Year End Strategies

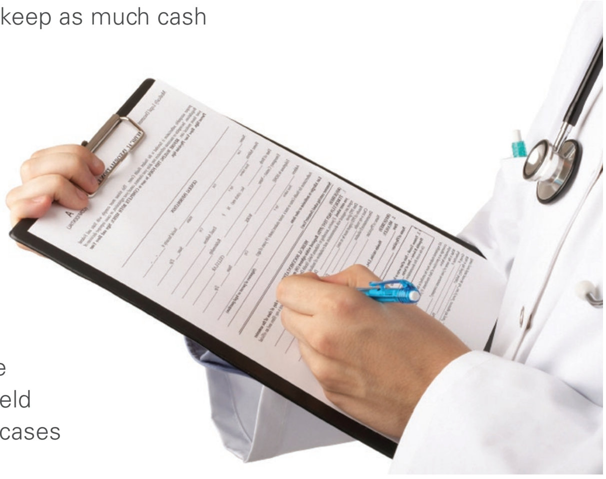
The 2009/2010 Tax Guide for You and Your Business

Year Round PLANNING

Get a year end tax health check

The end of the tax or business accounting year is a key time to focus on tax and financial planning.

Unlike birthdays, no one likes a surprise around tax time, particularly with the economy still on the mend and many still vulnerable after a difficult year. Now is the time to act and undertake a year end tax health check. It will help determine what action may need to be taken to minimise tax, reduce risk and keep as much cash as possible for the year ahead.



While opinions vary about the likely rate of the economic recovery from the recession, by preparing and updating a forecast of income and outgoings, businesses can identify times when money may be short and plan accordingly.

Many of the ideas outlined in this guide should be reviewed regularly and not held over until the end of the year. In some cases timing is critical so do not delay.

Tax arrangement deadline

Last year ATO announced measures to help small businesses struggling to manage their tax debts in the difficult economic climate. The deadline to apply for these measures is fast approaching.

Businesses with an annual turnover of less than $2 million with an activity statement debt can apply to the ATO for a General Interest charge (GIC) -free payment arrangement until 30 June 2010.

The ATO recognises the current financial pressures on small businesses. As a result, it does not want the GIC to impact a business and its ability to meet its tax and superannuation obligations and ultimately lead to the insolvency of that business.

For these businesses, payment arrangements (activity statement and income tax) negotiated from 1 June 2009 until 30 June 2010, will have GIC remitted in full for the period the payment arrangement is maintained (up to a maximum of 12 months).

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The end is near – tax year end that is!

In tax, timing is everything. With the end of the year rapidly approaching it is time for businesses to tidy up loose ends before the new tax year begins.

Here are a few things that business owners may need to consider and act on before the end of the year.

1 .Write off bad debts

In order to claim a deduction for bad debts, the amount must be written off from the accounts receivable ledger before year end. To qualify as a bad debt, there must be no reasonable likelihood that the debt will be recovered. If, after writing off the bad debt, it is recovered, the amount must be treated as taxable income in the year it is received.

2. Prepaid expenses

Some expenses can be prepaid, written off for financial reporting purposes and claimed as a deduction only when paid. Other expenses, however, can be prepaid and at the same time claimed as a tax deduction (e.g. stationery, magazine subscriptions, rates).

3. Review private use of company assets and loans

The Government has recently introduced legislation expanding the effect of section 7A of the Income Tax Act. Existing rules apply to private loans and have the effect of loans being treated as income to individuals. New rules relate to the private use of company assets by individuals. The change means assets owned by a company, available for use and under the control of an individual may create a benefit which will be deemed as a payment to an individual in much the same way as a private loan.

4. Pay employees superannuation by 30 June

Ensure that superannuation entitlements for employees are paid by 30 June 2010 in order to be tax deductable.

5. Value your trading stock

Businesses that have trading stock will need to value any stock on hand at year end. Most businesses would generally use the cost of the goods. However, if the market value of the stock on hand is lower than cost of the goods, businesses may be able to use that value instead. The value of closing stock does not include GST for businesses registered for GST.

6. Dispose of non-performing investments

Dispose of any non-performing investments to take advantage of the capital loss. Use these funds to reinvest in more worthwhile areas. Losses can be offset against other capital gains, but taxpayers need to be mindful of the ATO's warning against 'wash sales' where the asset is reacquired within a short period of time, solely to realise a capital gain.

7. Transfer business premises to super

A small business owning premises through another structure could consider the transfer of their premises to a SMSF. This may provide opportunities for the fund to borrow in order to acquire the premises and take advantage of Capital Gain Tax (CGT) concessions. The transfer could split between a contribution, borrowing and straight purchase.

SMSFs remain on tax office radar

The ATO remains concerned about the operation of Self-Managed Super Funds (SMSFs). With over 400,000 SMSFs controlling around $375 billion in assets there is good reason for the ATO to continue its vigilance.

While most trustees and professionals involved with SMSFs are following the rules by carefully managing their funds and lodging returns on time, there are still some problem areas.

Related party loans. The ATO is concerned that nearly 20 percent of all identified contraventions relate to breaching the prohibition on SMSFs providing financial assistance to a member or relative. These loans are often used to subsidise other business operations.

This can be a very tempting source of funds for a cash-strapped business, after the recent economic down fall, the warning is clear that this breach of the law will not be tolerated.

Lodging compliance. Despite the recent improvement in timely lodgement rates for SMSFs, there remains a significant number of funds that have a poor lodgement compliance record.

Self-managed funds that fail to meet their lodgement obligations can also be prosecuted or made non-complying, in which case they can lose their concessional tax status. In a recent case, the corporate trustee of a SMSF was prosecuted for not complying with court orders to lodge two outstanding income tax returns.

Excess contributions tax. Many taxpayers continue to exceed their super contributions caps resulting in serious tax consequences. Excess contributions tax is a penalty tax that applies to individuals exceeding the concessional contributions cap or the non-concessional contributions cap.

The penalty tax is imposed on the individual, although the tax can be deducted from the individual's super account. Exceeding the caps can be costly. The amount by which the contributions exceed the relevant cap is taxed at an effective tax rate of 46.5 percent.

The concessional contributions cap is $25,000 per financial year (indexed). For those over the age of 50 a transitional concessional contributions cap of $50,000 pa applies until the end of 2012.

Some individuals are at greater risk of being caught by excess contributions for 2009-10. These include individuals:

1. with pre-existing salary sacrifice arrangements that have not been reviewed and lowered, particularly those aged under 50 whose cap is now $25,000 pa
2. who make or receive some of the less common types of contributions, including members of defined benefit funds with notional taxed contributions
3. who contribute to super and do not keep track of their contributions.

The ATO has taken steps to help prevent inadvertent breaches following the reduction of the concessional contribution caps from 2009-10 by writing to taxpayers it has identified as being at risk.

Illegal early release of Super. Last year the ATO issued a Tax Alert warning against schemes promoting the illegal early release of superannuation benefits. To protect against these schemes new SMSFs will not be registered until the ATO is satisfied that they are legitimate.

This pre-emptive risk assessment work by the ATO for new SMSFs will add several working days to the registration process, but the ATO expects that the vast bulk of new registrations will still occur within five working days. Any small business looking to set up a self-managed fund should keep this in mind.

Verifying rollovers to new SMSFs. New SMSFs that are yet to lodge their first return will now be given a new status of "registered - status not determined" on the ATO's register. This move is intended to highlight to APRA-regulated funds (those with funds with fewer than five members) to take additional care when processing rollovers to these SMSFs.

The ATO has also developed, in conjunction with the industry, additional guidance about the steps large funds can take when processing rollovers to these new SMSFs. These steps include:

- determining if a SMSF trust deed exists;
- establishing if an investment strategy has been created; and
- obtaining documentation in regards to the establishment of a bank account.

Home is where the tax deduction is

Many people who received termination payments last year used the fund to start home-based businesses. Now, they are facing the first year of having to claim tax deductions for their home offices.

With so many businesses now being run from home, the ATO is eager to ensure that those claiming tax deductions do so correctly.

UNDERSTAND THE RULES

A home-based business is one that falls in one of two categories. A business may be run *at* home (such as a hairdresser) where all the work is done there, with clients coming to their home. A business may also be run *from* home. In this situation the business does most of its work on clients' premises and does not have any other premises of its own. Tradesmen, for example, work from home.

The responsibility for keeping invoices and records for a home office is the same as that for any other business expenses you are claiming. Invoices for these expenses must be retained.

Occupancy expenses

Business owners that are conducting their business at home may be entitled to claim a portion of their rates, house insurance and mortgage interest for income tax purposes.

The amount of these deductions is generally based upon the percentage of the home area that is used for business purposes, but there are some special circumstances.

Interest costs can generally be deducted for income tax purposes where the interest costs are directly attributed to a place of business. Whilst this may depend on particular circumstances, specific indicators include that the place is clearly identifiable as a place of business; it is unsuitable for private purposes; it is used exclusively or almost exclusively as a place of business and is used regularly by clients.

Taxpayers who satisfy the interest deductibility test may have to pay capital gains tax on part of any capital gain that is made when the house is sold.

Running expenses

Running expenses are the increased costs of running facilities within a home as a result of running a business. These expenses include electricity, cooling, telephone and cleaning costs. Taxpayers may claim the additional expenses incurred from running a business from home, however the method to work out these additional expenses must be able to prove that the claim is reasonable and not of a personal or private nature.

Business owners of home based businesses may claim depreciation for the decline in value of depreciating assets. These include items such as computers, photocopiers, furnishings and tools. Assets used for both business and personal activities must have the deduction reduced for non-business purposes.

SMSF reserves - old wine in new bottles

Reserves have been a tool by superannuation funds for a long time. They have been used by trustees to self insure, normalise investment returns, and pay temporary or permanent incapacity payments to members.

Self managed superannuation funds have also historically taken advantage of reserves to manage Reasonable Benefits Limits (RBLs). The traditional use of reserves have become redundant with the end of RBLs. However, the introduction of Simpler Super in July 2007 created some new opportunities that are within the realm of SMSFs.

A reserve in a SMSF is essentially an amount or asset in the fund to which no member is presently entitled. Simply put, superannuation laws allow a trustee to establish one or more reserve accounts for the fund. A reserve account is where the trustee subject to the terms of the trust deed, sets aside surplus assets of the fund into an account which is not directly for the benefit of a member. When a specific event takes place, the trustee may allocate from the reserve to a member account.

Generally, reserves are for a particular purpose. Provided that the trust deed allows, under the Simpler Super laws, reserves can be created for the purposes of:

- guaranteeing an agreed rate of return on a pension
- paying a bonus or additional payment to a dependant of a deceased member or the deceased member's legal estate
- creating other reserve accounts or making member superannuation benefit payments
- self insuring to fund temporary and permanent incapacity payments to members and death benefit payments to dependants and/or the legal estate of deceased members.
- funding general and specific expenses of the fund
- lending to members and related parties, acquiring artwork, and any other activity that would be classified as an in-house asset and allows the trustee to monitor the 5 percent threshold.
- short term warehousing of contributions for a term no greater than 28 days

SMSF reserves can be used for a wide range of purposes, some of which can be very tax effective, increasing the capital value of a SMSF. Before implementing any reserve strategy, the trust deed must be updated to allow the creation of reserves, provide for specific reserve types and provide a means for the allocation of reserves.

Year End Tips For Property Owners

✓ **Be prepared to Substantiate Your Claim**
Make sure you keep receipts to prove your deduction and show why the expense was incurred to derive assessable income.

✓ **Carry out inspections**
Carry out property and pest inspections and ensure any work required is carried out before June 2010.

✓ **Prepare a depreciation schedule**
Having a depreciation schedule prepared by a qualified quantity surveyor may help to add a significant tax deduction for depreciation. The cost is also tax deductible and helps substantiate any capital allowance claim you may have.

✓ **Pre-pay Interest**
If allowed by your lender, this is a strategy to defer the payment of tax. Factors such as anticipated future income, interest rates and cash flow impact should be considered fully beforehand.

✓ **Increased CGT Monitoring**
The ATO is has recently ramped up data matching to help identify undisclosed capital gains, including gains from disposing of assets to invest in superannuation. Ensure any capital gains on the sale of property are correctly recorded.

✓ **Borrowing Cost**
Borrowing costs may be written off over the lesser of five years or the term of the loan.

✓ **Fixtures and fitting**
Purchase fixtures and fittings that cost less than $300 to claim an immediate tax reduction.

✓ **SMSF borrowing to buy property**
SMSFs are able to borrow to invest, creating opportunities to acquire assets and increase fund investments. There are strict rules that need to be considered before making any purchase using this strategy.

✓ **Renovations By Previous Owner**
You may be eligible for a deduction for depreciation on the cost of improvement by a previous owner, provided items are identifiable and itemised in a depreciation schedule.

We Are Here To Help

This guide is merely a starting point, designed to help you identify areas that might have a significant impact on your tax planning.

Please keep us informed of your plans and consult us early for help in taking advantage of tax-saving opportunities and tax effective investments.

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