes the future interest on that portion of the loan is tax deductible. The interesting titbit is a very old case Case F17 6 TBRD 1955 where the board held that even though the need for the business overdraft arose from the extravagant lifestyle of the business owner he was entitled to a deduction for the interest on the overdraft where it related to cheques drawn to pay business expenses.

Now remember if what you do is a scheme to avoid tax you cannot capitalise interest. I am not suggesting a particular course of conduct. I am just saying not to waste good cash sitting in the business bank account and don't forget if you draw money on your home loan to put into the business bank account for business expenses the interest on that portion of the loan will be deductible.

Note this gets a lot more complicated if the business is a trust or company as the money is not your money so you need to speak to your accountant about safe methods of withdrawing the money from the business and replacing it. Generally the arrangement won't work as well in companies or trusts.

Plant and Equipment Costing Less Than $1,000

Plant and equipment costing less than $1,000 qualifies for accelerated depreciation in a low value pool at a rate of 18.75% in the first year regardless of what time of year it was purchased and 37.5% for each year after that, at a diminishing rate. If the rental property is owned 50:50 between two owners then a piece of equipment costing $1,999 would qualify to go into the pool. Once you decide to set up a low value pool all future acquisitions that qualify must be placed in the pool section 40-430. There are no grouping provision for low value pools (ID 2003/946) ie if you buy 2 curtains costing $900 each they both qualify for the low value pool.

If you use the diminishing cost method and the item is reduced to a closing written down value or adjusted value of less than $1,000 it can be moved into the low value pool. This will generally give you a higher rate of depreciation. It maybe worth going through your depreciation schedule and look for items that have been

reduced down to $1,000. Note if they originally cost less than a $1,000 you cannot move them into the low value pool. Items costing less than $1,000 can only be placed in a low value pool in the first year they become income producing. But items costing more than $1,000 that are now written down to below $1,000 can be moved into the pool at anytime. It is not necessary to move them the minute they drop below $1,000.

The above applies to both rental properties and equipment used in a business.

Evidence of Expenses

The ATO's impact statement, released in June, on Dram Nominees Pty. Limited appears to want us to believe that we need to comply with the substantiation rules in regard to all tax deductions.

The truth is the substantiation provisions, requiring a receipt for expenses only applies to claims for most work related expenses. In most cases income tax law only requires a record to be kept.

In Dram Nominees Pty. Ltd. V FCT 2006 ATC 2504 the ATO had disallowed claims for interest and building depreciation on the basis that the taxpayer did not have sufficient evidence that they had incurred the expenses. The senior member of the AAT hearing the case took a much more realistic view. He could see that at least some of the expenditure had to have been incurred because improvements had been made to the premises. Further he accepted that some of the company's borrowings could probably have been used to finance these improvements so he made a reasonable estimate and allowed that much of the taxpayer's claim.

The ATO has accepted the AAT finding and issued an impact statement saying that "The decision of the AAT was open to it as the Applicant's claims for a deduction for interest expenses was allowed only to the extent to which the Applicant was able to provide evidence to establish and substantiate those claims". There is no mention in the impact statement that such evidence simply amounted to the extensions exist therefore costs must have been incurred and from general discussion in the court room a reasonable amount was decided. Nevertheless, if the ATO accepts that such a method of estimation amounts to evidence to establish and substantiate claims then this is very handy to know.

Notable quotes from the case include; "there was no direct evidence connecting the borrowings and interest paid to specific expenditure on the property" and "The first question then to be dealt with is what amount is reasonable to accept as the capital expenditure incurred"…. "a figure of $50,000 would appear reasonable as a probable cost. I am prepared to accept the applicant's estimate of $15,000 for the shop front and exterior improvements 9A."

Just When Do You Become an Employer

If you are concerned that you should be paying your contractors as employees ie deducting tax from their pay and contributing to superannuation for them, take a quick test on the ATO web site at www.ato.gov.au/businesses/content.asp?doc=/content/00095062.htm When you have completed the questionnaire you can print up a report that gives you a summary of the information you have provided and the basis for the ATO decision. The ATO has undertaken that you will not be fined if you follow the information provided in the report.

If you are concerned that the person who pays you to work for them should be paying you as an employee this test may help convince them but do not be concerned it is only the employer who will be liable if they are paying you the wrong way.

Conditions to Contribute Super From your Own Co. or Trust

If you are a director of either your investment company or the corporate trustee of your trust make sure you consider the following before making a superannuation contribution. There is also a trap if, instead of having a company as trustee for your trust, you are the trustee. Any superannuation contributions made for you will not be deductible to the trust even if you are also an employee.

The ATO has addressed these issues in Interpretive Decisions (ID) 2007/144 and 145. Be warned interpretive decisions are not binding on the ATO they are simply a guideline as to what the ATO is currently thinking.

The first hurdle for any trust, in business or not, to overcome is that it must make a contribution for an employee. If the trust is not in business ie passively holds investment properties you might not be considered an employee ID 2007/145 address this. Quoting section 82AAA(1), which applies to companies and trust alike, it points out that an employee needs to be engaged in producing the assessable income or a resident of

Australia engaged in the business, this includes directors. It defines engaged in the business as being busy, occupied or involved.

If you have got past the stage of the trust having an employee the next question is does that employee have an employer? You see a trust not being a legal entity cannot make a super contribution for an employee, it is the trustee that must make the contribution. If the employee is also the trustee then the ATO considers the employee to be making the super contribution for him or herself. Section 82AAC(1) allows a tax deduction for a contribution made by the taxpayer for another person, subject to certain conditions. So if the employee is also the trustee of the trust super contributions for that employee would not be tax deductible according to ID 2007/145 because the contribution is not made for another person. Usually a trust has a company as trustee and you would be a director of the trustee company so when the trustee company makes the contribution for you as director that is for the benefit of another person.

ID 2007/144 which is about companies allows superannuation contributions to be claimed even thought the only income of the company is from passive investments and it states that the activities of the company do not constitute a business. There is no reason to believe this would not apply to trusts.

The directors were paid $100 each in wages. The ID states that the payment of the wages was permitted by the company's constitution providing it was agreed to at a meeting of the shareholders. Having passed these requirements the ATO had no problem with the company claiming a tax deduction for superannuation contributions made to directors even though the company wasn't in "business". That is of course providing the directors are actually involved in producing the assessable income of the business as discussed above.

Considering the above, if you want your company or trust to make superannuation contributions for you make sure, in the case of a trust, you are not the trustee. In both the case of an investment company or a trustee company it would be prudent to keep a diary of the work you do, pay yourself a wage of at least $100 per year and make sure that the deed or constitution allow directors to receive wages.

How do You Count Bees?

According to the ATO, in TD 2007/D7, bees are livestock just like cattle and sheep. And just like cattle and sheep, bee farmers need to keep live stock counts. This means each year counting the stock you hold and valuing it. This ruling is intended to apply retrospectively so not only do you need to start counting your bees now, you should have been doing it every year. Stay tune the ATO will soon be releasing a practice statement specifying how this is to be done.

New Workplace Rule Takes Effect

By the 20th October, 2007 all employers with, employees under the Federal system, must have given their employees a Workplace Relations Fact Sheet. To get a copy of the fact sheet go to:
www.workplaceauthority.gov.au/docs/EMPLOYERS/FactSheet/FS-WR-020707.pdf

Tax Free Redundancy Payments From Your Own Business

Back in December 2002 the ATO announced that taxpayers who are employees of their own business that must apply to the ATO for approval if they pay themselves a tax exempt bona fide redundancy payment.

At the time we had a little rant about the ATO making up its own rules. Well the matter has finally gone before the courts and the ATO lost. Nevertheless the ATO is still making up its own rules. The case reference is Long v FCT 2007 ATC 2155. Important factors in the case were:

1) The payment was what would have been paid if the parties were dealing with each other at arms length
2) While the employee was involved in the decision to close the business, the need arose because their only customer terminated the contract.
3) Mrs Long's son also received a redundancy payment and he was not a director though other employees did not

The tax office has since issued a Decision Impact Statement claiming that the judgement is only limited to the particular facts of the case. The only thing the ATO is prepared to take on board from Long's case is that it is not an automatic exclusion from the redundancy concessions just because the employee was involved in the decision to terminate their own employment. The ATO certainly wouldn't approve of a bona fide redundancy payment to an employee (owner) who decided to sell the business. Not that this matters as in most cases the small business concessions provide all the tax relief needed.

For the 2008 financial year the maximum tax free bona fide redundancy payment an employee can receive is $7,020 plus $3,511 for each full year of service.

A bona fide redundancy payment is not always the best option if the directors are likely to be in a low tax bracket in the future, due to retirement, and the company has franking credits. It may be more appropriate to take the assets out of the company as a fully franked dividend and possibly get some of the franking credits refunded because the taxpayer's average marginal rate on all the dividend income is less than 30%. Once the company is closed the franking credits will be lost forever.

Free, Grow Your Business Checklist

The Federal Government have made available on there web site information to assist businesses. Go to www.business.gov.au/Business+Entry+Point/Information/Checklist.htm

Great Super Guarantee News for Employers & Employees

As the law currently stands if an employer does not pay the superannuation for their employees by the due date it does not count towards the super guarantee. This is the case even if it is only paid a day late. So if the payment went into the next period by just one day it was considered to only cover that or future periods, there was nothing the employer could do to cover the previous period other than to confess up to the ATO and pay the fines, interest and super contributions to the ATO. This meant that employers had a big incentive to just ignore the period they missed rather than put it in the next time because if the ATO caught up with them they would effectively have to make the payment twice anyway. Also the chances of the ATO catching them out were slim. These strict rules rather than protect the employee, increased their chances of missing out on their superannuation contributions.

I don't think I have ever seen laws quite as unrealistic and draconian as the superannuation guarantee penalties. But they didn't work, when the laws become so difficult to comply with people just don't and the reality is they cannot police everyone no matter how lucrative the penalties. The big stick didn't work.

On the 2nd October, 2007 the government announced that it would remove the doubling up of the superannuation contribution but the penalties and interest would remain.

This won't be law until it receives Royal Assent. Now here is an even bigger incentive to not pay anything that is already late until the bill is through Parliament. The press release states that any employer who has an old liability at the time of Royal Assent can use the new rules to offset against the old debt any extra super paid after that date. There is a big benefit for employers to delay paying the ATO. Though interest will continue to apply it is hardly likely to reach 100%.

Large Partnerships

From the 1st July, 2007 partners in large partnerships are much more likely to qualify for the small business CGT concessions. These can reduce the capital gain on the sale of your business to zero.

There are two tests, either of which will get you through the gate. The first test is electing for the simplified tax system (now small business entity) which means the partnership would have to have a turnover of less than $2million, which is unlikely. The other test is net business asses of less than $6million. Now a large partnership may well have more than $6million in net assets but if the individual partner owns less than 40% of the partnership then only his or her share is taken into account.

Amnesty for Debit Loan Accounts in Companies

Division 7A covers some very confusing rules intended to stop you from borrowing money from your company on a non commercial basis. Many companies still have these debit loan accounts and the penalties are huge should the ATO find out. In PSLA 2007/20 the ATO is allowing taxpayers to correct any errors made between the 2001/02 financial year and 2006/07 by including a commercial rate of interest for those years in the company's 2007/08 tax return.

Until now Div 7A has been another example of when the ATO makes it too hard to comply with the laws and the ramifications of putting your hand up and coming clean on an error are just too costly, people just don't comply. Try as they might the ATO does not have the means to catch everyone out so it is far better to make it workable so the majority of people who are willing to comply can afford to.

Are Bucket Companies really Necessary Anymore?

A bucket company is somewhere you put your profits so that they are only taxed at 30%. The methods and restrictions on how you do this are numerous but that is not point of this article.

No matter which party is elected to government on 24th November, 2007 taxpayers cannot expect to pay more than 30% (ignoring Medicare) until their taxable income reaches $75,000 this year or $80,000 in future years. Taxpayers in the position to utilise bucket companies are also in a position to distribute income to other family members so in the case of a couple that is a combined family income of $150,000 to $160,000. Further by 2013/14, if Labor is in power each taxpayer will have to earn over $180,000 per year before they exceed the 30% tax bracket.

The low income offset is an exception to the rule here. While it is shading out at 4 cents in the dollar for each dollar over $30,000 taxpayers are effectively taxed at 34%. This difference is hardly worth setting up a bucket company arrangement but for those readers who have already organised their affairs to include a bucket company may want to consider using their bucket company for any spare profits if each individual's income is between $30,000 and in 2008 $48,750, 2009 $60,000, 2010 $67,500, 2013 $82,500.

Goods for Own Use

Each year the ATO issues an estimate of the value of goods taken for the private use of business owners in a number of common small business categories. Fortunately this is based on changes in the CPI so does not seem to bear any resemblance to the prices of items on the supermarket shelves. For once this could work in your favour. Nevertheless, if you feel the following exceeds the value of the goods you take from your business for you and your family's consumption, you should keep a diary instead.

Business Type	Adult over 16 years	Child 4 -16
Bakery	1,040	520
Butcher	700	350
Licensed Restaurant or Café	3,570	1,425
Unlicensed Restaurant or Café	2,850	1,425
Caterer	3,100	1,550
Delicatessen	2,850	1,425
Fruiterer or Greengrocer	750	375
Takeaway Food Shop	2,700	1,350
Mixed Business ie Milk Bar, General Or Convenience Store	3,400	1,700

Note these amounts exclude GST

Workplace Health and Safety Risks

The following examples are extracts from the Jefferson Collins Joiner newsletter. They are Chartered Accountants specialising in solvency issues. The information they publish in their newsletter is always interesting, you can subscribe by e-mailing them on reception@jcjpartners.com.au

A truck with a hydraulic bin mechanism owned by Bin Bros Systems Pty, Limited, was taken to repairers. A mechanic was killed. The company (Bin Bros) was charged under the Occupational Health and Safety Act (NSW). It was held that as it had some discretion in the repair of the equipment and as it had delivered it to the repairer, then it may be liable.

A worker fell five metres through a skylight panel onto a concrete floor. The company was fined $95,000 and the director was fined $9,500 for the lack of safe work practices, lack of training and workplace consultation.

In another case in NSW, a worker was injured by falling approximately four and a half metres. A handrail had been installed but the worker had removed it on three previous occasions. The company was fined $73,125 and the director fined $4,100.

In SA, a deck hand fell overboard, the crew did not learn of his absence until his subsequent rescue by another vessel. The company was fined $45,000. The judge in that case indicated "the evidence established there was a foreseeable risk, albeit that it may have been a low risk, of grave injury to an employee…..

Shifting Non Deductible Debt to Business Debt

PBR 79002 is about borrowing to pay business expenses including the purchase of trading stock and using the income of the business to pay off non deductible debt. Seems a bit cheeky but it is perfectly legitimate. Mind you a PBR is only binding on the ATO for the benefit of the person who applied for the ruling so if you are at all concerned you should apply for your own.

The key is being able to cover the arrangement as not being a scheme with the dominant purposes of a tax benefit. Nevertheless, it is not for the ATO to tell you how to run your business.

In the situation described in the ruling the taxpayer opened a separate bank account into which the business income was deposited. From this account the private home loan was repaid, some business expenses were paid and the interest on the line of credit used to pay the balance of the business expenses was paid. The ruling found that as the taxpayer was a sole trader he or she was not precluded from using the business income to repay private debt.

The ruling found that there was not a dominant purpose of a tax benefit in the arrangement because there was no tax benefit! In fact it was simply a finance option available to business. This finding was further supported by the fact the taxpayer intended paying off the home loan in 3 to 4 months and then working towards persuading the bank to accept the business as security on the loan for the business expenses, arguing that the dominant purpose of the arrangement was asset protection ie the family home. An argument the ATO accepted.

Debit Loan Accounts, Div 7A & Deemed Dividends Softened

The ATO's softer approach to deemed dividends is outlined in PSLA 2007/20. The law has been changed to allow the ATO to exercise its discresion to waiver the deeming of dividends and the penalties associated with being caught by Division 7A when the taxpayer has made an honest mistake or inadvertent error. In the PSLA the ATO allows taxpayers to automatically assume the discretion has been granted and permits them to go back and amend any years where they have paid penalties or declared a deemed divided. But remember the concessions only apply if you have made an honest mistake or inadvertent error. The statement makes 2 main points:

1) The error must be corrected. In most cases this will mean repaying the loan or entering into a division 7A loan agreement and commencing repayments.
2) The error must have occurred between the 2002 and 2007 financial years and all of the taxpayers tax returns are lodged.

When You Have a Carried Forward Loss

I am not talking about a capital loss. Just a normal revenue loss. This can happen if you have a negative rental property and take some time off work to travel or look after children. It is also applicable to non residents of Australia for tax purposes that own a negative geared rental property here, they save these losses for when the property becomes positively geared or they move to Australia.

Carried forward losses are reduced each year by exempt income. Basically exempt income is income that you do not have to include in your tax return. But this is more complicated than you would expect because income is a wide term. For example it can include Family Tax Benefits Part A payments received for your children. Here is a list of some typical payments that you may be concerned about:

Does Reduce Your Carried Forward Losses

Family Tax Benefit
Child Care Benefit
Child Care Tax Rebate
Maternity Allowance
Maternity Payment
Baby Bonus
Maternity Immunisation Allowance
One-off Family Payments
Defence Force Reserve Payments
Educational Scholarship, Bursaries, Assistance etc

Does Not Reduce Your Carried Forward Losses

Government's Co Contribution to your Super
- because it is income to the super fund not you

Any capital gain not taxed due to CGT concessions
- because this is not exempt income it is income but not actually taxed due to the concessions Reference ID 2004/120.

Non resident income of a non resident of Australia
- specifically excluded from the offset rules by section 36-20

Apprenticeship Wage Top-Up
Exempt Payments to Overseas Defence Force Members
Foreign Diplomats wages earned in Australia
The Overseas Earning of Foreign Diplomats in Australia
Australian Residents for tax purposes exempt overseas
Overseas wages exempt in Australia because you worked 91 days or more

The same conditions apply if you have a loss from a business.

Taxi Drivers

The ATO uses an industry average earning rate per kilometre to review taxi earnings. In 2007 if you declared gross income that was less than $1.10 per kilometre you may be reviewed by the ATO to see if you are declaring all your income. Trouble is for $1.10 to be the national average many people had to be less than that, so don't be bullied, just make sure your record keeping leaves nothing to be desired.
TR 2006/11 contains the ATO's guidelines for record keeping for Taxi Drivers.

Interesting Statistics on Small Business

In his speech on delivering for the community Michael D'Ascenzo pointed out that two-thirds of small businesses are home base and one-third of small business operators were born overseas.

Small businesses with a turnover of less than $2million account for two-thirds of the outstanding debt to the ATO.

CGT on the Sale of a Business

Concessions are permitted regarding capital gains made on assets that are not plant and equipment, where the business qualifies as a small business entity under the Simplified Tax System (STS) **or** the Net business assets of the business and associates are less than $6 million.

The only requirement a business needs to meet to enter the STS is to have a turnover (total sales) of less than $2million.

The $6 million net business asset test does not include your spouse's business assets if your businesses are not related. If an individual partner in the business owns less than 40% of the partnership then only his or her share of the net partnership assets is taken into account when calculating the $6 million.
How the Small Business CGT Concessions work:

f) The 50% capital gains discount - only half of the gain is included in your taxable income. This concession is not available if the asset is owned by a company. You must have held the asset for more than 12 months for this to qualify
g) The 15 year ownership exemption. This requires you to have held the asset for more than 15 years. The asset must be an active asset. You need to satisfy the controlling individual test if the asset is owned by a company or trust. The taxpayer or the controlling individual, if a company or trust, must also be over 55 and retire or permanently incapacitated.
h) Retirement exemption – can only apply to an active asset and the taxpayer or controlling individual must be over 55 and retire or put the funds into a super fund where they will not be taxed on entry or exit. A taxpayer can only process $500,000 worth of capital gains this way in their life time. This does not require the asset to have been held for more than 12 months
i) 50% discount for active business assets – can only apply to an active asset. This does not require the asset to have been held for more than 12 months.
j) Rollover relief where an active asset can be sold and another active asset purchased or improved within two years or in the previous year. This does not require the asset to have been held for more than 12 months. From 1-7-07 if you don't spend the rollover you declare it as income or use the retirement exemption in the year the 2 years expires. Pre 1-7-07 you had to go back 2 years and amend

Note b) to e) from 1-7-07 require your net assets and those of your associates to be less than $6mil for the business to be a small business entity. More than one of the above can be used if you qualify. It is not that difficult to meet the retirement condition but if that is the case you would not be looking to use the rollover

relief. You can use the 50% capital gain discount together with the 50% active asset discount to only pay tax on only 25% of the gain. For example:

Gain of	$100,000
Less 50% CGT Disc	50,000
	50,000
Less 50% Active Asset Disc	25,000
	25,000
Purchase A New Active Asset	25,000
Amount subject to CGT	0

An asset is not an active asset if it is held merely for the purpose of earning rental income. From 1-7-07 to qualify as an active asset it must be used in a business, the business can be one owned by an affiliate, and it must be active for at least half the time it was owned or 7 ½ years whichever is the least.

There are problems if the asset is held in a company. Firstly the 50% capital gain discount is not available. The controlling individual test cannot be met in many circumstances so the 15 year ownership or the retirement exemption may not be available. The active asset discount stays within the company. If you try and get the money out of the company (without putting it into a superannuation fund note possible age base limit problems) every dollar you receive, including the dollars that the company did not have to pay tax on because of the discount will be fully taxable as a dividend in your hands. Using the rollover relief provisions is only useful if you are buying another business and it will force you to continue to use the company so continuing the problem next time you sell.

Changes in the 2007 budget now mean that there can be up to 8 controlling individuals in any business.

Diesel Fuel Credit for Whipper-Snippers

Businesses entitled to diesel fuel credits include construction, landscaping and property management so if you have a lawn mower or whipper-snipper that runs on diesel you maybe entitled to a fuel credit.

ATO Audits

Doing so many seminars lately I am hearing too many horror stories about ATO auditors. Please do yourself a favour and make sure you inform the auditor you will be taping the whole process and make sure you do. This will make them take much more care when making comments and prevent them from bluffing.

Depreciation Rate Update

TR 2008/4 has recently been released by the ATO with updated depreciation rates for Primary Producers, the Resource Industry, Manufacturing, Medical, Building Industry, Hospitality, Communications Industry and Transport. It does include the depreciation rates for rental properties but these remain the same as in previous years. The ruling is quite detailed, here is just a sample of some more common rates

Item	Effective Life	Prime Deprn Rate	Diminishing Deprn Rate
Nailing Guns	3 years	33.3%	66.6%
Forklifts	11 years	9%	18%
Generators	20 years	5%	10%
Trailers	15 years	6.67%	13.3%
- if used in water	8 years	12.5%	25%
Poly Tanks	15 years	6.67%	13.3%
Tractors	12 years	8.33%	16.66%
Farm Motorcycles	5 years	20%	40%

To Claim The Home as a Place of Business Or Not?

Whether your home is a place of business is a question of fact based on a balance of considerations such as do you see the public there, is it clearly identifiable as a place of business ie signage and an area set apart from the home for business purposes. Simply choosing to take work home rather than do it at your normal place of business will not change the nature of your home office to a place of business.

If your home office does not fit the description of a place of business but you do do some work there in a room separate from the rest of the family, then you are still entitled to claim the additional running costs such as electricity, computer, phone, internet use and wear and tear on the room. But you cannot claim the occupancy costs, that is costs, that would be incurred whether you used the home in the business or not, such as interest and rates.

On the other side of the coin if your home is also a place of business then it cannot be fully covered by your main residence exemption so there maybe some CGT to pay on the sale. The worse thing about this outcome is the record keeping requirement rather than the tax. You will need to keep a record of every cost associated with the house, plants, light globes, cleaning materials, lawn mower fuel. But the CGT is unlikely to be of any significance if you are entitled to utilise the small business concessions. You see the part of your home that is used in a business would be considered an active asset if it has been used in the business for at least half the time you own it or 7 ½ years, whichever is the shortest period of time. As an active asset you would be entitled to an additional 50% CGT discount on top of the standard CGT discount leaving only 25% of the percentage of the gain on the house attributable to the business use. This remaining 25% can but put straight in your pocket tax free if you are over 55 years of age and have not utilised the retirement exemption in relation to more than $500,000 worth of capital gains. If you are under 55 the $500,000 limit still applies but you must put the proceeds into a superannuation fund, this contribution is not taxable in the hands of the super fund. If this does not suit you could choose to roll the 25% into another active asset, which could be the office in your new home.

Don't try to avoid exposing your home to CGT by not claiming a deduction for interest etc. If it qualifies as a place of business CGT will apply whether you claim the expenses or not. Another trap is if the property has never produced income before (ie been rented out) then when you first start to use it partly for business the cost base for the whole property is reset to the market value at that time. Not good in the current property slump.

Note the CGT consequences above only apply if the owner of the home uses it to produce income, so if your trust or company runs a business from there it will not trigger the CGT problems providing you do not charge the company or trust rent and do not claim occupancy costs such as interest and rates. It is still ok for the company or trust to claim for the phone, electricity etc.

Entrepreneurs' Tax Discount

This little gem has limited application and doesn't get much publicity so is an easy one to miss, here is a timely reminder. If your business turnover is more than $75,000 excluding GST don't bother looking any further into this. When the business turnover is less than $50,000 the full rate of the discount applies. Between $50,000 and $75,000 the rate shades out. Note this is turnover of the business, for example total sales not net profit. The business also has to elect to be a small business entity to qualify.

The Entrepreneurs' tax offset flows through trusts to apply to the tax payable by the beneficiary, Partners claim it in their personal tax returns too. The offset or discount is 25% of the tax payable on all your taxable income apportioned between you business income and wages income. For example if you had a total taxable income of $80,000 the tax payable on all your income would be $18,0000. 25% of that is $4,500, if half your taxable income was from the business (ie $40,000) the discount or tax offset would be $2,250 (half of the $4,500 maximum).

GST and Small Farm/Home Stays

Commercial residential premises are subject to GST. This doesn't just mean that you need to charge your guests or tenants GST it will also mean that when you sell these premises you will have to charge GST if you are still registered for GST. On the up side you can claim the GST back, if applicable on the purchase of the property. The trouble is if you were entitled to claim the GST back on the purchase then if you de register for GST and still have the property, you may have to pay back some of the GST credits.

As you can see it is important to know exactly where you stand. The trouble is it is not all that clear for small B&Bs, farms and home stays. GSTR 2000/20 goes into great detail on the fine line between a normal rental property which is not subject to GST and commercial residential properties such as motels. It seems that if you only have one unit of accommodation and do not provide much in the way of services to your guests you do not have to register for GST because you are just providing a normal domestic rental, this could continue to be the case if you have more than one unit providing they are not in the same complex. But once

you get more than one unit on the same property and you are advertising short term accommodation you should consider whether you should be registered for GST. The best way to be sure is to apply to the ATO for a ruling. Note if your turnover is less than $75,000 you are not required to be registered for GST anyway so you can rest easy until your current month turnover, taking into account seasonal fluctuations, suggests that your turnover will exceed $75,000 within the next 12 months.

Of course a typical motel like situation would have to be registered for GST if the turnover is more than $75,000, no need for a ruling to clarify.

Cash Businesses Watch Out

Never throw out your records and always take every action by the ATO very seriously no matter how outrageous it appears, is the lesson to be learned from Bui V FCT 2008 AATA 666.

During an audit of a restaurant the ATO found 4 handwritten pages that it purportedly recorded the sales for 4 non consecutive weeks in 1998. The ATO took this information, applied its benchmark ratio between cash and credit card sales then applied that to the 1997 and 1998 tax returns. Note the audit didn't even start until January 2006. How can they possibly go back that far you say? Isn't there a 4 year limit on amendments? If the ATO suspects fraud they can go back as far as they like. This is a very relevant point for readers considering rationalising their records. On the other hand tidying what you keep is highly recommended.

The taxpayer also did a very poor job of defending herself and the burden of proof always rests with the taxpayer. Possibly she felt that the sight of the ATO flashing four pieces of scribble around the court room and expecting to change tax returns a decade old would quickly resolve itself without too much effort from her. Wrong, she even copped a penalty of 75% of the tax the ATO estimated was unpaid.

Just as a matter of interest the ATO benchmark for restaurants is % of all sales are on credit card so they would expect % of credit card sales to equal the cash takings.

Cash Economy Benchmarks

The ATO has release 5 detailed benchmarks in industries where it considers there is a great risk of undeclared income, Concreting, Floor Sanding and Polishing, Metal Roofing and Guttering, Painting, Tile Roofing and Taxis. There is much more detail on the ATO web site but here is an example, the sort of information available:

Taxis – earn $1.14 per kilometre (including GST) and travel an average of 150,000 kms per year

Concreters – 50 to 60% of sales should be materials, charge per square metre $50 for plain concrete to $55 for coloured, stamped or stencilled. Up to $70 per square metre. The ATO expects 2 tradesmen to be able to lay 5,110 square metres per year and 3 tradesmen 7,700. The average labour charge is a bit more flexible at between $200 to $300 per person per day.

Painters – On repaints 15% to 25% of the price charged goes in paint. New work 30%. 8 to 10 litres used per day. Price charged $25 to $50 per hour.

Benchmarks for more industries are due to be released soon. You can keep an eye on them by going to www.ato.gov.au and select the business option on the left of the screen. This will give you a menu for business tax, right down the bottom are the ATO industry benchmarks.

If you are in these industries please ask your accountant to review your tax return and discuss any variations with you.

The ATO has already won a case, in relation to GST, where they increased a taxpayer's income based on benchmarks. The taxpayers' expenses were also reduced because they did not have any tax invoices for their fuel. In Huynh's case 2008 ATC 10-020 the AAT accepted the ATO's estimates of the taxpayers' income because the taxpayers' records did not appear to be authentic. The way these cases work is that the ATO can estimate whatever they like. The burden of proving the ATO wrong rests with the taxpayer, this is where proper record keeping is required. What is worse is that the ATO estimated the income without having to estimate the expenses so the taxpayers were taxed on the estimated income without the benefit of a corresponding deduction for the fuel that would have been necessary for the taxi to travel those kilometres.

Huynh's case also emphasised a frequent misunderstanding in the taxi industry between drivers and owners. The correct position for GST is that the driver pays GST on all of the fares received and the owner gives the driver a tax invoice for the bailment fee. So the owner pays GST on the share of the takings they receive and the driver gets an input credit for $1/11^{th}$ of the amount paid to the owner. This has the net affect of

the driver only paying GST on the share of the takings he or she receives but the figure at G1 on his or her BAS is the total takings.

Claiming a Guard Dog

In PBR 84610 the ATO agreed that the purchase price, initial veterinary fee and training of a guard dog could be depreciated and the maintenance costs claimed as a tax deduction. The dog guarded a business run from home and a commercial vehicle kept there. The only catch was that because the dog inadvertently also guarded the home the costs had to be apportioned between private and business related.

10% Investment Allowance for Business Plant

To help stimulate the economy the Government has announced that it will allow an up front tax deduction for 10% of the cost of plant and equipment purchased on which construction began between 13th December, 2008 and 30th June, 2009. Providing the plant and equipment is new and costs more than $10,000. If constructed it must also be installed ready for use by 30th June, 2010.

The asset must be new equipment or new additions to existing equipment. Assets that qualify for depreciation under Div 40 of the 1997 ITAA will qualify if they are tangible. Intangible assets and rights will not qualify nor will assets depreciable under Div 43 (Special Building Write Off). Cars are included.

No draft legislation is available yet and the media release refers to asset used in a business. So even though rental property plant and equipment is also depreciable under Div 40 it may not be included in the concession.

Small Business PAYG Instalments Reduced by 20%

To help small businesses suffering as a result of the economic down turn those with a turnover of less than $2 million will have a reduction in their December PAYG instalment (Payable in February) of 20%. The PAYG instalment is based on the previous year's profits. It would further add to businesses wows by asking them to make an instalment based on last year's income and then have to wait until they lodge their tax return to receive it back because they have made less profit than in previous years. Nevertheless if the business does make the same profit or more they will have to top up their tax when they lodge their 2009 tax return.

Keeping Saleable Stock on the Shelves

Many retail outlets seem to be reacting to the economic downturn by reducing the stock they purchase. They anticipate a drop in sales so carry less stock. The trouble is this could become a self fulfilling prophecy because customers unable to get what they want will begin to shop elsewhere.

When ordering stock bear in mind that the items no longer on the shelves are those that your customers buy and the ones left maybe dead stock. If you must reduce stock try to carry the same items just lower quantities.

Temporary Investment Allowance

This is only from the draft of the bill so it is very early days yet. The allowance is a one off tax deduction of 30% of the cost (net of GST) of new (not second hand) equipment and it includes motor vehicles but not those claimed for on the cents per kilometre basis. You will still be entitled to depreciation on the full amount paid for the equipment. The acquisition needs to be made between 13 December, 2008 and 30th June, 2009 and the asset must be installed ready for use by 30th June 2010. If you qualify as a small business taxpayer (turnover of less than $2 million) then you need only spend $1,000 per asset but other businesses need to spend $10,000.

From the first of July, 2009 to 31st December, 2009 there will be a 10% investment allowance.

It is proposed that the legislation be contained in a new section of the 1997 ITAA ie section 41 so it is quiet possible that it will not apply to rental properties. Further it requires the asset to be used in a business and rental properties are not normally considered a business.

The asset must at least, at the time it started to be used in the business, be principally used in Australia to carry on a business. As long as it is principally used for business purposes the allowance does not have to be apportioned for private use.

Buildings, land, computer software and intellectual property do not qualify for the allowance.

30% Investment Allowance and Cars

Refer Newsflash 183 for a more general article on this investment allowance. This article deals directly with the amount of advertising material encouraging people to buy cars before the allowance finishes at 30th June, 2009.

Unfortunately, the law covering this has not made it through Parliament yet and you only have to look at the alchopops debacle to see that nothing is certain. It was put before the house of representatives on 19th March, 2009 for its first reading and has not progressed. On 31st March Parliament went into recess and will not sit again until the 12th May. At this time the budget will take priority yet the Investment allowance bill has to get through both the house of representatives and the Senate. There is a good chance that by the time the 30th June 2009 deadline is reached you will not know whether the bill will ever become law. So if you are only updating for the sake of the allowance you are taking a bit of a risk. Let's hope it gets through in enough time for you to make a decision before 30th June, 2009. It doesn't matter if the dealer is out of stock as long as you have committed and take delivery before 1st July, 2010.

Here are some basics, relevant to cars, from the Explanatory Memorandum and the bill that was presented to Parliament, this is not necessarily how it will end up.

1) It does not apply to cars that will be claimed under the 5,000km method.
2) The car must cost you over $1,000 if you are a small business entity ie turnover of less than $2mil or over $10,000 for non small businesses. If you are entitled to claim GST input credits then this amount is the net of GST figure.
3) The car must be brand new but note section 41-20 (3) allows for reasonable testing or trialling so demonstrator vehicles may still be considered new it is all a matter of what is reasonable. In the explanatory memorandum it states that an asset is still brand new if it has only been held as trading stock or held ready for resale. It gives an example of a demonstrator vehicle that the dealer used to drive to and from work and says the allowance is not available so if you are going to buy a demonstrator you best get a certificate that it has only been used for test drives and make sure there are only a "reasonable" (to quote the Bill) number of kilometres on the clock.
4) To get the full 30% deduction you need to have made a commitment by the 30th June, 2009 (an option will not suffice) and take delivery before 1st July, 2010. After those dates the allowance is only 10% and only for goods committed to before 31st December, 2009 and installed by the 2011-2012 financial year. The year you claim the allowance in your tax return is the year that it is first used in the business.
5) The allowance is not reduced by any private use of the asset providing it is principally used in a business.
6) The allowance only applies to assets used in a business so it is not available to passive rental property investors though in some circumstances holding rental properties can be considered a business but you need to have a lot and manage them yourself.
7) Even though the taxpayer will receive an outright tax deduction of 30% of the purchase price (net of GST if an input credit has been claimed) they will still be able to claim depreciation on 100% over the vehicle's effective life.
8) It is the person that is entitled to claim depreciation for the car that is entitled to the allowance. This becomes a little messy in partnerships and the partnership agreement needs to be referred to, to decide who is entitled to the depreciation on the asset and so the allowance. In the case of a leased vehicle it is the lease company who is entitled to the depreciation unless the car is a luxury car then it is the lessee who is entitled to the depreciation so the lessee in these circumstances would be entitled to the allowance. The luxury car limit for 2009 is $57,180 (Reference TD 2008/17).
9) If your car exceeds the luxury car limit then you can only claim 30% of the luxury car limit so for 2009 you can only claim $17,154.
10) There is no claw back of the allowance once the car is sold or its use is no longer principally for business unless it was not bona fide purchased for the business in the first place.
11) Note the allowance is a tax deduction not a tax credit so if the deduction reduces your income below the taxable threshold it is wasted and you will not be able to get any cash back for it though it can create a taxable loss you can carry forward after offsetting exempt income and maybe helpful to you in the following year.

Now let's do a worked example of just what this means to you in the end. Assume you are considering updating a car you purchased late 2005 for around $20,000 after GST credits. It is now written down to $9,147 on a diminishing basis at 18.75% pa. The dealer will give you $10,000 for it as a trade in but of course you will have to remit 1/11th of that to the ATO in GST. The new car you want to buy will cost $25,500 on road and including GST and you are in the 31.5% tax bracket.

For simplicity we will assume the new vehicle is paid for in cash but please consider that there is another cost of this transaction and that is you have probably come close to paying off your current vehicle so you are committing yourself to probably another 5 years in interest repayments either because you borrow to buy the car or because using your spare cash to purchase the car will mean you will have to borrow for other reasons in the future or because you could have invested this money.

If you had kept the old vehicle over the next 5 years depreciation would have been a lot less than the new car not just because the depreciation is on a diminishing value method but because assets purchased after 10th May, 2006 are entitled to a higher rate of depreciation, 25% in relation to cars, when using the diminishing value method.

	Old Car	New Car	Difference
Year 1	1,715	5,809	4,094
Year 2	1,393	4,357	2,964
Year 3	1,132	3,267	2,135
Year 4	920	2,450	1,530
Year 5	748	1,838	1,090
Value of vehicle in 5 years both based on 18.75% dim value	**3,239**	**8,227**	**4,988**

	Cash Inflow		Cash Outflow
Trade In	10,000	GST on Trade	909
Tax Refund on Loss on Trade	18		
GST on Purchase (not on Rego)	2,264	Purchase	25,500
Tax Refund on Extra Deprn	3,721		
Increased sales value in 5 years	4,988		
Tax credit for Investment Allow	2,196		
Total	**23,187**	**Total**	**26,409**

Even with the incentive you are still going to be out of pocket over all by $3,220 to buy the new car rather than keep the old one. So if you think the extra repairs you may incur to run an older car would be less than this you are better off keeping the old car.

Investment Allowance Warning

Check with your accountant before buying plant and equipment for which you intend claiming the new Investment allowance as there are many exemptions such as computer software, plant for rental properties and equipment used for water conservations such as a pump used by a farmer.

As discussed in Newsflash 184 if you are only making the purchase decision because of the 30% investment allowance you had better wait until it at least gets through both houses of Parliament and that is not likely to happen until just before the 30th June deadline.

Cost of Acquiring a Franchise

In ID 2009/3 the ATO states that the cost of acquiring a franchise cannot be counted as blackhole expenditure. Blackhole expenditure can be deducted over 5 years and generally includes the cost of setting up a business. In ID 2009/3 the ATO argues that regardless of the wording of the contract a franchise agreement is an acquisition of rights to enable the purchaser to carry on a business. Only expenditure that is not taken into account elsewhere in income tax law can qualify as blackhole expenditure. Copyrights, patents and registered designs are depreciating assets. Any non depreciable assets acquired under the contract are CGT assets so again not blackhole expenditure.

An example of blackhole expenditure is company formation expenses. ID 2009/1 states that the cost base of shares in a company cannot include its set up costs nor is it deductible under any other provision so it can qualify for the blackhole concessions.

Motor Vehicle Data Matching

A very timely reminder for taxpayers driven by the investment allowance stimulus to buy motor vehicles they can't really afford. The ATO has announced that it will be obtaining details of all purchases of vehicles over $10,000 from the motor registries in each state and matching this against the owners reported taxable income to see if maybe they are earning more than they have declared in their income tax return.

Professional Sports People able to claim Management Fees

The high court has ruled that professional footballers are not simply an employee of the club that they accept a contract with. They are in the business of commercially exploiting their sporting prowess and associated celebrity. Accordingly, when they engage a manager to organise their employment contract with their club they are already in business. The ATO argued, as is the case with normal employment contracts, the fees were incurred to soon to be considered a cost of employment. Instead they were a cost of obtaining employment.

This case will probably be limited to situations where at least one contract is already in place and there is more than just an employment contract with a club. The court linked the employment contract with the club with their other sponsorship contracts as part of the one business on the basis that there was a synergy between them. Reference Spriggs and Riddell 2009.

Useful Rates for the 2009/2010 Financial Year

Maximum income at which people of age pension age do not have to pay tax or Medicare:
Singles $29,867 Each Member of a Couple $25,680
Threshold at which Medicare Surcharge will be payable if you do not have private health Insurance:
Singles $70,000 Family (includes non custodial parents contributing to a child's maintenance) $140,000
Amount of passive income a minor can have without paying tax providing they have no other income:
$3,000.00
Tax Thresholds:

0	-	6,000	0%	6,001	-	35,000	15%	35,001	-	80,000	30%
80,001	-	180,000	38%	180,001	+		45%				

Tax Offset - Amount of offset $1,350 No Tax payable if income only $15,000
Truck Drivers Reasonable Meal Allowance – no substantiation required if employer pays allowance.
Salary below $93,601 $82.05 Above $93,600 $89.50 Reference TD 2009/15
Overtime Meal Allowance – Maximum amount you can claim without receipts if you receive an overtime meal allowance: $24.95 Reference TD 2009/15
FBT Interest Rate –5.85% Applicable to employee loans and notional calculation of interest on car provided to an employee. For the FBT year 1st April, 2009 to 31st March, 2010. Reference TD 2009/16
Div 7A Loans - 5.75% reference TD 2009/10
Improvements to Pre 1985 Assets – You can spend up to $124,258 in 2009/10 improving a pre 1985 asset without having the improvement classed as a separate post 1985 asset but note the construction of a building on pre 1985 land will always be considered a separate asset. Reference TD 2009/12
Luxury Car Limit - $57,180 same as for the 2008/09 financial year. Reference TD 2009.13
Investment Allowance Key Points - The following only applies to businesses that have a turnover of less than $2 million

1) 50% of the amount spent if entered into the contract before 31st December, 2009 and installed ready for use by 31st December 2010
2) Must spend more than $1,000
3) All amounts are net of GST if you are entitled to claim GST
4) Purchases after 31st December, 2009 will only qualify for 10%
5) Land, buildings, computer software and intellectual property do not qualify.
6) Batches of identical items or items that form part of a set, can be added together to pass the threshold and identical items acquired before 31st December 2009 can be added to those purchased

after that period to see if the threshold has been passed. Though then only 10% will apply.

7) You must purchase a new asset or new improvements to a current asset.
8) The asset must, at the time it started to be used in the business, be principally used in Australia to carry on a business.

These are the basics. The issue is covered in detail in our year end tax strategies booklet for 2009.

Fuel Rebate

The rate for vehicles that travel on public roads with a GVM greater than 4.5 tonne has been reduced, effective 1st January 2009, from 18.51 to 17.143 cents per litre purchased. This includes both petrol and diesel engines.

Note petrol (ULP) has only been eligible to be claimed since 1st July, 2008 and only if used specifically in fishing, forestry, mining, marine transport rail transport, nursing or medical and emergency vessels. The list also includes agriculture but this is for farm use only, it does not include vehicles used on public roads. Such vehicles have to be over 4.5 tonne to be eligible. This means that farmers cannot claim their trips to town to pick up supplies in a normal vehicle (under 4.5 tonne GVM). Farmers can claim a fuel rebate for machinery used on the farm at the rate of 38.143 cents per litre.

Petrol (ULP) has only been eligible to be claimed from 01/07/08 if used in the specified activities of agriculture (on farm use only – and not in a vehicle on a public road, as the GMV has to be >4.5tonne to be eligible), fishing, forestry, mining, marine transport, rail transport nursing or medical and emergency vessels.

From 1st July 2008 the construction, manufacturing, wholesale/retail, property management and landscaping industries were added to the list of industries eligible for a rebate of 19.0715 cents per litre on the diesel or petrol used in machinery, plant or equipment.

Having Your 50% Investment Allowance & Leasing it Too

Unless the car you lease exceeds the luxury car limit, it is the lease company that is entitled to the investment allowance. In ID 2009/89 the idea of buying the car then a month later selling it to a lease company was addressed.

The ID accepted that the vehicle had been used principally for business (more than 50%) during that month so the purchaser was entitled to the investment allowance and there was no adjustment when the vehicle was sold to the lease company. But note it specifically states that the use of the vehicle once it was leased back must also be taken into account. This may suggest that buying a vehicle and selling it a month later just to qualify for the investment allowance could result in the ATO using Part IVA against you. Nevertheless, it doesn't appear that anything in the law specifically prohibits this and the ID argument is based on the words the use by the taxpayer covering both the period before and after the lease. This argument wouldn't apply to the use after one month of a completely new purchaser.

Note ID's are just an expression of the ATO's opinion and not binding on them. If the above was a bit confusing the basic case is buying a vehicle, claiming the investment allowance and then selling it to a lease company is fine providing during all that time it was used more than 50% in your business. Buying a car claiming the investment allowance and selling it on the open market one month later may also be ok but the ATO still has part IVA up its sleeve so you should get a ruling before being this cheeky.

Using Company Assets

If you have been holding assets in a company so that the profits that purchased those assets were only taxed at 30% and you use those assets for private purposes then from the 1st July, 2009 you should be paying market rent.

The law has not been written yet but in the May 2009 budget the Government announced that if these benefits slipped though the FBT system then they would be caught as a deemed dividend. We can't advice you exactly how the law will operate yet but at a minimum you should be keeping a diary of any private use of company assets and discuss this issue with your accountant before 30th June, 2010.

2009 Budget Highlight

Major Changes to the 30% Investment Allowance – The 30% has now been increased to 50% and you have until the 31st December to enter into a contract to buy the equipment as long as it is installed, ready for use by 31st December, 2010

Are You In The ATO Benchmarks?

(November 2009)

In its pursuit of the cash economy the ATO has created benchmarks for 56 businesses. The idea is that if your margins do not fall within these they may just audit you to make sure none of your cash is slipping out of the till. They cannot argue that you must perform to these percentages, but if your record keeping isn't spot on then they will use them. So the idea is to ring up all sales, keep the till tape and reconcile this till tape to deposits ie show what goods and or wages were paid out of the till to bring the gross sales down to the amount deposited. The benchmarks examine cost of goods sold, labour and rent as a percentage of sales. You may even find them useful in evaluating your business. Look at the difference between a chicken shop and a sushi shop, they are also worth examining if you are considering purchasing or setting up a business. There are different ratios depending on the size of the business. The following is a list of the business for which there are benchmarks, to get the full details for your industry go to www.ato.gov.au; the link is on the home page. The percentage that the ATO expects your cost of goods sold to be of your total sales is also included below for small businesses of a medium size.

Bakeries and Hot Bread Shops*	32 to 40%	Cake Shops and Patisseries*	35 to 43%
Air Con, Refrigeration & Heating Services	38% to 54%	Block Laying	5 to 10%
Brick Laying	Under 10%	Electrical	31 to 41%
Concreting	Under 10%	Fencing	42 to 56%
Painting	14 to 22%	Plastering – if supplying materials	33%
Plumbing	33 to 43%	Roof Guttering Installation	45 to 55%
Roof Painting and Repair	20 to 40%	Installing Tiles & Metal Roofing	20 to 44%
Tiling and Carpeting	16 to 32%	Timber Floor Installation	50 to 70%
Timber Floor Sanding	N/A	Clothing Retail	54 to 64%
Computer Retailing	60 to 72%	Floor Coverings Retail	56 to 68%
Florist	44 to 54%	Footwear Retail	55 to 63%
Seafood Retailing	66 to 74%	Poultry Retailing	56 to 74%
Fruit & Veg Retailing	68 to 76%	Furniture Retailing	56 to 64%
Grocery Retailing	73 to 81%	Houseware Retailing	49 to 59%
Liquor Retailing	76 to 82%	Butchers	64 to 72%
Newsagents	69 to 77%	Tyre Retailing	63 to 69%
Chicken Shops	50 to 60%	Coffee Shops	33 to 43%
Fish and Chip Shops	49 to 57%	Kebab Shops	40 to 48%
Pubs and Taverns	42 to 54%	Restaurants	33 to 41%
Sandwich Shop	40 to 52%	Sushi Takeaway	36 to 44%
Takeaway Food	41 to 55%	Takeaway Pizza	37 to 45%
Courier Service (motor vehicle expenses)	11 to 21%	Road Freight (truck expenses)	11 to 37%
Delivery Services (motor vehicle expenses)	4 to 22%	Towing Service (truck expenses)	14 to 26%
Furniture Removal (motor vehicle expenses)	11 to 21%	Video Hire	24 to 38%
Industrial Cleaning (Labour)	19 to 41%	Pest Control	9 to 17%
Barber	4 to 14%	Beauty Salon	19 to 25%
Hairdresser	14 to 20%	Dry Cleaning	7 to 15%
Nail Salons	8 to 18%		

Taxis are expected to generate sales of $1.18 for every kilometre they travel

*You may qualify to use the business norms percentages when calculating your GST

N/A means that there are benchmarks available but they do not include the percentage of sales that should be cost of goods sold.

If you are concerned please ask your accountant to review your ratios in relation to the benchmarks and your record keeping methods. Make sure you are armed with a list of things that may affect the benchmarks

that are particular to your business. Also record unusual events such as the loss of stock as a result of a freezer break down.

If your industry has an * against it consider asking your accountant whether using the business norms percentages would reduce you record keeping costs for GST purposes. The first step to qualify is that you do not have the point-of-sale equipment that will identify and record separately GST free and GST taxable sales.

Employing Contractors Will Not Get You Out Of Super

If you employ someone as an employee or subcontractor it does not matter. If the contract is for their labour you will be liable to make a superannuation contribution for them.

In Roy Morgan Research P/L vs FCT their interviewers were found to be employees and entitled to have superannuation contributions made for them, over and above the payments they had received. This was the case despite the interviewers being told right from the start that they were independent contractors and payments being made without tax being deducted. Morgan Research had a lot of control over how the interviewers operated even though they were paid a flat rate per interview rather than an hourly rate. The AAT based its findings on the fact the questionnaire was structured and the interviewers were not allowed to depart from it. The interviews were controlled with precision, the interviewers were even told what words to emphasise and how to record the answers.

New Federal Employment Laws – Fair Work Australia

If you are in business it is time to get acquainted with these rules. That is of course unless you are in Western Australia and not a trading company. I once heard a Western Australian boasting they were going to tear along the dotted line and sail away from the west of Australia, they certainly have succeed on this one. For all the rest of us and trading or financial companies operating in WA, we will break the new law down into segments over the next few newsflashes. This edition covers the basics.

The web address for more details is www.fairwork.gov.au.

Fair work Australia does not apply to employees of the state and local governments.

You must provide any new employees with a fair work information statement before or asap after they start employment. A copy of this statement is available in the small business section of our web site.

As a transitional measure the State awards will continue to operate alongside the Federal Law until the end of 2010. Any differences between the two sets of rules will be decided in favour of the employee.

Unpaid work trials are not permitted. Employees are to also be paid for meetings, training and opening and closing duties. All employees must receive a pay slip within 1 working day of being paid and all payments within the award must be made with money not goods and services.

You cannot require an employee to work overtime without their consent. Nor can you send them home early without paying them for the rest of their shift.

Of course it is unlawful to apply undue influence, pressure or coercion on your employees.

The minimum national wage is to be determined by the 1st July each year. The first under the Fair Work Australia rules will be on the 1st July 2010 for adults, but the rates for trainees, apprentices and juniors will not be set until 1st July 2011. In the meantime the minimum wage for a full-time adult is $14.31 per hour plus leave entitlements and superannuation unless an existing award specifies a higher amount.

Fair Work Australia – Termination Notice

Different basis's of employment require different Notices of Termination.

Full-time employees for the purposes of the new rules are ones who generally work 38 hours a week, and have a continuing contract of employment with sick leave, holiday pay, carers leave and long service leave.

Part-time employees work regular hours each week but less than 38. They are entitled to sick leave, holiday pay, carers leave and long service leave but on a pro rata basis.

Casual employees are less likely to have regular or guaranteed hours. They receive a casual loading to compensate for the fact they are not paid sick leave, holiday pay etc. Fair Work Australia specifies that this loading must be at least 20%. Due to the casual nature of their employment no notice is required to terminate their employment.

Apprentices, outworkers, contractors and trainees There are separate rules for apprentices, outworkers, contractors and trainees.

If an employee, both full-time and part-time, but not casual, has worked for you for less than a year they are entitled to 1 week's notice, 1 to 2 years service 2 week's notice, 3 to 5 years service 3 weeks notice, after that 4 week's notice. For employees over 45 years of age who have completed at least 2 years service the notice period increase by 1 week. Instead of working out their notice an employee can be paid the equivalent wages they would have earned in that time. Employees on the other hand are not required to give any notice.

Fair Work Australia – Contractor or Employee

The fair work Australia rules recognise that some employers utilise contractors to keep their labour cost down by avoiding paying award minimums and leave entitlements.

Regardless of the fact they have a contract the following rules define whether they are a contractor or employee, the latter being entitled to be employed under the rules of Fair Work Australia.

Contractor	**Employee**
Controls how they go about their work	Works under the direction of the employer
Bears the cost of their mistakes	Paid regardless of the result ie hourly basis
Sets their own working hours	Hours set by employer
No entitlement to leave or other employee benefits	Paid regularly and receives leave benefits
Pays their own tax and superannuation	Employer deducts tax and pays superannuation
Uses Own equipment	Materials and equipment supplied by employer
Is paid on a per job basis rather than hourly	
Presents an invoice for payment	
Has insurance	

The ATO has also announced it will be increasing its activities in this area to ensure employers are deducting tax from payments and making superannuation contributions unless there is a genuine contractors arrangement. The ATO guidelines on the issue are similar to those listed above.

Warning to Credit Card Merchants

Apparently in a typical merchant contract with their bank there is a clause giving the banks the right to reverse a transaction when an overseas credit card is used.

It takes the banks several days to confirm whether an overseas credit card has been stolen so they deposit the money in your account before it has cleared. If the card turns out to be stolen then they have the right to reverse the entry and you have no recourse. So if you take an order for goods paid by an overseas credit card and dispatch them once you see the funds go into your account you are still vulnerable to not being paid for those goods.

There are people out there that know this and take full advantage of it, so be very suspicious if someone tries to use an overseas credit card.

Latest for Trusts with Bucket Companies

Bucket company, describes the situation when a discretionary trust sets up a company as a beneficiary so that it can distribute profits to the company to hold at the company tax rate of 30%. TR 2009/D8 is the ATO's latest attempts to minimise the impact of this practice. Note it is only a draft ruling but it is intended to apply to distributions made after 16th December, 2009. This means it will apply to distributions of the profit for the 2009/2010 financial year. Accordingly, it is time to consider an alternative strategy because a discretionary trust must create a minute on how it will distribute its profit before 30th June. We probably won't have a final ruling by then so this draft ruling gets to rule this year without sufficient review.

The draft ruling looks at when profits, that have been taxed in the hands of the company, continue to be used by the trust. If the trust had retained the profits itself it would have been taxed at the maximum tax rate. This strategy allows the trust to use the funds as if it had retained them but a tax rate of 30% is only paid on them. The cash that does not flow through to the company (ie held back by the trust) is called an unpaid present entitlement (UPE). Until now, the ATO had accepted that while ever it remained a UPE not a loan. The draft intends to change this, stating that a UPE that has not been paid within by the due date for the lodgement of the company's tax return is a loan and caught in the Division 7A rules. The scary thing about this section (Division 7A) is that if the loan is not made under the strict conditions of Division 7A as to term and interest rate it is considered to be taxable income. So it is important that the loan or UPE is documented correctly.

So what is the decision when making your 30th June 2010 distribution minute? If you distribute some of the profit to the bucket company it will have to charge the trust market interest on the loan back of this money. Not too bad an outcome because the trust will get a deduction (assuming the funds are used to produce income) for the interest it pays and the bucket company will pay tax on this interest at 30% and probably lend it straight back to the trust. So you may choose to continue to distribute to the bucket company this year anyway, then wait and see if you have to charge interest. Then the important thing is to get the loan appropriately documented.

On the other hand if the UPE is not being used for deductible purposes by the trust it maybe time to reconsider you tax planning strategy. Remember superannuation is only taxed at 15% but it is locked away until you are at least 55 years of age and retired.

Fair Work Australia – Discrimination

Race, colour, sex, sexual preference, age, physical or mental disability, marital status, family or carer's responsibilities, pregnancy, religion, political opinion, national extraction or social origin, trade union membership or lack thereof are all considered catalysts for discrimination. For example if a pregnant employee applies for a promotion, even though you know she will be on maternity leave during a vital part of that new position you cannot refuse her the promotion on that basis. Of course these issues also apply to employing someone in the first place and if it is considered that you terminated an employees employment due to one of these factors it would amount to unfair dismissal. Discrimination includes treating an employee differently from other employees in their conditions.

It is also considered discrimination if you were to terminate someone's employment due to or during their absence from work because of illness, injury, bringing an action against you under Fair Work Australia, participating in an emergency management activity, maternity or parental leave.

More ATO Data Matching To Control The Cash Economy

The ATO utilises many indicators to consider whether a business in the cash economy may not be reporting all its income. The most significant of these is their benchmarks for particular industries, there are now 100 different business types covered. Details are available on the ATO web site. Further, the new tax agent regime requires the person preparing your tax return to consider whether you have declared all your income. For tax law purposes the onus of proof rests with the taxpayer so unlike a murderer you are considered guilty until you prove yourself innocent.

The latest data matching tools the ATO will be accessing are details of merchant card sales for business who have their merchant card facilities with the 4 major banks. Plasterers should also be aware that Boral Ltd, CSR Ltd and La Farge Plasterborad Pty Ltd will be providing details to the ATO of sales to approximately 10,000 individuals and entities.

Who Owns & Gets To Depreciate Leasehold Improvements?

It is common in commercial properties for the Lessee to undertake major changes to the premises at their own cost. The question is who gets to claim, what sort of deduction is allowed and what happens at the end of the lease. This is best answered by some straight forward examples, if the Lessee incurs expenditure to install the following:

Structural Changes and Improvements to the Building That Cannot be Removed – The question here is does the Lessee have any ownership rights to the improvements? To possess ownership rights the Lessee must have some rights to compensation (that is not a nominal amount) under the lease or a method of removing the improvements. There are also various laws in the different states that give Lessees rights to improvements they make to leasehold property.

If the Lessee does not have any ownership rights then no depreciation can be claimed, ownership of the improvement passes to the Lessor at the time it is attached to the building and there is a CGT event at this date.

If the Lessee does have an ownership right as described above. The Lessee is entitled to the building depreciation (2.5%) but only while they continue to lease the premises. If they move then they generally can't take this with them so the Lessor is then the one entitled to claim the 2.5%. At this point in time a CGT event is triggered. Now if nothing is received from the Lessor for the benefit of the improvements or they are not dealing with each other at arm's length then market value is deemed to have been paid for the improvements. The cost base for this CGT event is the amount spent on the improvements less depreciation claimed to date.

If the lease requires the lessee to remove the improvements and bring the premises back to their original state then the costs of the improvements that remain after deducting depreciation claimed to date, can be fully

claimed as a tax deduction at that time (scrapping). But the actual costs of removing the improvements has to be written off as black hole expenditure over 5 years. As part of the negotiations with the Lessor the Lessee should consider that if they remove the improvement and destroy it in doing so then they will be entitled to a tax deduction. On the other hand if the improvement is left there the Lessor will be entitled to claim 2.5% pa of the cost of the improvement to the Lessee so there is some incentive for the Lessor to pay the Lessee to leave the improvement there.

Plant and Equipment – As this is removable it is owned by the Lessee so the Lessee is entitled to claim depreciation over the effective life. Generally these would be removable at the end of the lease but if it is left there then CGT rules do not apply to plant and equipment. It would still change hands to the Lessor so a balancing adjustment needs to be made in the depreciation schedule. It is deemed to be sold for the amount paid by the lessor or market value if the transaction is not arm's length.

Maintenance such as painting and replacing cracked tiles – Lessee is entitled to claim as an up front deduction.

Tarting the place up such as painting and new tiles – This is an improvement so just as discussed at the top of this list, if the Lessee has ownership right then the Lessee is entitled to claim building depreciation at 2.5% and the consequences on termination of the lease are the same.

Tarting the Place up with Removable Partitioning – The very fact it is removable means the Lessee has ownership rights. Lessee is entitled to claim depreciation over its effective life (20 years) including, if applicable, any wiring running through it. If left with the premises when the lease expires there is a deemed disposal to the lessor for market value or the amount paid by the Lessor if it is at arm's length. If you take it with you and use it in other premises then the cost of moving and installing it in other premises is added to the amount you continue to claim depreciation on. Restoring the property to its original state is part of the cost base of the lease which can create a capital loss.

If instead of the lease expiring the lease is assigned ie the business sold there would still be a disposal of the assets, treated the same way. In these circumstances the new lessee will be entitled to claim the building depreciation and any other depreciation, not the Lessor.

The above is a generalisation there are many fine lines, especially between what is plant and what is part of the building, that could create a different result in your particular circumstances.

Fair Work Australia – Unfair Dismissal

Now this is the topic that sends shivers down the spine of the average employer and in my experience is the weapon of choice by employees who have no idea how to produce a result and feel you should be satisfied with the fact they turned up for work. I take some satisfaction in knowing that even the labour party have had these sorts of problems with their staff.

Most important to know is that if you have the equivalent of 14 full-time employees or less then you are exempt from the unfair dismissal provisions providing you follow the small business dismissal code. The code is available in the small business section of our web site. Further, no employee can bring an unfair dismissal claim against you until they have worked for you for over 12 months.

If you have more than 14 employees you need to consider whether (in the opinion of the National Workplace Relations Tribunal) the dismissal is harsh, unjust, unreasonable or not a case of genuine redundancy.

Redundancy is when a person's job no longer exists. This is not the case if they can be redeployed in your business or an entity associated with you. Making an employee redundant may entitle them to a redundancy payment of up to 16 weeks wages if you employ 15 or more people and they have been a permanent employee (full time or part time) for more than 12 months.

Harsh, unjust or unreasonable consider if there is a valid reason for the dismissal in the employees conduct or capacity. But the employee must be given the reason and an opportunity to respond. Warnings are required if the reason for dismissal is unsatisfactory performance. If you can prove you dismissed a person for assault, fraud or theft, then it will not be considered unfair dismissal.

The worst case scenario with unfair dismissal is to reinstate the employee or pay them up to 26 weeks wages though this is capped at $54,150.

Hua-Aus Escorts and the Cash Economy

Ahh just the type of heading newspaper editors would love me to write all the time. Who says tax isn't interesting? Get a load of the basic facts listed in this case, the following points are quoted word for word from Hua-Aus Pty Ltd v FCT 2010 FCA 341.:

1. Hua-Aus carried on business as a provider of escort services
2. Mr Mike Hua was the sole director of Hua-Aus
3. Hua-Aus supplied delivery and advertising services to escorts used in its enterprise

4. The escorts provided escort services to clients
5. Hua-Aus carried on the enterprise of supplying escort services, with the escorts in the position of contractors to Hua-Aus
6. Hua-Aus received one-half of the gross fee paid by the client and the escort received the other half
7. Hua-Aus was not in partnership with the escorts it provided to clients
8. There was no evidence that the escorts participated in the management of the affairs of Hua-Aus
9. The relationship between Hua-Aus and the escorts operated as an unwritten contract. Activities were performed according to the unwritten understanding between Hua-Aus and parties who had a role in its activities.

Not only did Hua-Aus get whacked for claiming more GST input taxed credits than it was entitled to there were two other issues that go right to the heart of the operations of many small businesses. So now that I have your attention with a bit of fun let's get down to the issues that should concern you.

Hua-Aus had not been withholding tax from payments to the escorts. It appears the escorts did not have ABNs because it was calculated that Hua-Aus should have withheld $49,195 from $101,433.67 in payments made to escorts. That's how it works if you don't get an ABN or TFN off anyone that your business pays more than $75.00 (exclusive of GST) to, you need to withhold 46.5% of the payment and remit it to the ATO. And I mean absolutely anyone. Further if you get a TFN instead of an ABN then you are crossing the line to employer responsibilities and still need to withhold tax though probably at a lesser rate.

The next problem for Hua-Aus was that the ATO found some deposits in the company's bank account that had not been treated as income and so the GST had not been paid on them. The burden of proof rests with the taxpayer to prove that the ATO assessment is excessive, guilty until you prove yourself innocent.

One of the main platforms of the ATO's argument in the AAT, from which this case was appealed, was that the taxpayer should not be believed by the courts, that in standing in his own defence he was not a creditable witness. So the burden of proof rests with the taxpayer to prove that the deposits to the bank account were not income yet, a cornerstone of the ATO's case was that the court should not believe any explanation he offered on the basis he could not be trusted. So you are not only guilty until proven innocent but you cannot say anything in your defence! The ATO submitted that the taxpayer's explanations were "simply improbable and extemely unbelievable". The Federal Court said that statement by the ATO had "no foundation whatsoever, it should never have been made"! The Federal Court found that the witness appeared to be truthful. The taxpayer even had a letter from the depositor and a supporting contract re the purchase of a property to justify deposit yet the AAT chose to ignore the lot so the taxpayer had to go to the expense of appealing to the Federal Court which saw reason. At times in the AAT, the ATO even stopped the taxpayer mid explanation so he couldn't fully explain himself.

As it turns out, the deposits were money received from partners who purchased a property with the taxpayer and there was a settlement of the property, with the other partners' names on the title, to substantiate the transaction and a letter from one of the partners. Yet it still had to go this far and get this expensive.

The moral of the story – forget trying to hide some income and get very concerned about justifying any deposits you receive that you do not declare as income because you will be guilty until proven innocent and from the looks of this case, the ATO will consider you not only guilty but a liar so there is little you can offer in your defence, not even third party verification. Your only recourse may be the cost of going to the Federal court. In this case if the taxpayer had not appealed, not only would he have had to pay tax on money that was not really income but he would have been up for penalties on that tax short fall. All on income that does not exist!

Trusts With Bucket Companies

Rumour has it that the ATO is not backing down from applying Div 7A rules to profit distributions from trusts to companies. The funds are usually lent back to the trust by the company so the whole arrangement is just to divert the profits through the company so they can be taxed at the company tax rate. The ruling is supposed to be finalised around 30th June, 2010. Accordingly, it is important that all trusts who intend to distribute profits to a company enter into a loan agreement to ensure the profits will not be caught as unfranked dividends.

Investment Allowance

Most of the benefits here have passed, you have had to already qualified by now because the contract had to be entered into by small businesses by the 31st December, 2009 to get the big 50% investment allowance. Big businesses only got 30% and had to enter into the contract by 30th June, 2009. All that is left now is a 10% investment allowance. Small business with a turnover of less than $2million must spend at least $1,000 and big business at least $10,000

Here are the basics to bear in mind when preparing your tax return. The year in which you get to claim the investment allowance is the year in which the asset is installed ready for use. Batches of identical items or items that form part of a set, can be added together to pass the threshold and identical items acquired during the 50% or 30% time frame can be added to those purchased during the 10% time frame to see if the threshold has been passed. But if total identical purchases before 31st December, 2009 are under the threshold then even if purchases after that date bring them up to the threshold they will only be entitled to the 10% investment allowance. Further, you must purchase a new asset or new improvements to a current asset. You will still be entitled to depreciation on the full amount paid for the equipment.

As long as it is principally used for business purposes the allowance does not have to be apportioned for private use. Buildings, land, computer software and intellectual property do not qualify for the allowance. It does not apply to cars that will be claimed under the 5,000km method.

It is the person that is entitled to claim depreciation for the car that is entitled to the allowance. This becomes a little messy in partnerships and the partnership agreement needs to be referred to, to decide who is entitled to the depreciation on the asset and so the allowance. In the case of a leased vehicle it is the lease company who is entitled to the depreciation unless the car is a luxury car then it is the lessee who is entitled to the depreciation so the lessee in these circumstances would be entitled to the allowance. If your car exceeds the luxury car limit then you can only claim 50% of the luxury car limit. There is no claw back of the allowance once the car is sold or its use is no longer principally for business unless it was not bona fide purchased for the business in the first place.

The allowance is a tax deduction not a tax credit so if the deduction reduces your income below the taxable threshold it is wasted and you will not be able to get any cash back for it though it can create a taxable loss you can carry forward after offsetting exempt income and maybe helpful to you in the following year.

Selling a Luxury Car

There are various provisions in tax law that ensure a person who buys a luxury car does not gain any tax benefit for the value of the vehicle above what the ATO considers reasonable. Accordingly, depreciation can only be claimed on the luxury car limit not the actual cost of the car. As the law is intended to prevent a tax benefit being gained for the premium above the luxury car limit the provisions must go further than just limiting the depreciation because ultimately the vehicle will be sold and the tax benefit from claiming the loss on the sale also needs to be restricted. How it works is covered in TD 2006/40. Firstly, the luxury car limits are dependent on the date you purchase the car $57,180 for 2008/09 $57,123 for 2007/08 $57,009 for 2003, 2004, 2005, 2006 & 2007 and $55,134 for 2002**.** Note you use the GST exclusive price if you can claim an input credit. But note it is not a case of reducing the cost by all the GST charged on the vehicle as you are only allowed to claim GST up to the amount you could claim if the car was just under the luxury car limit. The example in TD 2006/40 explains this as follows:

> 5. *The car had a purchase price of $60,000. The car limit for the 2005-06 financial year is $57,009. The first element of the cost of the car ($60,000) is reduced by the input tax credit of $5,182 (1/11 of $57,009) that the taxpayer is entitled to for the acquisition of the car to $54,818. As this does not exceed the car limit, the first element of the cost of the car will not be further reduced under section 40-230* .

Now when the vehicle is sold the funds received are apportioned in accordance with the ratio between the luxury car limit in the year of acquisition and the actual cost. Take the luxury car limit at the time that you purchased the car then add to it any further improvements you have made to the car since purchase. Then divide this amount by the actual total cost of your car. The total cost of the car includes any improvements but does not include the GST that you were entitled to claim back. This gives you the percentage the car limit is of the actual price you paid for the car

Now take the amount you actually received for the vehicle and reduce it by the amount of GST you charged (ID 2002/933), this is your termination value. Multiply the termination value by the percentage calculated above. In other words you are apportioning the termination value between what you where allowed to claim depreciation for and what your weren't, on a pro rata basis.

You then take the portion of the sale proceeds that is applicable to the portion you were allowed to claim depreciation for and compare it to the current written down value (luxury car limit less depreciation claimed) to see if there is an assessable profit or loss. Of course you can't claim a tax deduction for any loss on the amount above the luxury car limit.

Trust Distributions

In Bamford's case it was decided that when a trust has a different profit for tax purposes compared with accounting purposes, the proportional approach should be used to decide how much taxable income each beneficiary receives. There are various ways a trust can end up with a different accounting profit to its taxable profit, and generally these are not noticeable until the accounts are finalised. The trap is that the profit distribution minute must be made before 30th June.

This is best explained by example. The trust may have a beneficiary under 18 who has no other income, so $3,000 can be distributed to that beneficiary tax free so the distribution may read that $3,000 of the profit goes to the child and the balance to an adult beneficiary. Now if the trust deed defines income, as many older deeds do, as something other than the taxable income you could end up with a minute even specifying the amounts to be distributed, but because of the proportional approach the beneficiary will be taxable on a different amount than his or her entitlement

Even in the tidiest set of accounts you may determine the distribution according to the profit shown in the account but when preparing the tax return it is realised that the cheque for the superannuation contributions for employees under the guarantee for the month of June was drawn in June, but the superannuation fund did not receive it until July. As a result the trust will not be allowed to claim June's superannuation contribution as a tax deduction until the following year. Nevertheless for accounting purposes the superannuation contribution is deducted so the taxable profit is higher than the accounting profit. Let's say the taxable profit is $11,000 the superannuation contribution $1,000 so the accounting profit is only $10,000. Ideally the minute drawn at 30th June would distribute $3,000 to a child because that is the maximum they can earn tax free. After that amount they are taxed at the maximum tax rate. The wording of the distribution minute would mean that for accounting purposes $3,000 would be distributed to the child and $7,000 would be distributed to the adult. The proportional approach however means that 30% of the taxable profit belongs to the child even though the minute specified only $3,000. This means that while the child is only entitled to $3,000 in actual distribution they must pay tax on $3,300. Of course the additional $300 will be taxed at the penalty minor maximum tax rate.

This problem could also arise if the ATO where to audit the trust and disallow a tax deduction.

Now there are numerous ways that a discrepancy can arise between taxable income and accounting income, for example:

1) The trust deed has some particular rules about defining income that are not in accordance with tax law.
2) Distribution of exempt capital gains
3) Timing differences in superannuation deductions
4) The trust tax return being prepared on a cash basis rather than the accrual basis as possibly required by the deed.
5) Prepaid expenses to reduce taxable income may not qualify to reduce accounting profit in the current year.

What to do?

The first step would be to have the trust deeds definition of income available for distribution amended, so that it said taxable income or otherwise as the trustee determines. If you take this approach make sure that you still have the right to distribute amounts that are not income, such as exempt capital gains which could be distributed from a capital reserve. It is important that these amendments are made by a solicitor to ensure the ramifications to the whole deed are considered.

The above will eliminate the possibility of the income changing when the tax return is completed, but it will not solve the problem of the ATO later auditing the accounts and denying a deduction. In these circumstances the income to children could be pushed over the $3,000 mark because the ATO will apply the extra taxable income on a pro rata basis across all beneficiaries (the proportional approach).

There is also the risk that knowing the trust will make a loss, the trustee does not make a distribution minute. If later the ATO finds there is a profit it will be taxable in the hands of the trustee which means maximum tax rates. This problem is avoided by making a distribution minute no matter what.

As long as the trust deed recognizes taxable income and a distribution minute is drawn before 30th June each year you have done all that you can to protect yourself from the effect of the findings in Bamford's case. There appears to be nothing that can be done to avoid the maximum tax rate if you have distributed to children and the ATO disallows a tax deduction to the trust.

Fortunately the ATO is not that concerned with trust distributions for the 2009/2010 and previous years so it is just a matter of getting it right from this year forward.

Choosing a Business Structure

The factors relevant to this decision are usually adaptability for the future, asset protection and tax minimisation. Asset protection needs to work both ways, if someone sues you they should not be able to access the business assets and if someone sues the business they should not be able to access your assets. Obviously this means holding the business in a separate entity from yourself such as a trust or company. The trap is if you own shares in the company or units in the trust, where your business is, then there is a good chance that your personal creditors will gain access to the business.

Discretionary trusts give you no rights to the assets held in the trust. It is at the discretion of the trustee, each year, who gets the profits or any assets distributed. The trustee would be a company which you will no doubt control by being the director and shareholder but it is not the trustee company that owns the assets it is the trust over which no one has any rights unless the trustee says so. You would also make sure you or someone you trust is the appointer of the trustee. The appointer can at anytime remove the current trustee and put another one in its place. A bankruptcy trustee cannot access your rights as an appointer and unlike directorships a bankrupt is not prohibited from being an appointer. So if you personally go bankrupt and the bankruptcy trustee seizes the shares in the trustee company it cannot then access the discretionary trust because you simply step in and change the trustee to an entity the bankruptcy trustee cannot access.

Superannuation funds are not permitted to run a business, though they do provide excellent asset protection and tax benefits so they are certainly the place to put resources you can do without until you retire. They can also own your business premises.

In many businesses it is impossible to separate yourself from the business because of your professional liability such as gas fitters, doctors, accountants etc. In these circumstances you would be more interested in keeping your personal assets out of your own name. Or at least set up a mortgage trust to make sure there is very little equity available for your creditors

A discretionary trust will provide you with the best barrier between yourself and your business but any losses from the business are locked into the trust, so not good if the business is just a side line to your wages job and you wanted to offset the losses against your wages income. Though with the non commercial loss rules it may not be possible to offset the business losses even if it was in your name. For more details on this refer our Division 35 booklet in the freebies section of our web site.

Discretionary trusts, through their ability to decide, each year, who gets the income also provide good flexibility for the future. And of course the tax benefit of being an employee of your own business and deciding at the end of each year who is in the best tax position to take the profits means a discretionary trust covers all three of our requirements – tax(except for offsetting losses), asset protection and adaptability.

In order to carry forward losses a discretionary trust may need to make a family trust election for tax purposes. Accordingly, you would only want members of your family to be beneficiaries. This can create a problem if two families come together to run a business. They should not use the same discretionary trust in case it has to make a family trust election or needs to pass the significant individual test to access the CGT small business concessions. When two separate families go into business together they should form their own individual family trusts then operate as a partnership of those trusts.

Unlike companies discretionary trusts also qualify for the 50% CGT discount.

Generally a discretionary trust is the best structure for a business because offsetting losses against your wages income would not be part of your plan otherwise why would you be going into business anyway? But the catch is if it flops you are going to have trouble using up the losses you accumulate. There is only one set of circumstances where trust losses can be offset against your other income in your personal tax return, and that is where the income of the trust is considered to be your personal services income. This is discussed in detail in our Alienation of Personal Services Income booklet available in the freebies section of our web site. The catch is if the income of the trust, once it starts making a profit is still your personal services income then you cannot distribute those profits to anyone other than yourself. So it sort of defeats the purpose of having the trust unless during the loss stage it is your personal services income but by the time it starts to make a profit you have other people working in the business providing services to clients that it is no longer income from your personal services. Briefly, income is caught as your personal services under two areas of law. There are the APSI rules which look firstly at whether your income is primarily from one payer and you are not liable to fix your own mistakes at your own expense. You will not be caught under APSI even if you only have one payer if you have an apprentice or business premises separate from your home. There is also a carve out for people who have lots of clients but only one payer such as Doctors who bulk bill and insurance brokers. If you get past the APSI rules then you still have to consider the old common law principles which

examine whether the business income is for personal services (income of an owner driver truckie would not be for personal services because the truck is the primary supply) primarily from your service. An example of this would be an accountant with two clerical staff whose time is not charged to clients and a part time accountant. In these circumstances the income could not be split through a trust because the majority of it is earned by the practitioner accountant. There has even been arguments by the ATO that if the employee accountant was full time, the fees would still be considered primarily for the personal services of the practitioner accountant because the practitioner's charge out rate would be higher so make a bigger contribution to the total practice fees.

There is an exception to this rule. Individual partners in a partnership are allowed to split income even if the majority of the work is done by one partner. This is because a partnership provides no asset protection so the reasoning is that as the other partner or partners are equally at risk with the working partner they should be entitled to a share of the profit. Partnerships are, subject to the non commercial loss rules, so for example if the business doesn't have a turnover of more than $20,000 the losses are locked into the partnership. Otherwise the partnership is entitled to distribute any losses into the personal tax returns of the partners to be offset against their other income. So if asset protection is not a priority for you and you pass through the APSI rules because you have many clients but are caught out by the fact most of the income is generated by you then a partnership could be the best structure for you.

ATO Cash Economy Audits

Despite stating they wouldn't, the ATO is now using its industry benchmarks to decide what income a business should have and assessing it on that amount when reported income is lower than the benchmarks. The only defence is good record keeping but that hasn't even been enough in the case of one taxpayer, that reported less income than the ATO thinks they should have. The ATO is arguing that there were less sales than the number of times the till was opened so their records must be false. This is a very difficult situation for the taxpayer, the ATO are being very aggressive in this matter yet the only reason the till was opened so frequently was because the keys to display cabinets and the toilets were kept in the till draw.

If you would like to check how your figures match up go to
http://www.ato.gov.au/businesses/content.asp?doc=/content/00214689.htm

If the ATO walk into your premises unannounced you can tell them that it is not an appropriate time and make an appointment for them to come back later. When they do we recommend that you record the interview, you will have to tell them that you are doing this.

Trust Law Re-write

Don't be alarmed when you hear that Treasury is proposing to re-write the trust laws. This is intended as to update the law to the style and reference numbers of the 1997 re write of other areas of income tax law, all in the name of simplification. They have undertaken that this will not involve and major departure from the intention of the currently law and taxing trusts as companies is definitely not on the agenda.

How To Roll Your Roll Over Relief Continuously

As part of the small business CGT concessions you can avoid paying CGT on the sale of an active asset, for CGT purposes, if you roll the gain into another active asset. The catch is when you sell that later active asset the CGT raises its head again. The idea is to then roll it into another active asset.

The definition of active asset to which the small business concessions apply excludes motor vehicles, trading stock, plant and equipment. This is to say that when you make a gain on any of these you cannot roll the gain over. But the definition of active asset into which you can roll a capital gain does include these items. So rolling your capital gain into your trading stock, assuming it is a fraction of your normal stock holdings, would ensure that the gain is protected for the life of your business.

Deducting Tax From Wages

Employers please make sure you obtain the new rates for deducting PAYG from your employee's wages. True the tax rates have not changed from 2011 to 2012 but the amount of low income tax offset that can be received during the year rather than through the tax return, has increased. On the high end of the tax scale there is also the flood levy to consider.

Budget Changes That Affect Small Business

Entrepreneurs' Tax Offset:

This is the last financial year that small businesses with a turnover under $75,000 will qualify for the entrepreneurs' tax offset which reduces the tax payable on their business income.

FBT On "Company" Cars:

Nothing has changed if the log book method is used to calculate the FBT payable on an employer provided car.

Most employers use the simpler, formula method. The way the formula works is it is assumed the more kilometres the car has travelled the more likely it is used for business purposes. The formula takes the original cost of the car (in most cases) and multiplies it by a percentage to determine the value of the fringe benefit. The more kilometres used the smaller this percentage is. The government is under the impression this is an incentive to drive the car unnecessarily. Accordingly, it intends to introduce a flat rate of 20%.

The rates will stay the same for cars purchased before the announcement but for new contracts entered into from 10th May, 2011 the new rates will apply. Though the new flat rate will be phased in slowly and remember it only applies to cars that are purchased after 9th May, 2011. From that date cars that travel less than 25,000 kilometres will be subject to the 20% rate. From 1st April 2012 (2012/13 FBT yr) cars that have travel up to 40,000 kilometres will be subject to the 20% rate. By 1st April 2014 all cars will be subject to the 20% rate.

Upfront Deduction On Vehicle Purchase:

This applies to all vehicles used in a business not just cars. The first $5,000 can be immediately written off. The balance is depreciated at 15% in the first year regardless of the month purchased then 30% in following years. This will apply to vehicles purchased after 1st July, 2012 so it may be worth delaying purchases.

Restraint Of Trade

Restraints of trade are extremely difficult to enforce especially when you have not paid a large sum for it as part of purchasing a business. So don't just rely on one to protect yourself from an outgoing partner or employee. It may prove difficult to enforce. The more restrict the restraint is the less likely the courts are to enforce it.

Carbon Tax Changes That Affect Small Business

The only concessions small business got was an increased threshold for capital expenditure write-off. Currently small businesses have to depreciate any item costing more than $1,000. This threshold will be increased to $6,500 so should provide quite bit of record keeping relief.

Deducting Franchise Fees

Inglewood v Commissioner of Taxation 2011 AATA 607 provides some interesting insight on the deductibility of Franchise Fees. The case involved a Bendigo Bank Franchisee.

Two franchise fees were payable, one was an establishment fee. The taxpayer agreed this was not an outright deduction but argued that it should be able to be written off over 5 years as black hole expenditure. The court found that it did not qualify as black hole expenditure because the fee was payable for the acquisition of a legal asset, the right to operate the branch, thus it was an asset for CGT purposes. Black hole expenditure is only a residual provision for expenditure not covered elsewhere in the act.

The other Franchise Fee was a renewal fee which is paid in advance to cover a period of 5 years. It entitles the Franchisee to continue in the business. At the end of the 5 years, unless they renew, they would not be allowed to continue to operate. The AAT found that as it was a re occurring payment and gave the franchisee no rights or asset at the end of the 5 years, then it was an expense of the business and could be claimed as a deduction but must be amortised over the 5 year period.

Directors Being Held Personally Liable for PAYG

If you had been worried about the proposal put to parliament to make directors automatically personally liable for the PAYG deductions of the companies they run, you will be relieved to know that it didn't get

through Parliament. Though, we are not out of the woods yet and even under current laws you can still become liable if you don't respond to ATO notices.

Matthew Joiner from PKF has provided the following comment:

This legislative update has been removed from parliament and will be revisited in early FY12 after further consultation with stakeholders. We will advise as it progresses.

Under current legislation, if a director or directors of a company do not act after receiving a 21 day Director Penalty Notice (DPN) issued by the Australian Taxation Office (ATO) they become personally liable for outstanding pay-as-you-go (PAYG) deductions due by their company. If the company repays the liability, enters into an instalment plan or the directors place the company into liquidation or voluntary administration during this period, the personal liability is avoided.

There is draft legislation issued following the FY11/12 Federal Budget that will trigger automatic director personal liability for PAYG and superannuation tax liabilities.

The proposed legislation encompasses:

- *The current DPN provisions;*
- *Potential personal liability for their company's PAYG and superannuation guarantee debts;*
- *Automatic personal liability where PAYG and superannuation guarantee remains unreported and unpaid for three months after the lodgement date for a return;*
- *Withdrawal of credits for directors and associates of directors PAYG withholding amounts where a company has failed to pay all those amounts to the ATO; and*
- *Removal of notice provisions to money collected under garnishee notices.*

If directors are unable to meet the liability, they should seek guidance on the best course of action to resolve the situation for their company.

Claiming Home Office Expenses

The ATO allows you to claim 34 cents per hour for each hour you spend working in your home office. This amount is to cover electricity and wear and tear on furniture, carpet etc. It is not necessary that you have to work at home because you don't have an office elsewhere. To make this claim you can simply have chosen to work at home. Phone calls, internet, computers and printers can also be claimed but utilizing the 34 cents per hour rate will prevent you from being able to depreciate the furniture in your home office.

If you have purchased furniture this year you may be better off claiming actual costs rather than the ATO's hourly rate. If you choose to do so here is some information that will help you calculate how much you can claim for the electricity. A computer costs about 5 ½ cents an hour to run and a fluorescent light about 3 cents an hour. The cost of running an air conditioner varies depending on the kilowatt input figure. To be accurate you should multiply the kw input figure by the rate you are charged per kilowatt for your electricity. As a general guide air conditioners cost around 17 cents an hour to run.

Before you can make any claim for all these home office expenses you need to keep a diary for one month showing how many hours the office is used for work related purposes, this includes managing your tax affairs and investments. In the case of equipment and furniture the diary will also need to show the ratio of deductible to nondeductible use so the expense can be apportioned.

Australian Government Sweat Shops

It made news in January that Apple had to admit that some of its suppliers were breaching its standard of a maximum 60 hour work week and minimum one day off per week. As I prepare my BAS and deal with various other government shackles placed on small business owners, how I wish that the Australian Government had a similar policy.

MYOB Users

When you roll over data in MYOB the previous year's entries are no longer accessible. In the case of an ATO audit you will not be able to print a report to show the individual entries that make up the amounts appearing in the tax return. If you do not have a pre roll over back up you are in deep trouble. Not just with substantiating your tax deductions, even if you go back and reconstruct from all your paper records you are still in breach of the requirements of section 262A. In that you didn't keep all your records in a manner that allows "ATO staff to determine a person's liability quickly and easily". Paragraph 25 of TR 96/7 makes it

clear that this requirement is more than just keeping receipts it includes keeping ledgers and journals. When you roll over MYOB these ledgers are no longer accessible.

It is my opinion that Quickbooks provides a much better method of retaining and reporting your tax records. Not only does it not require the data to be rolled over but the Quickbooks reporting function is far superior. You can simply block entries to non current dates with a password. This helps prevent incorrect dates being entered in current periods. The most significant advantage Quickbooks has over MYOB is its find facility which will allow you to produce a report on any basis for any date, even just look for entries of a specific amount. Quickbooks records data as a data base and allows you to sort on the basis of any of the fields in that data base.

Confessions of an Online Shopper

Ok I do it! I buy quite a bit of stuff online these days, but only from Australian sites. On every occasion that I have resorted to Google to find the goods I want, it has been after a frustrating day's shopping. If you can't get what you want in the shops of course you are going to shop online.

Retailers please consider that when you let your stock run down, what is left on the shelf is what your regular customers do not want. The last time I couldn't find what I wanted, I asked if they could get it in with their next order for me. The business owner said that she didn't know when she was likely to put in another order, it could be weeks away. So I walked out empty handed again.

When sales are slow it may take nerves of steel to spend money on stock but once people realise they cannot get what they want in your shop they are unlikely to come back. Difficult times are an opportunity to increase your market share. Why not be the shop that the dissatisfied customers go to instead.

Please don't act on this advice alone, if business is slow you need to work through some forecasts and cash flow analysis with your accountant to make sure your position is recoverable.

Problem if Company Declares Dividend Before it Pays Tax

If you operate your business through a company it is important that you arrange for your profits to be distributed at a time when they can be franked.

First an explanation of how franking credits operate. If a company makes $100 profit it pays $30 in tax. The shareholders of the company are entitled to a tax credit for tax paid by the company when they return the profit as income. So in this example, if the company was to pay out all of its remaining profit to shareholders they would pay $70 in cash and give the shareholders a tax credit of $30. The shareholders would include $100 in their tax return, if they are in the 38.5% tax bracket their notional tax bill would be $38.50 but they would only have to pay $8.50 to the ATO because they use the tax credit for the rest.

If the company distributes its profits before it pays the tax it cannot frank the dividend (attach the tax credits to the dividend). There is an exception to this rule when the franking account is overdrawn by a minor amount but for the sake of this discussion that is irrelevant. The maximum a dividend can be franked is 30%. So if you don't frank every dividend it is quite likely that the company will have excess franking credits that it will never be able to distribute to the shareholders.

If you need to take money out of the company before franking credits are available (ie before the company has paid its tax) then this must be done as a loan with the appropriate agreement in place or the payment will be deemed to be an unfranked dividend.

Fortunately, no interest is payable in the first financial year that the loan is made and it is acceptable to pay the interest annually so no interest needs to be paid until 30th June of the following financial year. Ideally you should have paid the tax on the profit by then and have declared a franked dividend. This can then be used to pay off the loan but with the added advantage of franking credits in your tax return.

Of course if the 30th June has passed the interest payable for this financial year should be calculated and added to the amount of loan repayment. You cannot gross up the loan by the amount of interest you owe. A payment must be made. Each year the ATO sets the interest rate. Interest for the 2012 financial year is required to be charged at the rate of 7.8%.

It may be necessary to delay the payment of the dividend if the shareholder is a trustee of a trust that beneficially holds the shares for the benefit of the trust. The idea with a trust is that it distributes its profit each year to beneficiaries otherwise it will be taxed in the maximum tax bracket. The dividend and franking credit flow through. So as per the example above the beneficiary will end up receiving the $70 but declaring $100 in their tax return with a$30 tax credit towards the tax payable. The trap here is that unless a trust makes at least $1 in profit it cannot distribute the franking credits. For example a trust may have $80 in losses from

another venture which it offsets against the $100 it technically receives from the company, leaving it a taxable profit of $20. The beneficiary will receive no cash and will only need to declare $20 in income from the trust but they will be entitled to a $30 tax credit which can be used to offset other tax payable or claimed back from the ATO. The problem arises when the trust has other losses that exceed the income it has received from the company. As the trust has no net profit to distribute, it cannot distribute the franking credit and it is lost forever.

So it is important that you check the tax position of the ultimate beneficiary of the dividend before it is paid. The amount paid must exceed any losses held by the shareholder if it is a trust. Accordingly, the declaration of a dividend may need to be further delayed to make sure there is enough accumulated profits to declare a dividend big enough to cover the losses of the shareholder. It is worth continuing with the loan agreement and just making interest payments in the meantime.

Once you have the loan agreement in place keep it going so you are covered should this happen in the future.

More Flexibility for Businesses Financing Equipment etc

From 1st July,2012 small businesses accounting for GST on a cash basis will be able to claim the GST input credit up front for their equipment purchases even when they are financed under a hire purchase agreement. Chattel mortgages have always had this ability but are less popular because they are usually more expensive.

Generally no GST input credits are allowed on interest payments but under the new law the whole of the hire purchase arrangement will be subject to GST even if the interest amount is listed separately. This means the GST input credit will simply be 1/11th of the total price. This only applies to contracts entered into after 1st July, 2012.

The QuickBooks vs MYOB Debate Continues

The battle of the major software packages rages on, for more see edition 242 of Newsflash, QuickBooks:

1) Allows you to print a financial statement over any period of time, it is not restricted by the financial year period you have selected.
2) Speeds up data entry by allowing you to just enter the date without the / in between
3) Does not require you to find and allocate a number for each account you set up
4) Offers you the details of the last transaction for the supplier so you only have to enter the differences.

Selling Only Part Of Your Shares In A Company

If you are only selling a portion of your shareholding in a company and you purchased those shares over time, for example dividend reinvesting, TD 33 explains how you calculate the cost base of the sold shares.

The ATO will accept your selection of which shares you have sold if you have the records. Most acceptable to the ATO is the first in first out basis. Average cost is not acceptable unless all the shares subject to the averaging were purchased on the same day.

Note if you have pre CGT shares it is important to keep records to show it is post 85 shares you sold.

Statistics

In June the statistics should be available from last year's census. This information can be very useful in business planning. It should be available on
http://www.abs.gov.au/websitedbs/censushome.nsf/home/data?opendocument#from-banner=LN

Here is a link to some very interesting trend data. Move your mouse from left to right.
http://www.abc.net.au/iview/?WT.srch=1&WT.svl=TV_iview_au#/recent

Get Those Superannuation Contributions in on Time

Employers have until the 28th July to make the superannuation contributions they are obligated to pay for the June period, under the superannuation guarantee. But if the contribution is made after the 30th June, 2012 the employer will not be entitled to a tax deduction for it until the 2012/2013 financial year even though the liability fell in the 2011/2012 financial year.

If you are contributing salary sacrificed contributions or have employees who are close to the $25,000 or $50,000 cap you should also take a careful look at their particular circumstances. The amount contributed for

the purposes of the cap is also based on the date it is received by the fund. Delaying these contributions until after 30th June could result in your employees missing out on maximising their cap this year and possibly exceeding their cap next year.

On the other hand if last year you made the June contribution in July but this year you are making it in June your employees will have 5 quarters' worth of contributions in the 2011/2012 financial year. Before you do this make sure you will not be pushing anyone over their cap.

In Peaker 2012 AATA 140, the employer posted the contribution on 28th June but it was not recorded as income of the fund until 5th July. This meant that the employee exceeded his cap for the following year. The AAT upheld the ATO's assessment of excess contributions tax as there were no special circumstances which would allow the amount to be allocated to another year.

Due to data matching the ATO will always be informed should your cap be exceeded.

Employees when negotiating their salary package should consider including a clause requiring their employer to physically make the superannuation contribution in the month that it is sacrificed.

New Reporting Obligation for the Construction Industry

From the 1st July, 2012 businesses in the building and construction industry will be required to provide the ATO with a report on all the payments they make to contractors. So make sure you get your record keeping in place straight away.

You will need a separate report for each entity or person you pay, it needs to record their ABN, name; address, gross amount (including GST) you paid them for the financial year, and the GST portion. Note even if the amount includes materials it must still be included in the report but invoices that are solely for materials do not need to be included. The report must be submitted to the ATO by the 21st July of the following year.

A standard accounting system will probably not be able to produce this report because it requires the amount to include GST and to only list payments made in that period. While your accounting system may be able to give you a report of the payments you have made to individual contracts it will probably be net of GST and on an incurred not paid basis so you may need to start a separate system to meet this requirement.

Anyone whose business is primarily in the building and construction industry and makes payments to contractors who are also in that industry is required to report. The obvious examples come to mind but it also includes payments for designs such as architects, decorating, earth moving, project management, installations, repairs and maintenance.

A business is considered to be primarily in the building and construction industry, if in the current financial year or previous financial year 50% or more of its income or activity is from the building and construction industry. So there is a carve out for businesses that may sell materials but also provide an installation service as a minor part of their business. The catch is many businesses are not going to know whether they cross the 50% threshold until the end of the financial year so you will need to keep the appropriate records if you are anywhere near the 50%.

Please note this obligation affects even the smallest contractors who may just pay someone to help them.

Preparing PAYG Summaries

During this year we noticed a lot of errors on PAYG summaries in the reportable payment boxes. Here is a quick check of common misconceptions.

Reportable FBT – This is the fringe benefit amount grossed up (multiplied) by 1.8692. If the fringe benefit amount before grossing up is less than $2,000 it does not need to be reported. This means that if you receive a PAYG summary with an amount less than $3,738 in the reportable fringe benefits box a mistake has been made.

Reportable superannuation contributions – this amount does not include payments your employer is required to make under the superannuation guarantee or award. It generally only catches salary sacrificed contributions.

Employers are only allowed to claim a tax deduction for superannuation contributions they have actually paid into a superannuation fund during the 2011/2012 year. This usually means they can't claim a tax deduction for the last quarter's super but can claim the last quarter's super from the previous year. This is not the case for reportable superannuation contributions. The amount that appears in the box is the amount of superannuation attributed to the 2011/2012 financial year ie. earned by the employee and sacrificed even if not yet received by the superannuation fund. For the purposes of superannuation cap it is added back to the amount actually received by the superannuation fund and allocated to the employee's account during the year

that contributes to the employee's cap, whether it be a salary sacrificed contribution or a compulsory amount paid by the employer.

Employee or Contractor?

The following is a link to an ATO tool to help you decide whether someone you are paying to provide you with services is really a contractor. Quite a hot spot with the ATO at the moment.
http://www.ato.gov.au/businesses/content.aspx?doc=/content/00095062.htm&mnu=42711&mfp=001/003

Discretionary Trust Distribution Minutes

Bamford's case resolved that the income of a trust is to be determined according to the wording of the trust deed and not in accordance with ordinary accounting concepts. This means that as a minimum the income clauses in your trust deed will need to be reviewed and possibly amended. In the following, a reference to a trust is a discretionary trust.

This article is based on a draft ATO ruling, changes to legislation that are less than a year old so untested and test cases that barely scratch the surface of the issue. In its draft ruling TR 2012/D1 the ATO creates some very bizarre circumstances where it claims that while some items are included as income for tax purposes they can't be included in trust income Accordingly, there are no guarantees with the following. It is compiled from a variety of material on the topic, looking for consistencies in opinions but also pointing out some possible traps. To truly cover yourself you should discuss this with a specialist lawyer in regard to your particular circumstances and the wording of your trust deed. The catch is the ATO hasn't finished with the changes yet! So of course if your trust is not in the danger zone below it would be great if you could delay a review of your deed until there is more certainty. To help in this regard we have listed the situations that may put you in the danger zone. If none of these apply to you then you may want to take the calculated risk of waiting for your review. For example previously it was thought that an income equalization (stating that trust income equals taxable income) clause was the solution but now in some cases this could work against you.

The Danger Zones - If any of the following apply to you, you need advice on the wording of your distribution minutes and may need to have your deed amended before 30th June, 2012.

1) There will be a small business capital gain made by the trust within the next 15 years. You will need to make sure there is continuity of ownership.
2) You will make a small business capital gain this year.
3) You want to stream (identify the beneficiary that is to get that particular stream of income) capital gains or franking credits.
4) You will make a capital loss this year. It will need to be recorded in the balance sheet to be carried forward.
5) Your deed states that trust income equals taxable income.

Our Ideal Income Distribution Statement In The Trust Deed – Would give the trustee the discretion to decide what is the income of the trust and the power to stream capital gains and franked dividends. This flexibility should be backed by a default definition of income, if the trustee chooses not to exercise its discretion, this clause should state that the trust income is to be determined in accordance with tax law.

Further, the trustee should be entitled to distribute gross income if it desires. This may be necessary to avoid the loss of franking credits as they are not entitled to be passed onto beneficiaries unless they follow at least some income. The Trustee should also have the power to make interim distributions.

The catch in all this is that you may trigger resettlement by making these changes. A resettlement will cause a CGT event.

Important Points For The Distribution Minutes - Do not delay organising your distribution minutes for the 2012 financial year. It must be done before 30th June, 2012.

The big concern when sorting out the wording of your distribution minutes is if the ATO later audit the trust tax return and decide that its taxable income is higher. Bamford's case determined that the taxable income is to be apportioned on a pro rata basis with the trust income. For example if the trust income was $1,248 and the distribution minutes gave $416 to a child and the rest of the income namely $832 to the parent then if the ATO later audited the trust and determined that the trust income was $1,500 then the child would have to include $500 in his or her tax return. The trap with this is children receiving passive income over $416 are subject to penalty tax rates.

It appears there is no way of wording the distribution minutes to avoid this problem so it is probably not worth the risk of distributing any trust income to children considering the little tax benefit gained compared with the risk.

As you are making the distribution minutes before the income of the trust is known it is important that the distribution minutes does not just list all dollar amounts. There needs to be a beneficiary that receives the balance, a mop up, as at this stage you only have a vague idea of the trust income.

Guidelines For Minutes In Simple Circumstances – First review the deed to check that the trustee has the discretion to determine income. Start with an explanation of how the trust deed defines income. If the trustee has discretion then make sure the minutes thoroughly covers how the trustee is exercising that discretion. Franked dividends, capital gains and other income should be individually addressed. Distribute at least $1 of gross income as it may help you distribute franking credits.

If your circumstances are very basic, with no expected capital gain or franking credits and the trustee has the right to determine income, here is an example of minutes of a distribution meeting. No guarantees, but it does have a few extra points that may help cover the unforeseen.

Minutes of the Meeting of –
Location –
Date –
Present –

In accordance with the powers granted to the trustee in the trust deed the trustee determines income to include all sources of income including if applicable gross capital gains and franking credits. From this gross income all beneficiaries listed below are to receive a distribution of $1. All expenses and outgoings from the trust are then to be deducted from the gross income to determine the net income of the trust which is to be distributed as follows:

A $ or %
B $ or %
C receives any balance of net income remaining

For the avoidance of doubt should any adjustment be made to the net income of the trust the dollar amounts stated above are not to change.

For the avoidance of doubt payments made by the trustee during the year do not necessarily constitute distributions unless expressly recorded by a resolution of the trustee. Further any interim distributions so recorded count towards the amounts shown above.

There being no further business the meeting was closed.

Signed as a true and correct record Dated

Traps - If the trust deed says income in ordinary concepts then only the net capital gain can be streamed. This could result in other beneficiaries paying CGT on a distribution they did not receive. To avoid this, an interim distribution of the whole capital gain will need to be made to the beneficiary who receives the capital gain.

A nasty shock in TR 2012/D1 was the ATO's opinion that franking credits, while taxable, cannot be considered trust income. If a trust does not have net income (ie does not make a profit) it cannot distribute its franking credits and they are wasted. A possible but not proven method of avoiding this problem is to distribute a small amount of gross income. If this could apply to you no harm in including it in your minutes just in case, as shown above.

Tip For Small Business Capital Gains - The small business concessions can reduce a capital gain to zero. On a $100,000 capital gain this could work as follows:

Capital Gain	$100,000
Less 50% CGT Discount	50,000
Less 50% Active Asset Discount	25,000
Less Retirement Exemption (Max $500,000)	25,000

When a beneficiary receives this amount it must be grossed back up again in their tax return but all the above discounts still apply. The trap is if that beneficiary had capital losses they would be wasted. If the beneficiary had capital losses of $20,000 the entry in their tax return would be:

Capital Gain	$100,000
Less Capital losses	20,000
	$80,000
Less 50% CGT Discount	40,000
Less 50% Active Asset Discount	20,000
Less Retirement Exemption (Max $500,000)	20,000

Still no capital gain but only 25% of the losses were effectively used. If instead of the retirement exemption the small business rollover was used by the trust then nothing would be distributed to the beneficiary in the current year. The trust has two years to buy a replacement asset. If it does not buy one then in two year's time the beneficiary will simply receive a capital gain of $25,000 (no grossing back up) this can be offset by the $20,000 capital loss and the balance of $5,000 applied to the retirement exemption leaving more of the $500,000 limit available in the future and requiring less of the funds to be locked away in superannuation if the beneficiary is under 55 years of age.

Disposing of Records

Don't throw out your old records as you get ready for this year's tax return. Not even if they are twenty years old! Think of the business that threw out its old records before the 15 year CGT concession was introduced. At the time they had no reason to believe the records would be needed.

When they sold the business they had no way of proving continual ownership for 15 years, through trust distribution records. If they could, the whole capital gain on the sale of the business would be tax free!

You don't know what retrospective law changes are around the corner.

Temporary Reprieve for LAFHA Changes

Due to the short notice of the changes to the Living Away From Home Allowance (LAFHA) announced in May and the draft legislation not even being available until the 28th June, 2012 the government has agreed to delay the introduction of changes to the Living Away From Home Allowance concessions until 1st October, 2012.

The following are the major points in the draft:

The 12 month Rule – The allowance can only be paid for the first 12 months that the employee lives away from home. This 12 month period does not start until 1st October, 2012 even if the employee begins living away from home before then. When the employee returns home for holidays etc this will not restart the 12 month clock but the time they are at home will not count towards the 12 months, yet they will still be entitled to a tax deduction for any accommodation costs they incur (back at their workplace) while at home but not food.

Taxable food component – Is the portion of the food component of the allowance that is considered to cover normal food costs so does not qualify for concessional treatment. This will now be held at $42 per week for people over 12 years of age and $21 per week for children. Previously, employers could simply reduce the amount they paid by this amount and no FBT would apply. It is now intended that whatever portion of the allowance that is paid for food will be deemed to include this component and the employer will have to pay FBT on it. Basically, forcing an employer to pay a taxable amount before they can pay an exempt amount. Hopefully this problem will be able to be solved by an employee contribution. Note employees must also give their employer a "deductible food and drink expense declaration".

Transitional Rule – Agreements that were in place on 8th May, 2012 remain unaffected until 1st July, 2014 providing they are not varied or renewed. A variation could simply be an increase in pay rate.

Taxable to Employees – Any LAFHA received, other than the food component, will be taxable income to the employee for which they will have to produce receipts to make claims for accommodation etc. In the case of

food the ATO will issue guidelines on what is reasonable and receipts will only be necessary, for all food expenses, if the claim is for more than these reasonable amounts.

Opportunity When not Receiving LAFHA – It will no longer be a requirement that your employer pay a LAFHA to qualify for this concession. All employees that meet the requirements of living away from home while maintaining another home in Australia will qualify to claim their costs, in the first 12 months, if they have the necessary receipts.

Maintaining Another Home in Australia – Of course this means no LAFHA concessions for people coming to Australia to work from overseas. Also people who lived with their parents etc before relocating will not be entitled. Maintaining another home means owning it or leasing it in your name or your spouse's name. It cannot be rented out while you are away but if you had boarder that was living with you before you relocated then they can continue to live there and you will still qualify.

Mining Accommodation – These changes will also affect employer provided meals and accommodation but this will only be of concern to the employer not the employee. The employer will only be able to exempt from FBT the portion of the costs that the employee would have been able to deduct if they were paid an allowance. This of course means no concessions after 12 months. It appears the remote area housing concessions will not be changed. The LAFHA concessions are not applicable to fly in fly out workers.

Now before you go acting on this remember, it is not through parliament yet, so anything could happen.

Personal Property Security Act

There is a lot more to the Personal Property Register than just checking if a vehicle or machinery you are buying is unencumbered or to confirm that an interest in goods you have supplied on credit has been registered. The traditional way we view our rights of ownership now have to change. It is not just a case of needing to register your interest to protect your rights, a lack of registration or incorrect registration can be used to override your rights in favour of someone else who is correctly registered.

If the entity that actually has possession of the goods is placed into administration or liquidation and your interests are not listed on the register then the administrator or liquidator can treat the goods as belonging to the entity in administration or liquidation and sell them to meet the debts owing to all creditors. You may well be able to line up along with the other creditors for some payment but you will not be specifically entitled to recover the goods or the proceeds of the sale of those particular goods.

There are transitional measures until 30th January 2014 for unregistered interests, which means you must register before that date but there is much debate currently among lawyers about whether these measures cover goods you sold on account even though you may have a valid retention of title clause written into your terms. The transitional measures do not cover arrangements entered into after 30th January, 2012 such as new customers signed up after 30 January, 2012

The full ramifications of this Act are far from clear with it already being tested in the courts by the WOW Sight and Sound Receivers who are busily trying to challenge the rights of any supplier, that was not already listed on the register, in favour of a secured creditor.

At a bare minimum, here are some of the circumstances readers should be concerned about:

1) Where you hold your plant, equipment, machinery, vehicles etc in a holding entity separate to your trading entity. The problem is they are either hired or leased for more than 90 days by the trading entity. If not registered, this arrangement will no longer provide you with any form of asset protection should your trading entity be placed into liquidation. The liquidator is entitled to treat the equipment in the possession of the insolvent trading entity as owned by the trading entity unless the holding entity has registered its interest.
2) Lease or hire arrangements with customers or subcontractors/drivers to use your machinery or equipment over a period exceeding 90 days must be registered. The machinery or equipment must be "serial numbered" assets such as motor vehicles, earthmoving equipment and plant. Even if your equipment is something else, you must also register for any lease or hire arrangements exceeding twelve (12) months.
3) If you are supplying goods on account you will also need to register your interest for each customer, if you want to retain the title in those goods, should the customer not pay for them

immediately. Fortunately, your interest does not have to be itemised just a general interest in their stock. We encourage you to obtain legal advice before registering your interest.

4) In the case of service providers such as storage facilities and repairers who do not release cars, goods or machinery until they are paid. This right maybe enforceable against your customer but if someone else has already registered their right over that equipment they are entitled to it.

Point 1 above would apply to many of our business clients. If any of these circumstances apply to you or you would like to talk to someone about your particular concerns we recommend you contact the following PKF branch, depending on which state you are in.

Queensland - Matthew Joiner on 07 3811 4441 matthew.joiner@pkf.com.au
Victoria – Dennis Turner 03 9603 1804 dennis.turner@pkf.com.au
NSW – James White 02 8264 6507 james.white@pkf.com.au

Travel Allowance Instead Of LAFHA?

As October, 2012 fast approaches and the end of Living Away From Home Allowance (LAFHA) for people who do not have a home that they are living away from, many questions are being asked. Unfortunately we still don't have the legislation but it is very clear that you will be required to have a home in your original location, that is not rented out, before you will qualify for LAFHA, which is exempt income.

So what about calling the food and accommodation costs, travel costs instead? The first problem of course is you would have to be moving on pretty regularly. Further, these costs are only deductible to employees if they sleep away from home. So again you need to have a home base.

If your employer reimburses you for your "travel expenses" your employer will be subject to FBT on the payment unless the otherwise deductible rule applies (reference TR 97/17). For the otherwise deductible rule to apply all the requirements must be met to the extent that the employee would have been able to claim the expense in his or her tax return. So a home base is still required.

Overtime Meal Allowances

If your employer pays you an overtime meal allowance as part of the award or industrial agreement you work under, you can claim a deduction for your meal. Unlike the other allowances we have discussed, even if you have the receipts for your meals and worked overtime, you will not be entitled to claim a tax deduction for them unless you have received an allowance. It is not enough that as part of your wage negotiation you are paid more to take into account the fact you have to buy meals when you work overtime. This will not count to make those meals deductible. You must actually receive the individual allowance each time.

Once you qualify by receiving the allowance you can then claim much more than you received, provided you do spend more and you have a receipt for the expenditure. Note you can stop at a restaurant on your way home after working overtime and claim that meal.

If you haven't kept a receipt for the meals then you are only allowed to claim up to $27.10 (reference TD 2012.17) and then only if you actually did spend that amount or more. This is the rate for the 2012/2013 financial year, a new amount is issued by the ATO each year.

Note employers do not have to put the overtime meal allowance on your PAYG summary if they believe it has been fully expended, so you will need to record for yourself the amounts you receive. If you want to claim a tax deduction in excess of the allowance you will need to include the allowance in your tax return as income to make a corresponding deduction.

If you operate your own company or trust you will be an employee of the company or trust but you will only be entitled to pay yourself a meal allowance if your trust or company pays you in accordance with the relevant award or industrial agreement. This is sometimes difficult for business owners as they only tend to get paid when the business has money available.

For a discussion on meal allowances for employee truck drivers please refer to Newsflash 252.

A Bit of Housekeeping If You Lodge BASs Or Pay Your Tax By Instalments

The ATO will be sending out notices to people who did not have some of their 2011/12 income taxed at source. The ATO takes the 2011/12 income that was not taxed at source then increases it by 6%, works out

the tax you will pay on that at 2012/13 rates, assuming everything else will remain the same. This tax amount is then divided by 4. Each quarter you will receive an Income Activity Statement (IAS) from the ATO for one quarter of this amount. It is important to note that if you want to vary this amount for the full year you must do so on your first IAS for this financial year.

Generally, during the year if you find you have made an error in the previous BAS you will simply adjust for it in the next BAS. It is best not to do this over two financial years. If you find an error that dates before 30th June, 2012 do not amend it in this next BAS. Instead ring the ATO and ask for a Revised Activity Statement for the June BAS.

If you start to employ for the first time during the year, don't forget to notify the ATO of this. From that point your BAS will be different, it will have W boxes on it where you can show the wages you have paid and the amounts of tax you have withheld. You also need to make sure you have a workers compensation policy in place. If they earn more than $450 a month you may also need to make superannuation contributions for them. Before you pay any new employee, make sure they fill out an employment declaration form and that you send it to the ATO.

Maintaining a Home for LAFHA Purposes

The changes to the Living Away From Home Allowance came into effect at the beginning of this month and the tax office has updated their web site to define maintaining a home.

To qualify for the Living Away From Home Allowance concessions an employee must maintain a home in Australia that is immediately available for their use. So effectively the LAFHA is now more restrictive than being paid a travel allowance and employers should give consideration to paying a travel allowance instead.

The ATO web site requires the employee or their spouse to have an ownership interest in the home, this could be holding a lease over the property. It would not be sufficient for the employee's parents to be the ones with the ownership interest. The employee must incur the ongoing costs of maintaining the home such as mortgage or rental payments and be able to return to the home at anytime and live there immediately so it cannot be rented out or sublet while they are living away from it.

Stay tuned we will update you on any further advancements in this area.

Claiming Interest After Your Company Has Closed Down

In Economedes V FCT 2004 ATC 2353 the shareholders were allowed a tax deduction for interest they paid on a loan that the company used. Companies are separate entities from their owners so, ideally if the owners are going to borrow money from a bank for the company's use it is important that they formally on lend it to their company and the company pay them interest at the same or higher rate than they are paying the bank.

In Economedes case there was no formal on lending agreement but the AAT didn't consider that an obstacle. The company made the loan repayments initially but once the business ceased trading the owners took over the payments and wanted to claim a tax deduction for the interest.

The ATO among other things of course argued that the interest was not a cost of the owners earning income either now or in the past, so it was not personally tax deductible to them.

There are a few cases where the ATO has been successful in this argument but the difference here was that Mr and Mrs Economedes were the only shareholders in the company. So if the company had made a profit they were the only people that would be entitled to the dividend.

In Economedes' case the Administrative Appeals Tribunal ruled that the interest was tax deductible because it was incurred with the intention of earning income, namely receiving the profits of the company as dividends.

Note this case won't help you at all if your business is run through a discretionary trust.

For sole traders and partnerships there is no question that the interest is incurred in producing your income because there is no separate entity between you and the business. Further, sole traders and partners are entitled to continue to claim the interest on their business loans after the business has ceased. There is no limit to the period of time the claim for interest can continue as long as the loan is not artificially "kept on foot for other reasons" (reference TR 2004/4).

The precedent cases here are:

FC of T v Brown, 1999 ATC 4600 where partners borrowed to buy a delicatessen and the business was eventually sold at a loss. The sale proceeds were paid off the loan but not enough to cover the full amount owing.

FC of T v Jones, 2002 ATC 4135 In this case it was a husband and wife trucking partnership. When the husband died the truck and equipment were sold but the proceeds did not fully cover the loan. Mrs Jones alone continued to pay the interest and was entitled to a full tax deduction for it. She even refinanced at a lower interest rate without losing the nexus between the original earning of income and the current day deduction.

Economedes' case referred to both the Jones' and Brown's cases when considering whether the loan could continue to be deductible after the business had ceased. So for companies, partnerships and sole traders alike the following principles from the Jones and Brown cases are important to maintain the deductibility of a loan after the business ceases:

1) All the proceeds of the sale should be used to repay as much of the loan as possible.
2) Endeavor to appear to be unable to repay the loan from other assets other than the family home. This may mean as a couple if only one member owned the property sold at a loss the other member should hold any further investments.
3) Don't refinance the loan to extend its term or increase the interest rate. You must appear to be doing all that is possible to eliminate the loan. So refinancing to reduce the interest rate is ok. On the other hand if you have to change the loan from principle and interest to interest only because that is the only way you can afford the repayments you may be able to justify changing the loan.
4) If the loan is already fixed at the time the investment is sold, then you have an argument that you could not pay it out. This is a factor to consider if you are refinancing before the sale.

Small Business Plant and Equipment

Most readers will be aware that from 1st July, 2012 small businesses are entitled to an immediate tax deduction for any plant they buy, including cars that cost less than $6,500. A little know trick is that there are no grouping provisions in that $6,500.

Employees or rental property owners only get a $300 immediate write off threshold. This means that if an employee buy's a set of 20 spanners for $400 they are not entitled to the immediate write off because each spanner is part of a set. Similarly if the owner of a rental property replaces some curtains in their property they have to add all the individual curtains together for the $300 test because they are like items.

Small businesses are entitled to apply the $6,500 to individual items whether they are part of a set or identical to other items.

Further, if small businesses buy a car for $6,500 or more they get an immediate write off for $5,000, the balance being depreciated at 15% in the first year and 30% after that.

LAFHA – Maintaining A Home In Australia

Readers are no doubt aware that there have been major changes to the Living Away From Home Allowance concession. The two major concerns have been that the allowance can only be paid for a maximum of 12 months per place of relocation, the employee must still maintain their original home and it must be located in Australia.

Section 31C of the FBT act defines maintaining a home in Australia as follows:

The employee satisfies this section if:

(a) the place in Australia where the employee usually resides when in Australia:

(i) is a unit of accommodation in which the employee or the employee's spouse has an ownership interest (within the meaning of the *Income Tax Assessment Act 1997*); and

(ii) continues to be available for the employee's immediate use and enjoyment during the period that the duties of that employment require the employee to live away from it; and

(b) it is reasonable to expect that the employee will resume living at that place when that period ends.

The term ownership interest used above is the same as the CGT definition in section 118-130 and includes a right to occupy. This means that despite what you might initially assume by reading the section above, you can rent the home you maintain in Australia, you do not have to own it.

More information is available on the ATO web site at www.ato.gov.au/individuals/content.aspx?menuid=0&doc=/content/00333793.htm&page=5#P46_4178 This information includes the requirement that the home must be available for your immediate use and enjoyment at all times while you are living away from it and you expect to resume living at the home when you return. Note a home can include a hotel, guesthouse, bunkhouse, caravan or boat. An ownership interest will not

normally exist when you live in your parents' home. The website also states that you cannot rent out or sublet your home while you are away and you must pay the ongoing costs of maintaining the home ie rates, rent or mortgage. If you do have a boarder or tenant who would normally live with you anyway they can stay as long as their presence does not prevent you also occupying the home. You can utilise a house-sitter to look after your home while you are away but they must either vacate when you return or live in a way that does not impinge on the availability to you to also use the place as your home.

PAYG Instalments – Not So Simple

The ATO have recently begun calling small businesses to discuss PAYG instalments reported on quarterly activity statements. This unusually proactive approach from the ATO indicates that there are still a lot of errors being made in the arena of Pay As You Go (PAYG) tax.

PAYG is a system for paying instalments towards your expected tax liability. When you lodge your tax return for the year your actual liability is assessed and instalment amounts that you have paid are credited against your assessment to determine your final refund or tax bill.

As a general rule the ATO will place you in the PAYG system if you have reported $2k or more of gross business and/or investment income (excluding net capital gains) in your last tax return; your last assessment notice included tax payable of more than $500; your notional tax is more than $250; you are not entitled to the Senior Australian or Pensioner Tax Offset.

Most people are required to pay instalments on a quarterly basis and will receive an Instalment Activity Statement (IAS). On this statement you will have the option to pay either an instalment amount calculated by the ATO or your own instalment calculated by multiplying your instalment income by a rate provided by the ATO.

The calculation of instalment income is the area in which the majority of mistakes are made. Instalment income is generally your gross business and/or investment income, excluding GST. It includes gross sales and fees received for services, gross interest, gross rent received, unfranked and franked dividend amounts, foreign pensions and other foreign income, royalties and income from trusts and partnerships. It does not include wages, imputation credits or income that is not assessable. Nor does it include Capital Gains.

You are able to vary the instalment amount or rate but there are heavy penalties for getting it wrong so it is a good idea to seek professional advice before making any variation to your PAYG instalments and before making a decision as to which instalment option you will select.

Contributed by Lyn Gower, owner of our Tenterfield, Stanthorpe and Gold Coast offices.

Directors' Liability for Unpaid Super and PAYG

Directors of a company can very quickly become personally liable for any superannuation that the company has not paid or any amounts of PAYG that it has withheld from wages but not paid to the ATO.

If 3 months have lapsed since the PAYG was due to be paid to the ATO, the ATO can simply serve a penalty notice on the directors and make them personally liable.

In the case of the superannuation guarantee, these payments must be paid into a superannuation fund before the 28th day after the end of the relevant quarter. If they are not paid by that date then the company must lodge and pay the superannuation guarantee charge within another 28 days ie 56 days after the end of the quarter. If this is not done then the company directors are personally liable.

More On Personal Property Security Act

The Personal Property Security Act (PPSA) will affect most of our business clients, possibly in many ways but the two primary areas of concern are:

1) Protecting from your business' creditors the assets you use in your business, but for asset protection purposes hold in a different entity ie a holding trust.
2) Retaining title to goods you supply on account, until you have received payment.

You can pretty safely assume that if you have not reviewed your asset protection strategy since the introduction of the PPSA, early last year, that you no longer have the protection you thought you had. For our initial discussions on the PPSA refer Newsflash 250. Since then we have had difficulty finding a firm of solicitors that can provide our clients with a stream lined approach. Stephen Harvey from Redchip Lawyers

www.redchip.com.au is very much on top of this issue and has given us some advice on what clients need to do and the cost. Here is the minimum:

Protecting Assets You Use In Your Business But Hold In A Separate Entity – The separate entity that technically owns these assets will now need to create a formal lease agreement and register this agreement. Redchip can review your agreement and make recommendations for $495. It should cost a further $1,320 to draw up a lease agreement. If you currently have no agreement in place and fill out their questionnaire correctly you can skip the $495 and just pay the $1,320. It will also cost $150 to register your lease agreement.

Retaining Rights To Goods You Have Supplied – This will involve Redchip reviewing your terms of trade agreements to ensure they are suitable. They will do this and make recommendations for $495. It will then probably cost you a further $2,145 to have your trade agreement updated and $150 to register your agreement over each of your customers.

This is not your standard newsflash article of tips. This is a deadly serious must act now issue!

More Information On Living Away From Home Allowance

To qualify to receive the exempt fringe benefit Living Away From Home Allowance (LAFHA) you need to maintain a home other than where you are living for work. In the February FBT subcommittee minutes there seems to be a window of opportunity for people to claim that they maintain a home that they share with their parents. There are some conditions though, just paying board doesn't cut it but if there is a commercial rent agreement in place and an allocation of utility costs they may qualify. Best to apply for a ruling first.

Living Away From Home Allowance (LAFHA) 2013/2014

The ATO has released TD 2013/4 which sets out the ATO's latest reasonable amounts for food and drink for LAFHA. If the employer pays more than this amount then either the employee will have to produce receipts to justify that they have spent all of the food component of the allowance on food and drink or the employer will have to pay FBT on the amount of the LAFHA paid that exceeds the reasonable amounts listed in the ruling. Accommodation is just done on an actual cost basis which should be pretty straight forward for record keeping anyway.

The full transcript of the ruling can be found at http://law.ato.gov.au/atolaw/print.htm?DocID=TXD%2FTD20134%2FNAT%2FATO%2F00001&PiT=99991231235958&Life=20130227000001-99991231235959

Note the above does not apply to people receiving a LAFHA under the transitional provisions, that is people who already had their LAFH package in place before 8th May, 2012.

There have been changes along the way to this becoming law, so don't be alarmed if this sounds different to what you have heard. The final situation is that LAFHA will remain completely in the FBT regime. This means that any employer who pays a LAFHA that does not meet the new requirements, for example the employee does not maintain another residence, will be liable to pay FBT on the amount. For more details on the new requirements refer Newsflashes 261 and 264.

FBT is payable at the maximum tax rate so there is much to be gained by not calling the payment a LAFHA if it does not qualify for the exemption. In many cases the employee will be earning less than $180,000 per year so not be in the maximum tax bracket. Any other allowance will be taxed in the employee's hand. Nevertheless, an employee is not going to be allowed a deduction for food, drink and accommodation unless they are travelling for work. Travelling is generally where the employee is without his or her family and away from home for less than 3 weeks.

There is room for negotiations between employer and employee to bring down the tax liability when the arrangement doesn't qualify for the exemption. If for example the employee had already been in the location for 12 months (after 12 months in the one location the LAFHA exemption no longer applies) but an employer may need to continue to pay an allowance to prevent the employee moving on to another location and possibly another employer. If the employer offers $1,000 after FBT of 46.5% is paid that leaves only $535 to pay the employee. If instead the employee was paid an extra $1,000 in wages, say a site allowance, and the employee's income is over $80,000 but under $180,000 then their marginal rate of tax will only be 38.5% which leaves $615 in the employee's hand after tax.

At first this might not seem worth haggling over but when you consider rent and food for your whole family your LAFHA could easily be $900 a week so this adds up. Be careful when you do the numbers to negotiate that you gross up the amount. Here is a worked example:

For the employer to pay you $900 clear they would have to pay $782.26 in FBT ($900 x 1.8692 x.465) so your gross pay could increase by $1,682.26 ($900 + $782.26) and the employer would be in the same position. If you are still under $180,000 for the year and are not subject to the Medicare Levy surcharge then you will pay tax of $647.67 ($1,682.26 x 38.5%) netting you $1,034.59 An extra $134.59 a week after tax. If you live away from home for 3 years that is $20,996.

Make sure you also take full advantage of the FBT exemption for relocation where the employer can pay the costs associated with the move including temporary accommodation and meals, even reimbursing the employee's buying and selling costs.

LAFHA Meal Rates

TD 2013/4 contains the amounts that the ATO considers to be reasonable for the food component of a Living Away From Home Allowance (LAFHA), for the FBT year 1st April 2013 to 31st March 2014.

If the following amounts are paid to employees and their families living away from home but in Australia, then no FBT will be payable providing all the other requirements, discussed in recent editions of newsflash are met, such as maintaining another home elsewhere that is not rented out and that the LAFHA is only paid for the first 12 months at any location.

If more than the following amount is paid then FBT will be payable on the excess unless the employee provides the employer with receipts for food and drink expenditure up to the full amount paid. In other words even the amounts below will need to be covered by receipts, not just the excess.

	Per week
One adult	$233
Two adults	$350
Three adults	$467
One adult and one child	$292
Two adults and one child	$409
Two adults and two children	$468
Two adults and three children	$527
Three adults and one child	$526
Three adults and two children	$585
Four adults	$584

('Adults' for this purpose are persons who had attained the age of 12 years *before* the beginning of the FBT year).

For overseas rates, larger families and more detail please refer to TD 2013/4
http://law.ato.gov.au/atolaw/view.htm?docid=%22TXD%2FTD20134%2FNAT%2FATO%2F00001%22

Note it will be the employer that pays FBT if the amount is exceeded without receipts, not the employee. FBT is effectively a tax at the maximum tax rate so it maybe more cost effective to pay any excess simply as wages.

Selling Your Business – Going Concern GST Concession

The Going Concern GST concession allows a business to be sold without having to charge GST. This can also include the building the business operates from if it is sold with the business. This is very relevant when a building is involved because the price will be lower so the stamp duty will be less. Of course reduced stamp duty only benefits the purchaser, so let's look at the risks on each side of the contract.

Firstly, a brief explanation of the requirements of a going concern clause: both the buyer and seller must be registered for GST and agree that the contract is the GST exempt sale of a going concern. The seller must also provide the buyer with all things necessary to continue the business and the seller must continue to operate the business up until the time of sale. If all these requirements are met the seller does not have to remit 1/11 of the selling price and the buyer is not entitled to claim GST input tax credits on the purchase. Accordingly, the property should be sold for 1/11th less than the market price for sales of similar properties that are not subject to the going concern concession.

From the Seller's Point of View:

All is good if you can still get the market value for the property, you have nothing to lose. But a well-informed purchaser would expect to pay less than market value for a property under the going concern concessions for reasons elaborated on in the Purchaser's point of view below. Your biggest concern is that the ATO will come along and decide that the going concern concession did not apply to the contract, for example because you did not supply all things necessary to continue the business. This issue is addressed in GSTR 2002/5 which has just recently been updated. Don't underestimate the ATO here; they even consider that key staff members need to agree to work for the purchaser. If the ATO considers that the sale does not qualify for the going concern concessions it can ask for $1/11^{th}$ of the sale price in GST, which is totally unfair if you have sold for below market value because of the going concern clause. Solicitors will generally try to protect you from this outcome by putting a clause in the contract requiring the purchaser to pay you the GST if the ATO decide that the going concern concession does not apply. The problem may then be finding the purchaser and, if you do, then going through the court process of making them pay up.

From the Purchaser's Point of View:

The purchaser is considered to have received a GST input credit on the purchase even though no money changes hands. This means that should you change the use of the building to residential, de register for GST or just stop using it to make supplies that are subject to GST, section 135 requires you to pay back to the ATO the notional GST on the purchase. This of course is unfair if you have already paid full market value for the property, it could be as much as $1/10^{th}$ of the purchase price.

If the ATO come along and deny the going concern concession to the sale then the purchaser, if they can obtain a taxed invoice, may be entitled to an input credit for the amount of GST the seller has to pay. This is quite a bonus if the contract doesn't have a protection clause stating that the purchaser has to pay the GST amount to the seller should the ATO deny the going concern concession.

The Margin Scheme:

A seller can reduce the amount of GST they pay out of the sale proceeds of a property by making the contract subject to the margin scheme. The catch here is you can't apply the margin scheme to sales that are exempt under the going concern concession and the purchaser must agree to the use of the margin scheme before settlement. So choosing to use the going concern concession instead of the margin scheme may completely eliminate the GST rather just a portion of it under the margin scheme but if the ATO decides that it didn't qualify as a going concern then you are left with full GST rather than the reduction under the margin scheme. You can apply to the ATO for an extension of time to apply the margin scheme after the contract is completed but the purchaser has to agree. In the event of the going concern concessions being denied the purchaser is unlikely to agree to the margin scheme because this means they are not entitled to any GST input credits, something that they would qualify for if the ATO deny the going concern concession.

The Fine Print:

Quite often the business and its premises are owned by different entities (within the same family group) for asset protection purposes. To qualify for the going concern concession the building has to be part of a going concern. This means it is either sold with the owners established business or it is leased out and the going concern business is considered to be the business of leasing out the building.

Getting back to the situation where the building houses the business, it is ok to sell say the business from your trading trust and the building from your holding trust and bridge the going concern concessions but only if both are sold to the same purchaser. This means that the purchaser cannot have the asset protection advantage of owning the building in a different legal entity than the business. The purchaser needs to consider whether this is really worth the risk just to save some stamp duty.

2013 Budget Update

Data Matching – Funds in the budget have been allocated to increasing the data matching that the ATO collects, to include, government grants, sales of property, shares and units in managed funds. They will also have access to data on sales through merchant services i.e. Managed investment fund distributions, partnership distributions, company dividends and interest payments.

Trusts – The ATO has received extra funding to attack trusts used to "conceal income, mischaracterise transactions, artificially reduce trust income amounts and under pay tax". Further work will be done on reconciling taxable trust income to ordinary trust income, hopefully giving a bit more clarity. One thing is for

sure Hybrid Trusts will be under even more scrutiny with threats being made to prosecute promoters of such arrangements.

2017 Budget Update for Small Businesses

Plant and Equipment - The most exciting news is that the $20,000 immediate write off for plant and equipment will continue until 30th June 2018. The equipment must be installed and ready for use in the year you claim it. If you have a turnover of under $2 million then you qualify. It is proposed that the turnover threshold will be increased to $10 million. If this passes the senate it will apply to the 2016-2017 financial year and of course to the 2017-2018 financial year. As usual we go into the lead up to the 30th June without certainty as to who will qualify for the write off. Accordingly, when it comes to businesses with a turnover above $10million, only people who can afford to do so without the tax deduction will buy plant and equipment anyway so it does not provide the incentive that it was intended to create.

Please note that once you have bought plant and equipment under $20,000 and written it off your responsibility does not finish there. Each year for the next 3 years you have to review whether the ratio of business and private use has remained the same. If it varies by more than 10% you have to make an adjustment to the amount you have written off.

If your low value pool balance has reached less than $20,000 you can write it off if you qualify as a small business.

New Small Business Definitions - The definition of small business varies depending on what tax concession you are after. The small business page on our web site has all these thresholds in one place so you can check which applies to you. It is down the bottom of this page http://www.bantacs.com.au/topics/small-business/ One thing is for sure, if your turnover is under $2 million you qualify for all the small business concessions. If your turnover is less than $10 million and you operate as a company you will be entitled to a tax rate of 27.5% on the company profits starting from the 2017 financial year. For businesses that are not incorporated refer the section on Individual Taxpayers.

Cleaners and Couriers – For the 2017 – 2018 year, cleaners and couriers will be included in the reportable payments regime. If it is anything like the construction industry the definition will be very wide so expect it to apply to you if you are in a business that is in anyway associated with courier or cleaning services. You will not have to complete the form until 28th August 2018 but it will need to cover the period starting 1st July 2017. The form requires you to include the GST inclusive amount you have paid but normal record keeping may not easily provide you with this amount. For tax purposes you are only interested in the net of GST amount if you are registered for GST. It is important that you are aware of your responsibilities so you can keep the right information from the start. Also make sure you get full details of the person you are paying, right from the start as they may not be around next year. Here is a sample of the form you will be required to complete so you can see the information you need to keep
https://www.ato.gov.au/uploadedFiles/Content/MEI/downloads/BUS00321342n74109.pdf

Individual Taxpayers - If you have small business income (sole trader, trust or partnership) that is not from a company and the turnover is less than $5million then you are entitled to an 8% tax offset on that income when it appears in your personal tax return, up to a maximum of $1,000. The government is boasting how in 2025 this will increase to 10% then 13% then 16% by 2027 but the turnover threshold does not increase and the $1,000 cap does not increase so the increase in the offset percentage is really just smoke and mirrors.

Ask BAN TACS

For $79.95 at Ask BAN TACS, www.bantacs.com.au/ask-bantacs.php, you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion. There is also a notice board where some askbantac users have generously allowed their question and answer to be published. Lots of good real life information.

More Information

Please make sure you continue to keep your knowledge up to date by subscribe to our Newsflash reminder. There are many other booklets available on our web site http://www.bantacs.com.au/booklets.php in fact the whole web site is full of useful information so also have a look around under topics.

How to Make Sure Your Next Property Is a Good Investment

- Do you really know how much the property is going to cost you to hold?
- What name should the property be purchased in?
- Will this property fit your investment strategy and goals?
- What does the contract say about GST?
- How does the price compare with similar sales in the area?
- If it is negatively geared, how much capital growth is required before you breakeven?
- Do you know what records you need to keep and how?
- Are your financing arrangements maximising your tax deductions?
- What happens if interest rates rise?

.....and the list goes on!
To ensure you don't make a costly mistake with your next purchase make sure you see a BAN TACS Accountant before you sign