MY TAX SAVERS

MyTaxSavers

MAY/JUNE 2017

30 JUNE TAX SAVERS

ATO DEBT ALERT

LATEST TAX DEVELOPMENTS

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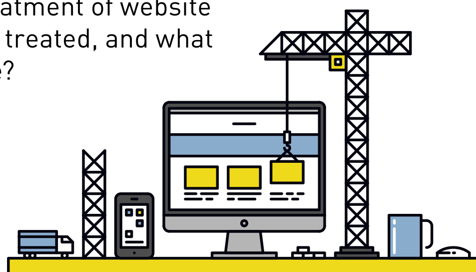

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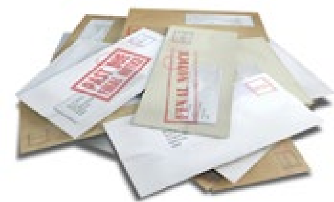

ATO DEBT ALERT
From 1 July ATO is severely cracking down on businesses with large debts owed. We detail the action you may need to take before this date.

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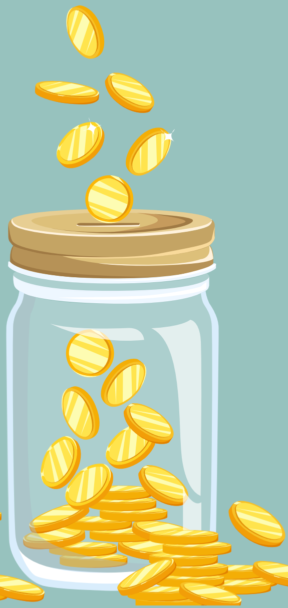
With the end of the financial year looming, this article provides you with tips on how to optimize your 2016/2017 tax position by 30 June.



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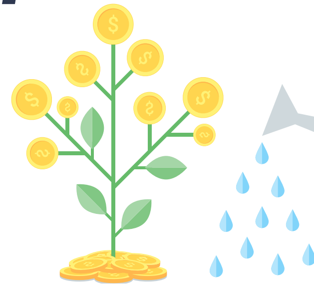

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Many businesses operate through a discretionary trust with a bucket company as beneficiary. This article examines the advantages of this, and various scenarios when distributing income to that company.

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IS THINKING

In this edition we examine the latest ATO Alerts – in relation to diverting personal services income and re-characterising trading income – and examine the tax treatment of ride-sourcing in light of a recent Federal Court ruling.

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GENERAL ADVICE WARNING: The information contained in this publication is general information only. Any advice, if any, is general advice only. Your objectives, financial situation or needs have not been taken into consideration. You should consider if this information is suitable for your needs and seek the advice of relevant taxation, superannuation and/or other relevant advisers before any financial product information is acted on.

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KEY DATES
FOR BUSINESS

Many lodgement and payment deadlines are looming for business including those relating to Activity Statements, superannuation, and more.

MAY 2017

21 MAY
April 2017 monthly Activity Statements – due for lodgement and payment

21 MAY
2017 FBT Annual Return – due for payment

26 MAY
3rd Quarter 2017 Activity Statements – due for lodgement and payment (for those lodging via Electronic Commerce Interface (ECI), Electronic Lodgement Service (ELS), Tax Agent Portal, BAS Agent Portal, or Standard Business Reporting (SBR))

28 MAY
Due date for lodgement and payment of the Superannuation Guarantee Charge Statement if you failed to pay Superannuation Guarantee on time for the January-March quarter. Superannuation Guarantee Charge is not deductible

JUNE 2017

21 JUNE
May 2017 monthly Activity Statements - due for lodgement and payment

30 JUNE
Superannuation Guarantee payments must be received by Superannuation funds by this date in order to be deducted in 2016/2017

*Where one of these dates falls on a weekend or a public holiday, the due date is extended to the next business day.

CORRECTION:

In the March/April edition of the tax journal, an article relating to the impact of concessional contribution caps on page 9 contained an incorrect figure in the worked example.

The impact on employees who salary sacrifice superannuation will result in an ability to salary sacrifice $17,400 under the reduced caps instead of the published figure of $12,400.

We apologise for this error.

R&D ALERT

The ATO has recently issued several Taxpayer Alerts in relation to the claiming of the Research and Development (R&D) Tax Incentive. This article details the ATO's concerns and helps you to get your claims right.

BACKGROUND

The R&D Tax Incentive is the Government's principle way of encouraging companies to undertake research and development investment in Australia. The program provides tax offsets for eligible entities (essentially Australian companies and foreign companies with an Australian permanent establishment) that spend $20,000 or more per annum on experimental R&D activities subject to strict conditions. If your company is eligible, the program can be quite lucrative as follows:

- 43.5% refundable tax offset for eligible companies with an aggregated turnover of less than $20 million per year – unless they are controlled by tax exempt entities. The 43.5% incentive is a refundable tax offset, which means that if a company makes a loss for the year and has no taxable payable, the entirety of its offset will be refunded as will any PAYG instalments that have been paid. On the other hand, if the company is in a profit position, the benefit will be in the form of a reduction in tax liability, and any unused offset amount will be refunded. If you have paid PAYG instalments during the year, these will be taken into account.
- 38.5% non-refundable offset for all other eligible companies (with a turnover of $20 million or more). This assists to reduce a company's tax liability. Where the tax liability is reduced to zero, any excess offset may be carried forward to reduce tax liabilities in future years. The excess offset won't be refunded.

The R&D Tax Incentive is proving very popular amongst companies. The 2016 Federal Budget papers forecast that it would cost the Budget $2.9 billion in 2015/2016 and 2016/2017, eventually rising to $3.9 billion in 2019/2020.

DEADLINE APPROACHING

To claim the R&D Tax Incentive you must first register an application with AusIndustry setting out your R&D activities. The registration has to be done every year over the life of the project, not just the first year. For activities conducted in 2015/2016, the deadline is 1 May 2017, i.e. it must be within 10 months of the end of your company's income year. Ensure you or your Accountant attend to this over the coming weeks if you are making a claim in respect of a 30 June year end .

ATO CONCERNS

On 9 February 2017, the ATO in conjunction with the Department of Industry, Innovation and Science has released four Taxpayer Alerts in respect to claiming the Incentive. Taxpayer Alerts are the ATO's "early warning system" designed to alert taxpayers and their advisors to significant new and emerging higher risk arrangements that the ATO considers may give rise to the risk of revenue loss on their part. Their stated objective is to "put people on notice that the ATO may disagree with claimed tax benefits".

The main Alert was ***TA 2017/3 – Claiming the Research and Development Tax Incentive for Ordinary Business Activities***. According to the Alert, the ATO and AusIndustry are reviewing arrangements that exhibit some or all of the following characteristics:

- A company registers one or more activities for the R&D Tax Incentive.
- In the R&D application from the Company, some or all of the activities registered are broadly described and non-specific. For example, projects may be registered instead of the specific activities undertaken.
- Some or all of the activities registered are ordinary business activities that are not eligible for the R&D Tax Incentive.
- Some or all of the activities were undertaken in the course of the company's ordinary business activities and re-characterised as R&D activities at a later time.
- The company claims the R&D Tax Incentive for expenditure that is not an eligible R&D activity.

ACTIVITIES

Picking up on these points…to qualify as an eligible "R&D activity" the activities themselves must have a knowledge-generating purpose – conducted for the purpose of generating new knowledge or improved materials, products, devices, processes or services. Moreover, the activities must involve the application of the scientific method; that is, proving or disproving a hypothesis through experiments. They must also be activities whose outcome cannot be known or determined in advance but must be determined using scientific methods and principles that proceed from **hypothesis to experiment to observation and evaluation to conclusion (the scientific method)**. Therefore, a process of trial and error will not qualify.

GOING FORWARD

The ATO and AusIndustry are working together to alert taxpayers and their Accountants to practices that may result in an increased risk of claiming the R&D Incentive incorrectly, particularly around ineligible activities.

With your advisor, you should take into account the ATO's above concerns when lodging any future R&D claims. If you have lodged claims where the above concerns are relevant, then the ATO advises that you should either phone them on **13 28 66**; or apply to AusIndustry to amend or withdraw your registration; or make a voluntary disclosure to the ATO; or amend your tax return.

SECURE YOUR Di$count

With the Capital Gains Tax (CGT) discount in the news again, this article examines this major tax concession – its availability, its effect, and possible changes.

BASICS

The CGT discount was introduced on 21 September 1999. It provides a discount of up to 50% for eligible entities that hold CGT assets for at least 12 months. It is one of the most significant and generous features of the CGT regime. As such, it is important to have a working knowledge of the main aspects surrounding this discount.

ELIGIBILITY

Only the following taxpayers are eligible for the discount:

- Individuals (50%)
- Complying superannuation funds (33%)
- Trusts – including non-complying superannuation funds and public trading trusts (50%)
- Life insurance companies in relation to capital gains from a Pooled Superannuation Trust asset (33%).

Therefore, on taxable capital gains the maximum effective tax rate payable for superannuation funds is 10% (the normal concessional tax rate of 15% is reduced by 1/3rd). On the other hand, for both individuals and trustees, the discount halves your capital gain (50%) and therefore even if you are on the top marginal rate of tax (currently 47%) the maximum tax rate you will pay on the capital gain if you are an individual is 23.5%.

The notable exclusion here are companies. They are not eligible for the discount however they may be eligible for the CGT Small Business Concessions.

INDEXATION OPTION

If the CGT event (e.g. sale) occurs after 21 September 1999 in relation to a CGT asset that was acquired before that date, you have the option of using the discount to reduce any capital gain or using the indexation method to reduce the assessable capital gain. The indexation method allows you to increase your cost base by applying an indexation factor (based on the Consumer Price Index (CPI)) up to September 1999. In terms of the calculation, this method involves applying the relevant indexation factor (which depends on the quarter in which you purchased the asset) then subtracting the indexed cost base from the capital proceeds. Although the discount method will generally result in the better tax outcome, it is still worth you and your advisor being mindful of the indexation option if the CGT asset was acquired before 21 September 1999.

HOLDING PERIOD

The 12 months is measured from the day that you sign the contract to acquire and then dispose of the asset (not the date of settlement). Where there is no contract, the 12 months is measured from when the change of ownership occurs. The ATO consider in *Tax Determination TD 2002/10* that a clear 12 months must exist between the acquisition of the CGT asset and the happening of the CGT event. For example, if an asset is acquired on 2 February then for the 12 month, 50% discount to apply it must be sold on or after the 3 February in the following year:

"In essence the CGT discount or cost base indexation are available if the CGT event happens on the day following the anniversary date of the acquisition of the asset".

This 12-month timeframe is a "black and white" requirement – if you are even one day short, the discount will be zero.

TAX TIP

Given the generosity of this concession (reducing your capital gain by up to 50%) if you are contemplating selling a CGT asset you may wish to consider if possible delaying the sale until this 12-month mark is met. Bear in mind the sale date is the contract date or change in ownership and not settlement date!

EXCLUSIONS

Contrary to popular belief, the discount does not apply to all CGT events. Namely, it does not apply to the following:

- CGT event D1 (creating contractual or other rights);
- CGT event D2 (granting an option);
- CGT event D3 (granting a right to income from mining);
- CGT event E9 (creating a trust over future property);
- CGT event F1 (granting a lease);
- CGT event F2 (granting a long term lease);
- CGT event F5 (lessor receives payment for changing lease);
- CGT event H2 (receipt for event relating to a CGT asset);
- CGT event J2 (change in status of a replacement asset);
- CGT event J5 (failure to acquire a replacement asset);
- CGT event J6 (failure to incur sufficient expenditure on replacement asset); and
- CGT event K10 (certain short term forex realisation events).

Perhaps the most notable of these exclusions is J5 and J6. That is, where you invoke the replacement asset rollover (which is one of the CGT Small Business Concessions) and fail to either obtain the replacement asset or incur sufficient expenditure on such an asset, you are then barred from reducing any resulting capital gain using the 50% discount.

INTERACTION WITH OTHER CONCESSIONS

In terms of the interaction with the other CGT concessions, the CGT discount should be applied in the following order:

1. If you are a Small Business Entity (SBE) apply the 15-Year Exemption. If you are not eligible, proceed to Step 2
2. Offset any capital losses for the year and any prior year unused capital losses against your capital gains for the year
3. Determine whether you are eligible for the 50% CGT discount for holding an asset for 12 months (not available for companies)
4. If you are a SBE apply the Active Asset exemption and then the other CGT Small Business Concessions

CASE STUDY

The following case study illustrates the effectiveness of the CGT discount:

EXAMPLE

Jerry is a University teacher who for 2016/2017 earned $110,000. During the year he sold his rental property that he owned for 13 months and made a gross capital gain (before any discounts or concessions) of $70,000. Earlier in the year he made a capital loss of $10,000 on the sale of shares.

Jerry's net capital gain will be calculated and taxed as follows:
$70,000 Gross Capital Gain – $10,000 Capital loss = $60,000
$60,000 x 50% = $30,000 (Net capital gain)

As Jerry is not carrying on a business (generally, renting a single or even 2 or 3 rental properties will not constitute the carrying on of a business) he will not be eligible for the CGT Small Business Concessions. The $30,000 net capital gain will be added to the rest of his income (salary of $110,000) and taxed at individual marginal tax rates. The total tax payable not including Medicare levy is $39,432 with the tax on the capital gain $11,100.

On the other hand, if Jerry was not eligible for the CGT discount (for example, he sold earlier in the year after only owning the property for 11 months) then Jerry's overall tax would be $50,532, with tax on the capital gain $22,200. All told, the 50% discount has saved Jerry $11,100 in tax.

CHANGES?

In the lead up to the Federal Budget it is being speculated that the CGT discount will be reduced, possibly from 50% to 40%. This would be the first change to the discount since it was introduced in 1999. The proposed reduction to 40% picks up on a recommendation contained in a review of the tax system for the Rudd Government by Ken Henry way back in 2010.

Even if this proposal eventually becomes law, the CGT discount will still represent a significant concession available to most taxpayers other than companies. Returning to the earlier example, if the rate was reduced to 40%:

- Jerry's net capital gain would be $36,000 (instead of $30,000)
- The tax payable on the gain would be $13,320 (up from $11,100, but still significantly less then the $22,200 if no discount applied).

FLOW THROUGH OF TRUST'S GENERAL DISCOUNT

Where a Trust has used the 50% discount and distributes the reduced capital gain to a beneficiary which is eligible for the discount (e.g. an individual), that beneficiary must gross up the capital gain by the amount of the discount. Then the general discount that that beneficiary is entitled to (e.g. 33% for a superannuation fund, or 50% for an individual) will apply to the beneficiary after they have applied their capital losses if any. This ensures that the discount is not only applied to the net capital gain, but also that beneficiaries apply the correct discount percentage depending on their type.

For example, if a trust distributed a reduced net capital gain of $600 to a company beneficiary, the company would be required to gross the gain back up by 50% to $1,200. It would then apply its own percentage entitlement which in the case of a company is zero. Therefore, it would be assessed on the gross capital gain of $1,200. If that same capital gain was distributed to a superannuation fund, it would again be grossed up to $1,200, and then (assuming no capital loss) reduced to $792 (reflecting the superannuation discount rate of 33%).

NON-RESIDENTS

On 29 June 2013, legislation passed Federal Parliament amending the law to make non-residents (including foreign residents and temporary residents) ineligible for the 50% general CGT discount. This law is backdated to apply to that part of a capital gain that accrued after 7:30pm on 8 May 2012.

By way of background, non-residents are only liable for CGT on "Taxable Australian Property". Taxable Australian property includes:

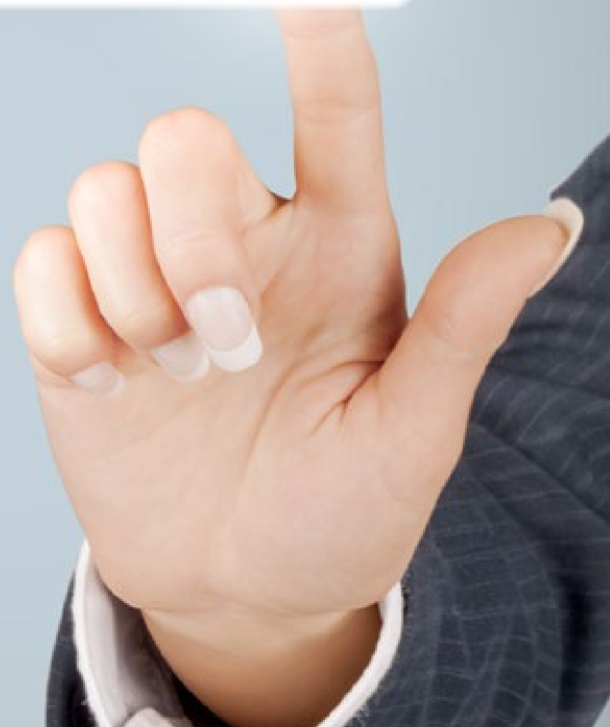
- A direct interest in real property in Australia
- An indirect interest in Australian real property – you and your associates hold 10% or more of an entity including a foreign entity, and the value of your interest is principally attributable to Australian real property,
- A CGT asset that you have used at any time in carrying on a business through a permanent establishment in Australia.

Additionally, where a gain sourced in Australia is distributed from a discretionary trust, a non-resident will be assessable on the gain even if the asset from which the gain arose was not taxable Australian property.

The operation of the new legislation depends upon when the non-resident acquired their CGT asset. If you:

- Had a period of non-residency after 8 May 2012 but owned a CGT asset before this date and sold it after this date, or
- Acquired a CGT asset after this date and also had a period of non-residency and residency after this date.

...you are entitled to a reduced discount.



Commercial Website EXPENDITURE

The ATO has recently finalised its position on the tax treatment of website expenditure. For the many businesses that have websites, which expenses are immediately deductible, and which can only be claimed over a number of years?

BACKGROUND

In the commercial world, websites are now considered an essential tool by many business owners. Modern websites may serve a whole range of functions from telling prospective customers about your business and its products, allowing them to interact with you (e.g. via email) and also allowing them to purchase your products and services online. However, the development and ongoing maintenance can involve a range of costs. The ATO recently finalised its position on the tax treatment of these costs in *Taxation Ruling TR 2016/3 – Income tax: deductibility of expenditure on a commercial website.*

DISTINCTION BETWEEN CAPITAL AND REVENUE

The Ruling divides website costs into either revenue or capital expenses.

Where the expense is revenue in nature, it can be claimed outright as a deduction in the year in which it is incurred. On the other hand, where it is capital and not otherwise deductible, the expense may be classed as in-house software and claimable under the capital allowances regime whereby:

- It is deducted over 5 years from the time it is first installed ready for use
- It is allocated to a software development pool (no deduction in the initial year, but 40% in each of the next 2 years, and 20% in the final year after that)
- If you are a Small Business Entity you may choose to write it off in the year of the expense if under $20 000, or use the Small Business pool rules and claim 15% in the first year, and 30% in subsequent years.

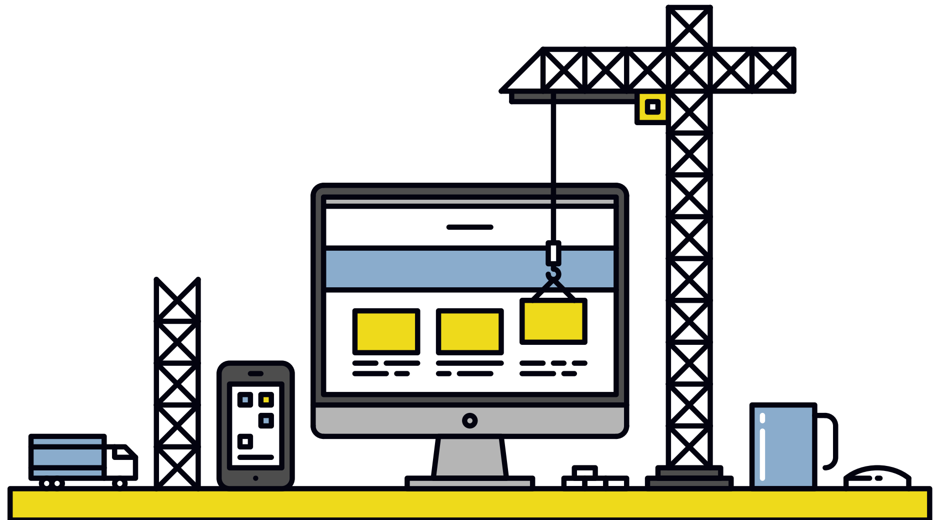
By way of background, an expense will typically be capital in nature where it is incurred with the intention to create an asset or advantage that is lasting or enduring. So in determining the correct tax treatment of each website expense, you need to ask the question: is this expense revenue or capital in nature?

If it is neither capital or revenue in nature, then the expense will generally be dealt with under the capital gains tax (CGT) regime where it may form part of the cost base of a CGT asset.

INITIAL CONSTRUCTION AND ENHANCEMENT EXPENSES

Any expenditure incurred in acquiring or developing a commercial website for a new or existing business is capital in nature. This is the case where you develop the website yourself, or pay professionals to do so. The initial construction and design expenditure provides enduring benefits to your business (such as providing online advertising space for your business where your clients can view your products and contact you; or enabling you to sell your products online etc.). As such, the initial construction costs are capital in nature and therefore not immediately deductible.

Likewise, any modifications to the website that adds new functionality, for example an online ordering system, will be capital in nature as the expense enlarges the profit-yielding structure of your business.



DOMAIN NAME EXPENSES

Another common website-related expense is around domain names. These are a unique name registered with a domain registrar, for example ***www.ato.gov.au***. Periodic registration fees for a domain name including initial registration fees are revenue expenses and are therefore deductible in full when paid (unless they relate to a period greater than 13 months – in which case they will be deductible over the period to which they relate).

An amount paid to permanently use a domain name is capital. This right is a CGT asset. Therefore, the expenses form part of the cost base of that asset.

UPGRADING EXISTING WEBSITE SOFTWARE

Such is the pace of technological change, business owners will likely incur expenditure for regularly upgrading existing website software so as to allow webpages to appear correctly with new mobile devices, browsers and operating systems. The good news is that these expenses are dealt with on the revenue account and are therefore immediately deductible.

OTHER EXPENSES

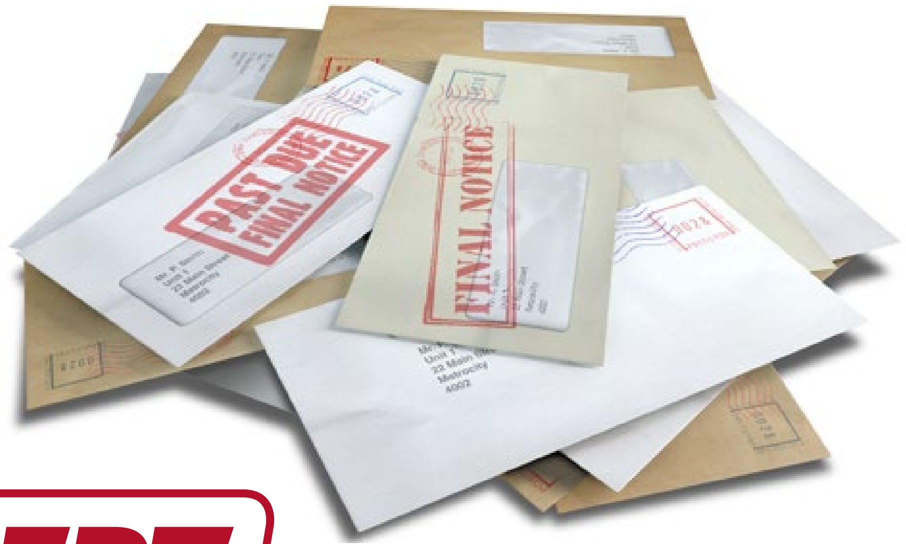
Many other examples of expenses are dealt with in ATO Ruling along with accompanying comprehensive examples which you can access in the legal database section of the ATO website ***www.ato.gov.au*** Some of those include:

REVENUE	CAPITAL
"Off the shelf" software product expenditure that is licenced periodically	Social media presence. This is separate from the website and is considered to be capital
Expenditure for maintaining a website e.g. periodic operating, registration, web hosting and licensing fees.	Expenditure incurred to migrate content from old to new website or migrate to a new platform as part of an upgrade

WHAT MAKES A GOOD WEBSITE?

According to Customer Service Expert Martin Grunstein, all good websites should have the following pages:

- ***Why Choose Us? page***
- ***What Our Clients Say page***
- ***Contact Us page.***



ATO DEBT ALERT

From 1 July the ATO is cracking down on businesses with large debts owed. This could have far-reaching consequences for affected businesses. As a result, action may need to be taken before this deadline.

BACKGROUND

The ATO is currently owed more than $19 billion in overdue tax. Of this, approximately two-thirds is owed by small businesses (those with a turnover of less than $2 million). This presents a delicate balance for the ATO and Government with the need to protect Government revenue coming up against the desire not to send businesses 'to the wall' and the flow-on costs that come with that (unemployed staff etc.).

However, in the Mid-Year Economic and Fiscal Outlook (MYEFO) it would seem that the Government has had enough, announcing a rather dramatic debt measure that all business taxpayers should take note of.

DETAILS

In MYEFO, which is the Government's mid-year Budget update in December, it was announced that where an entity meets the following criteria in relation to an ATO debt, the ATO will be permitted to disclose this debt to Credit Reporting Bureaus:

- You or your business has an ABN
- Your debt is more than $10,000
- Your debt is more than 90 days old and
- You have not engaged the ATO in respect of repaying the debt.

This is a big shift from current practice where the consequences of not paying ATO debt have no real tangible impact on your day-to-day operations other than the incurring of a General Interest Charge (currently 8.78%, compounding daily) and the issuance of a Director Penalty Notice requiring company directors to personally pay outstanding PAYG Withholding and Superannuation Guarantee Charge. By contrast, the implementation of this new policy (which at the time of writing is set to go ahead) could have profound effects for a small business. Credit default 'black marks' last for five years. In the worst of cases, support from financiers may be withdrawn and supplier credit stopped.

QUESTIONS???

The new rules raise a number of questions which at the time of writing (March) are still unclear, including:

- What constitutes "engaging with the ATO". If a business partially repays a debt that it owes, does this constitute engagement? Or need you have entered into a formal payment arrangement with the ATO? And what happens if a business defaults on the formal payment arrangement?
- Will the reporting to Credit Agencies lead to the standard 5-year listing with them? Or will it be less than this?
- Is the disclosure by the ATO automated or will it be done on a manual, discretionary basis? Will the ATO advise the business of the disclosure? With the unreliability of ATO systems, it is to be hoped that the reporting is done with utmost diligence, as an incorrect credit report could have a devastating (and unfair) impact on business cash-flow.
- How will the ATO treat debt that is in dispute or before the courts? Will this be reportable? Or does the dispute need to be resolved first?

ACTION POINTS

This change does not require legislative passage through the Parliament. As such the ATO is free to implement this policy from 1 July without Parliamentary approval. Given the profound consequences of a 5-year credit 'black mark' on a business (potentially drying up finance) we would strongly recommend that businesses who meet the above criteria with respect to a current ATO debt either **(a)** repay the debt to at least below the $10,000 threshold or **(b)** enter into a payment arrangement with the ATO before 1 July 2017. Indeed, irrespective of whether the above conditions are met, it's always best practice to engage with the ATO by entering into a payment arrangement. Having a record of cooperation and compliance can assist in future ATO dealings in respect of extensions/ leniency etc.

The good news is that the ATO is very flexible with payment arrangements – they will generally make every effort to accommodate your requirements. The ATO can also offer interest-free repayment plans to some small businesses in relation to Activity Statement debt. To enter into a payment arrangement, you should phone the ATO on **13 28 66** or get your Accountant to contact them on your behalf.

The ATO provide further guidance on help with paying debts at ***www.ato.gov.au/general/paying-the-ato/help-with-paying/***

30 JUNE Tax Planning

With 30 June approaching, this article offers a range of year-end tax tips. Areas covered include the abolition of the Deficit Levy, the final days of the Small Business instant asset write-off, delaying after-tax superannuation contributions and much more.

DEFICIT LEVY SOON GONE

The abolition of the Deficit Levy from 1 July 2017 presents a tax-planning opportunity for high-income taxpayers. By way of background, the Deficit Levy was introduced on 1 July 2014. It is a 2% levy which applies on that part of an individual's taxable income which exceeds $180,000.

If you are on track to earn over this amount in 2016/2017, then consider deferring income where possible until after 30 June 2017 and enjoy a 2% tax saving.

INCOME DEFERRAL AND EXPENSE ACCELERATION

Similar principles apply for those earning below $180,000 who are not impacted by the Deficit Levy as follows:

- If you will be earning more money this financial year (2016/2017) than next year (2017/2018) then consider deferring income until after 30 June 2017 where possible. This may involve for example deferring taxable capital gains by simply delaying the sale of the asset. Or it may involve delaying your retirement slightly and thus receiving any payout in 2017/2018 when you will likely be earning less income than when you were working.
- If you are looking to minimise your taxable income in 2016/2017 (perhaps you will be earning more money this financial year than next year, or you just need some cash-flow relief) consider bringing forward some planned deductible expenditure to before 1 July. Or if you have made a capital gain, and are holding a loss making CGT asset, you may wish to consider crystallising that loss – however, in pursuing this strategy, we recommend you speak to your investment and tax advisor before any sale.

EXAMPLE

Sammy is a sole trader operating a computer repair business. He accounts on an accruals basis. He is on track to earn an estimated $210,000 in 2016/2017. Coming up to 30 June, he is nearing completion of a $10,000 repair job.

If Sammy went ahead and completed the job, his tax liability on this $10,000 would be $4,700 (not including Medicare Levy).

On the other hand, if Sammy were to delay the completion of this task by a few days until 1 July, his tax liability on the $10,000 would be $4,500…a total tax saving of $200.

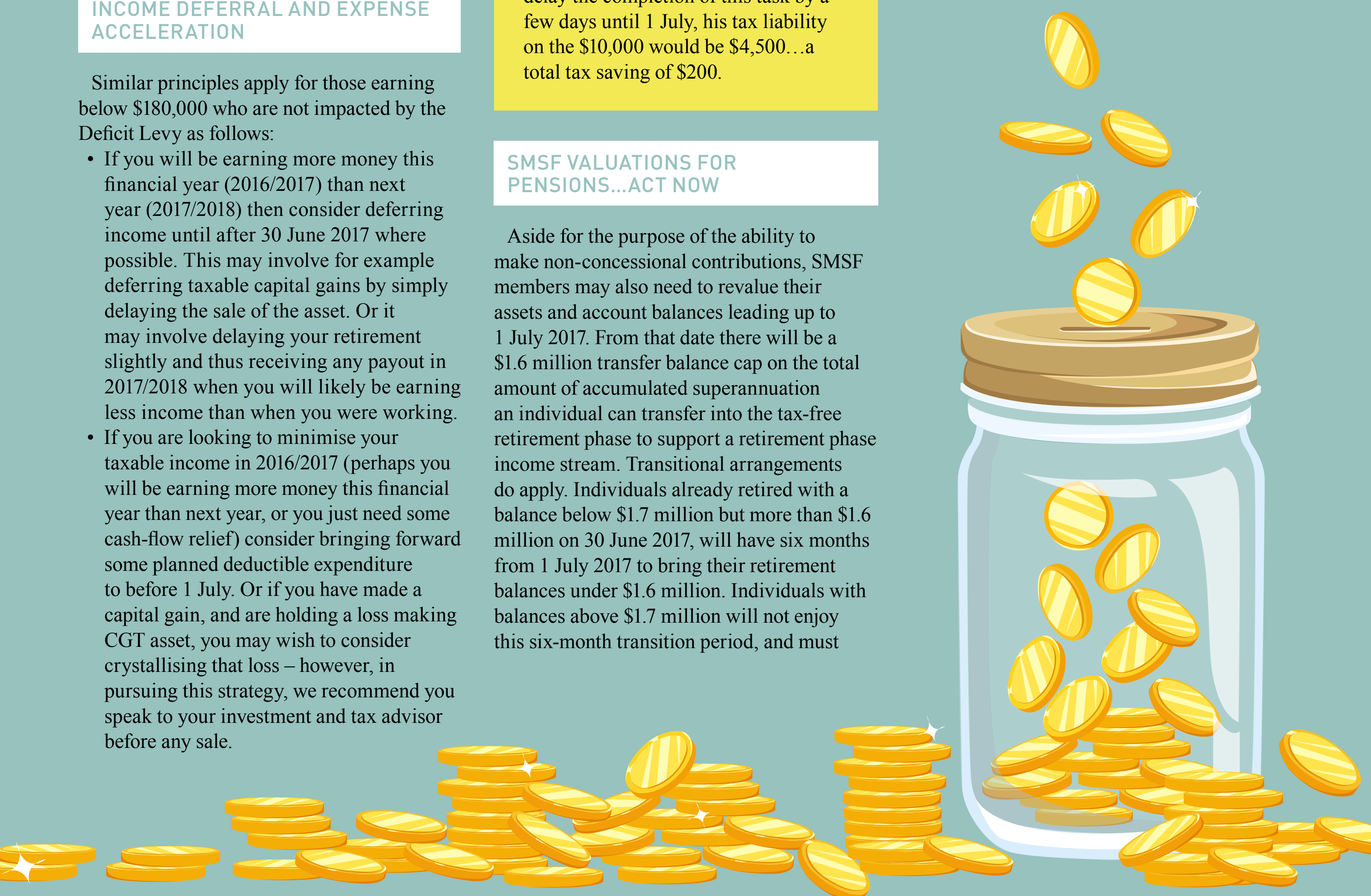
SMSF VALUATIONS FOR PENSIONS...ACT NOW

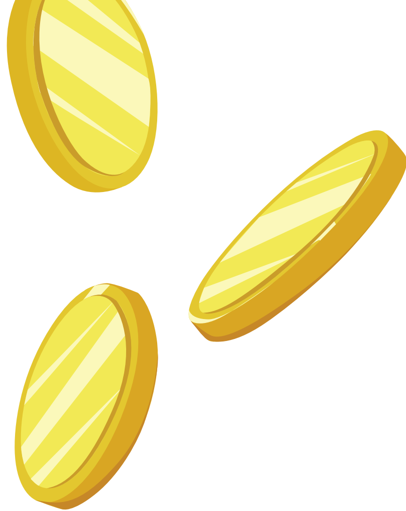
Aside for the purpose of the ability to make non-concessional contributions, SMSF members may also need to revalue their assets and account balances leading up to 1 July 2017. From that date there will be a $1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase to support a retirement phase income stream. Transitional arrangements do apply. Individuals already retired with a balance below $1.7 million but more than $1.6 million on 30 June 2017, will have six months from 1 July 2017 to bring their retirement balances under $1.6 million. Individuals with balances above $1.7 million will not enjoy this six-month transition period, and must take action before 1 July 2017 to bring their account balances below $1.6 million.

INSTANT ASSET WRITE-OFF...GOING

These are the final months of the $20,000 instant asset write-off – to be abolished from 1 July 2017.

Until 30 June 2017, Small Business Entities (SBEs) can claim an immediate write-off for most depreciating assets for used in their business if the asset cost less than $20,000 and the below timeframes are met. In broad terms, SBEs are entities (including sole





traders) that are carrying on a business and have an annual turnover of under $2 million. This includes the turnover of any connected entities and affiliates.

Being in its final year of operation, the timing requirements around the instant asset write-off are important.

To claim a deduction in 2016/2017, the asset must have been acquired on or after 1 July 2016 and first used or installed ready for use in your business on or before 30 June 2017.

Assets acquired before 1 July 2016, but used or installed ready for use between 1 July 2016 and 30 June 2017 are also claimable in full in 2016/2017.

If you miss the deadline (i.e. if the asset is not being used in your business or installed ready for use on or before 30 June 2017) then the write-off threshold reverts to $1,000. Missing the deadline will result in a worse cash-flow outcome for your business than if the deadline is met (see later example).

WHAT'S THE BENEFIT?

The real benefit from the $20,000 write-off is an improvement to your cash-flow. The write-off improves small business cash-flow by bringing forward deductions rather than having them spread out over more than one year. Cash-flow can be a significant issue for small business, particularly start-ups.

That said, it is important to have perspective. You are only getting back the tax rate on the asset, not the full value of the asset. This is the same as the old law where the write-off was $1,000 (which will apply from 1 July 2017). You don't get any extra cash than you would otherwise have received under the old rules – you simply get it sooner. Consequently, you should not let tax distort or blur your commercial instincts – as you don't get any extra cash than you would otherwise have under the old rules, you should continue to only buy assets that fit within your business plan.

CASE STUDY

CASHFLOW BENEFIT

An eligible SBE company purchases an eligible asset for $19,999 on 2 July 2017. As the asset is not installed purchased and installed ready for use on or before 30 June 2017 the instant write-off threshold is only $1,000. As this asset exceeds this threshold, the standard pooling rules apply. The asset will be written off at 15% in the first year 2017/2018 ($19,999 x 15% = $3,000) and 30% in subsequent years (Year 2 $16,999 x 30% = $5,100). The cash-flow the company would receive from these depreciation claims are $855 for the first year (assuming a 28.5% small company tax rate) and $1,454 in the second year (assuming a small business company tax rate of 28.5%). The company would continue to depreciate its general pool at 30% until the pool was under $1,000, at which point the entire pool could be written-off (after approximately 9 years).

By contrast, if the purchase of the asset was brought forward a few days and the asset was used or installed ready for use on or before 30 June 2017 under the $20,000 threshold, the company would be able to immediately deduct the entire $19,999 in the first income year (2016/2017). The cash-flow benefit the company would receive from this is $5,699 ($19,999 x 28.5%) in the first year ($4,845 more than under the old rules – i.e. the benefit is brought forward rather than spread out). This benefit reduces the company's income tax payable so intrinsically the company has retained cash in its working capital via paying less to the ATO, and is then free to apply this brought-forward cash immediately (e.g. pay off debt or suppliers, or re-invest in the business etc.). In the second income year, there is no further depreciation of this asset as it has been written-off completely. This means that the company is paying more tax in the second year relative to the earlier scenario (but no more and no less tax overall).

This Case Study illustrates the importance of meeting the 30 June 2017 deadline this financial year. After this date, the write-off threshold reverts to $1,000.

DELAY AFTER-TAX SUPER CONTRIBUTIONS

If you are planning on making after-tax superannuation contributions in the coming weeks and months, it may be very tax-effective to delay those contributions until after 30 June 2017. The Government's long-awaited superannuation changes have passed the Parliament including an increased ability to claim a deduction for your after-tax contributions. The following case study illustrates the benefits of delaying your contribution until on or after 1 July 2017.

CASE STUDY

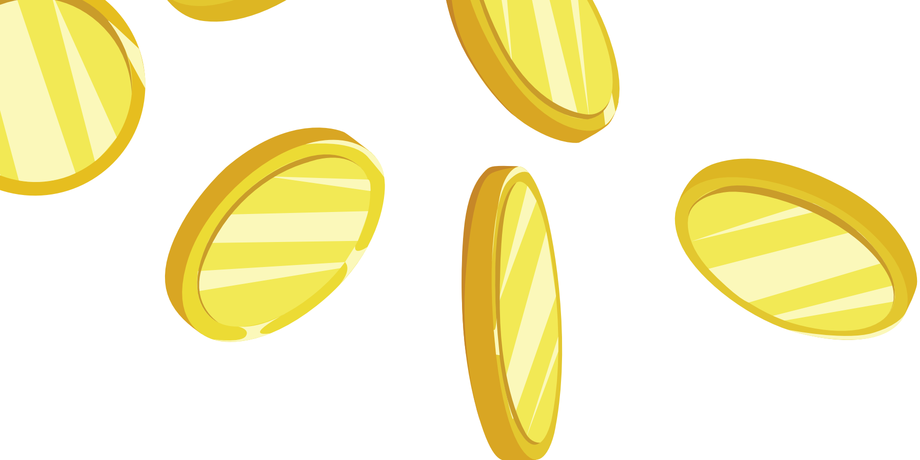
Cameron is a 56 year-old employee landscaper who works four days per week and earns $70,000 per year from this job. For two of the other three days he operates his own lawn mowing business in which he earned $9,000 for the year. He also has $1,000 of dividend income.

Nearing the end of 2016/2017, keen to provide for his retirement, Cameron is contemplating making a $15,000 superannuation contribution.

BEFORE 1 JULY 2017

If Cameron were to make this contribution before 1 July, he would not be entitled to claim a tax deduction as more than 10% of **(a)** his assessable income **(b)** his reportable fringe benefits plus **(c)** his reportable employer superannuation contributions (e.g. salary sacrifice contributions) for the year are from being an employee. This is otherwise known as the "10% Rule". In Cameron's case 87.5% of his employment income falls into those 3 categories (being his $70,000 wage for working as an employee landscaper).

This 10% Rule has caught out many employees – preventing them from claiming a deduction for their after-tax superannuation contributions.



ON OR AFTER 1 JULY 2017

The 10% Rule has been abolished from 1 July 2017. From this date most people, regardless of their employment arrangements, will be able to claim a full deduction for personal superannuation contributions they make until they turn 75. Individuals who are aged between 65 and 75 will need to meet a "Work Test" to be eligible to claim the deduction. This test requires that you must work at least 40 hours in a period of not more than any 30 consecutive days in the financial year in which you plan on making a superannuation contribution. "Employment" involves any endeavour for which you receive remuneration for your efforts.

Turning back to the example…if Cameron delays his personal contribution to on or after 1 July 2017, the 10% Rule will no longer apply. Therefore, as he is aged under 75, he will be entitled to a deduction for the full amount of his personal superannuation contribution ($15,000). Assuming he had no other deductions and his assessable income remained the same in 2017/2018, this superannuation deduction would reduce his taxable income to $65,000, and result in a tax saving of more than $5,000. A massive result, all because Cameron delayed his contribution by a few weeks until 1 July 2017. As illustrated, the benefits of this measure can be enjoyed by taxpayers including employees on standard incomes…you need not be wealthy to enjoy the benefit.

TRUSTEE RESOLUTIONS

If you operate your business through a Trust (including Family Trusts), ensure you make trustee resolutions to distribute the 2016/2017 Trust income by 30 June. Failure to do could result in the undistributed trust income being assessable to the Trustee at 47%.

The manner in which resolutions are to be made is governed by your Trust deed. While some deeds will allow for oral resolutions, other deeds will require written, documented resolutions for distributing the Trust income. It is vital therefore that trustees are familiar with the terms of their trust deed and what it requires in this respect.

It is advantageous if Trustee resolutions can be made orally. This provides a further defence if ever a written trust resolution were deemed to be out of time. That said, where the deed allows you to make oral resolutions, it's still recommended that these oral resolutions be documented in official minutes, even if the official minutes are not made at the time of the oral resolution. In an ATO audit scenario, some documentation to fall back on is always preferable. Remember however that regardless of whether your Deed allows you to make oral resolutions, the ATO has ruled that a written record is essential if you wish to effectively stream capital gains or franked dividends.

Finally, it's important to note that most Trust deeds contain a default beneficiary clause which makes a particular beneficiary entitled to the trust's income if no other resolution is made by 30 June. Therefore, if the Trust wishes to distribute income to someone other than this default beneficiary it will need to have a resolution in place by 30 June 2017.

SMALL BUSINESS PREPAYMENTS

As a Small Business Enterprise (SBE with a turnover of less than $2 million including affiliates and connected entities) you can claim an immediate deduction for certain prepaid business expenses where the payment is for a period of 12 months or less and ends in the following income year that the payment was made.

EXAMPLE

In May 2017, Bruce's company pays $12,000 for an advertisement to be run in the local newspaper every month for six months from May until October at $2,000 per month.

NON SBE

If Bruce's business was not an SBE (i.e. had a turnover of $2 million or more) and the prepayment was for $1,000 or more (which it is) the deductions must be apportioned over the periods to which they relate. Therefore, only $4,000 (two month's worth of deductions for May and June) could be claimed in 2016/2017. The remaining must be claimed in 2017/2018 being the period to which they relate.

SBE

As the period is for 12 months or less and ends before the conclusion of the following income year (2017/2018), Bruce can claim the entire prepayment as a tax deduction in the 2016/2017 tax return. This reduces his business's taxable income for the year by a further $8,000 resulting in $2,280 less tax payable in 2016/2017 and a consequent cash-flow benefit.

The prepaid expenditure concession provides SBEs with cash-flow relief by enabling them to bring forward deductions that would otherwise be apportioned over two income years. Examples of business expenditure items that you may wish to prepay over the coming months before 1 July include:

- Rent
- Insurance
- Advertising
- Repairs to business assets
- Subscriptions
- Business trips
- Deductible interest
- Seminars and conference bookings
- Contract payments
- Deductible car registration fees
- Leases, and
- Telephone and internet services.

DEAL WITH PRIVATE COMPANY 'LOANS'

Have you received a 'loan' amount from your private company in 2016/2017 – that is taken money other than franked dividends, Director's Fees, or salary and wages from your company? If so, you may need to take urgent action by 30 June in order to

avoid some harsh income tax consequences imposed by Division 7A of the Tax Act.

If you have received one of these from your private company during 2016/2017, then unless you take corrective action by 30 June the full dollar value of these 'loans' may be assessed to you personally as an unfranked dividend. 'Corrective action' involves one of the following:

- A written loan agreement (formal Division 7A agreement) is put in place – annual minimum interest and principal repayments are required in subsequent income years
- You repay the amount before the lodgement date or due date for lodgement (whichever is earlier) of the company's income tax return in the year in which the loan is made.

For more information, see the March/April 2017 edition of this publication at our website ***www.mytaxsavers.com.au***

RENTAL PROPERTY OWNERS

Leading up to 30 June rental property owners can also optimise their 2016/2017 tax position:

PREPAY INTEREST

Many lenders allow borrowers to prepay interest on loans. By prepaying before I July you can claim a tax deduction for up to 12 months interest. Of course, you should also factor in your own cash-flow in making a decision to prepay any expense. This is only available for SBE taxpayers (see earlier) and non-business individuals.

QUANTITY SURVEYOR REPORT

At this time of year, many owners have their depreciation/capital allowances schedules prepared. The reports itemise all of the depreciable items in the property, as well as the available capital works deductions. We recommend that this report be done by a qualified Quantity Surveyor. Their expertise can add thousands of dollars worth of deductions to your rental property claim. Payments for their services are also tax deductible.

DIRECTORS FEES

If your company is planning on paying directors fees prior to 1 July, you may need to have a resolution in place by this date.

A popular year-end tax strategy for companies is to make a resolution to pay directors fees in the current financial year, but not actually make the payment of the fees until the following financial year. This is what is known as 'accrued directors fees' i.e. the fees are accrued but not actually paid. The benefit in such a strategy is that while the company claims a tax deduction for the Directors Fees in the year that it makes the resolution, it doesn't actually make the payment until the following financial year. This is a win-win for the company (they can claim a deduction and improve their current year tax position, but without having incurred any cost).

In *Income Tax Ruling IT 2534* the ATO outlines its views on the taxation treatment of Directors Fees stating that accrued Directors Fees are only deductible at the point in time that a company is definitely committed to making the payment. Consequently, it's essential that your company, via an appropriately worded minute, makes an unconditional resolution in a shareholders' meeting making the company "definitely committed" to making the payment. The resolution must not be conditional; it must not be subject to cash-flow considerations etc. Directors Fees are subject to PAYGW and superannuation requirements.

EXAMPLE RESOLUTION

COMPANY ABC PTY LTD
Minutes of Shareholders Meeting
Venue: Brisbane St, Brisbane
Date: 30 June 2017
Present John Smith, Sue Jones
Directors Fees:
It was resolved to pay Directors Fees to the directors for their services to the company during the 2016/2017 income year. The following amounts are payable:

NON-CONCESSIONAL SUPERANNUATION CONTRIBUTIONS – PERHAPS THE LAST CHANCE!

The other 30 June sensitive superannuation change to be aware of (aside from the abolition of the "10% Rule" – see earlier) is the $1.6 million limit on your superannuation balance. Where you have reached this limit, leading up to 30 June may be your final opportunity to make non-concessional contributions to superannuation.

To recap, back in November 2016 among the superannuation changes that the Government passed into law was that commencing in July 2017, where your "total superannuation balance" is equal to or greater than $1.6 million at 30 June of the prior year, your non-concessional contribution cap in the following financial year will be nil. That is, you will be unable to make any non-concessional superannuation contributions. This type of contribution includes after-tax personal contributions for which you can not claim a deduction (as you fail the 10% Rule – see later); contributions made for you by your spouse; amounts transferred from foreign superannuation funds (excluding amounts included in the fund's assessable income); and contributions made for the benefit of a person under the age of 18 that are not employer contributions.

For the purpose of this new rule, an individual's "total superannuation balance" is the sum of:

- The market value of all your accumulation accounts
- The market value of all of your account-based income streams (including Transition to Retirement Income Streams)
- The total value of all non account-based income streams included in your transfer balance account
- The value of any benefits that are not included in either your accumulation accounts or your transfer balance account as they have been rolled over and are in transit.

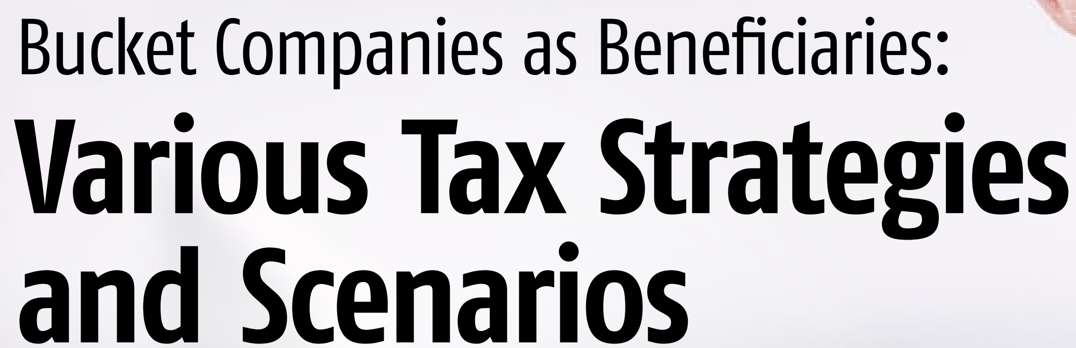
EXAMPLE

Tom is 50 years of age, and has a 'total superannuation balance' of $1.9 million.

If this remains the case on 30 June 2017 then Tom will be prevented from making any non-concessional contributions to superannuation in 2017/2018 as his balance on the last day of 2016/2017 was above $1.6 million.

However, leading up to 30 June 2017, Tom is free to contribute up to the non-concessional cap limits ($180,000 for the year, or $540,000 over three years) as the new rule does not apply until 1 July 2017. Therefore, if Tom has the cash on hand (perhaps he has just sold an investment property etc.) he is free to contribute as much as $540,000 to superannuation before 1 July 2017. By doing so, he can get this large amount into superannuation and the earnings on it such as interest will be taxed at the concessional 15% superannuation rate as opposed to Tom's marginal tax rates outside of superannuation.

If you are uncertain of your superannuation balance leading up to 30 June, you should contact your advisor or your superannuation fund directly. Furthermore, before acting on this strategy, you should consult your advisor.



Bucket Companies as Beneficiaries: Various Tax Strategies and Scenarios

Many businesses operate through a discretionary trust. Where this is the case, they will often make use of a corporate beneficiary (often referred to as Bucket Companies) to assist with tax management. This article examines the advantages of this, and various scenarios when distributing income to that company.

BACKGROUND

Bucket companies are so described as they are essentially nothing more than a vehicle to primarily house distributions from a trust, rather than being established to carry on a business. This article will focus on bucket companies as beneficiaries of a trust (including family trusts).

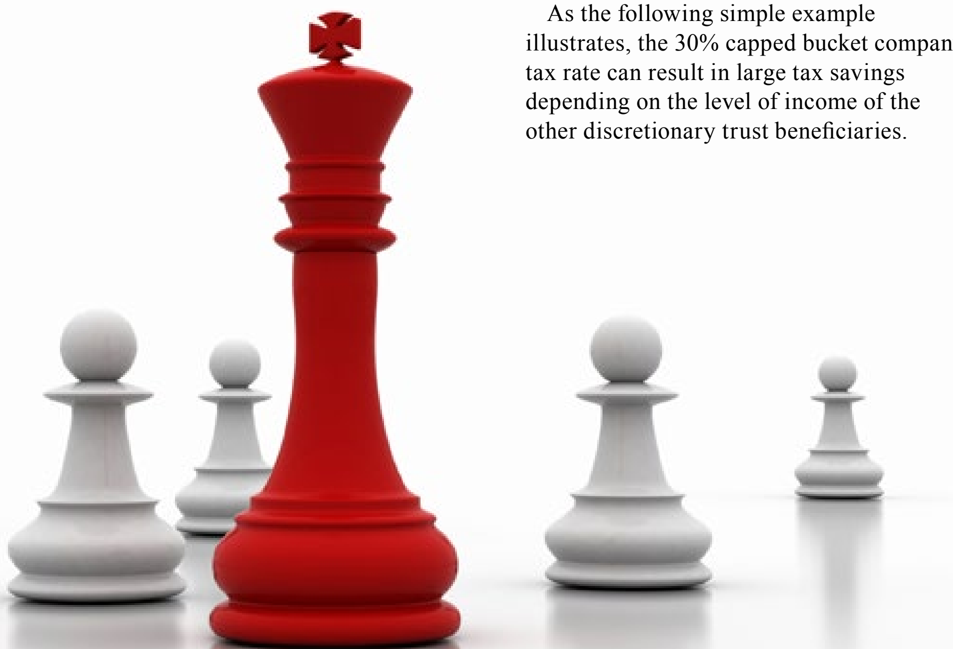
Taking a step back, there are many advantages in operating your affairs through a discretionary trust as follows:

- Asset protection – the trust is a separate legal entity. Therefore, if your business fails, creditors only have recourse against the assets of the trust rather than the assets of the individuals operating the business.
- Unlike companies, trusts are able to access the 50% CGT discount and the other various CGT small business concessions
- Flexibility in respect of trust income. Different types of income can be allocated to the most tax-advantaged beneficiaries, and low income beneficiaries.

However, if the discretionary trust has significant taxable income, it may not wish to distribute this income to individuals as they may be on a high marginal tax rate. This is where bucket companies can be useful.

ADVANTAGES

Bucket companies generally have a tax rate of 30% as they are thought to be not carrying on a business. Thus, where a discretionary trust distributes its income to a bucket company beneficiary, the tax rate is capped at 30% irrespective of the amount of the distribution.



TAX TIP

While it has long been considered that small companies holding passive investments are not carrying on a business and are therefore not eligible for the 28.5% Small Business Entity tax rate, the ATO's recently released Draft Taxation Ruling *TR 2017/D2* seems to indicate otherwise.

Footnote 2 to the Draft Ruling states: "This ruling is not concerned with what amounts to carrying on business. However, generally, where a company is established or maintained to make profit or gain for its shareholders it is likely to carry on business. *(Brookton Co-operative Society Ltd v FCT (1981) 147 CLR 441 per Aicken J at 469; American Leaf Blending Co Sdn Bhd v D-G of IR* [1978] 3 All ER 1185 Per Lord Diplock at 1189; *Inland Revenue Commissioners v Westleigh Estates Company Ltd; South Behar Railway Company Ltd; Eccentric Club Ltd* [1924] 1 KB 390). This is so even if the company only holds passive investments, and its activities consist of receiving rents or returns on its investments and distributing them to shareholders. *(Brookton Co-operative Society Ltd v FCT (1981) 147 CLR 441 per Aicken J at 469.*"

This may provide scope for business taxpayers and their advisors to access the 28.5% tax rate where a company holds only passive investments.

As the following simple example illustrates, the 30% capped bucket company tax rate can result in large tax savings depending on the level of income of the other discretionary trust beneficiaries.

EXAMPLE

Mr. and Mrs. Armstrong operate a computing business (repairs and equipment sales) through a discretionary trust. The taxable income of the trust is $90,000, and the beneficiaries are Mr. and Mrs. Armstrong and their 10-year old Son Brock. This is the only family income for the year.

NO BUCKET COMPANY

If there is no bucket company, the minimum amount of tax payable on the distribution would be $13,344 by way of the following distributions:

- Brock - $416 tax-free
- Mr. Armstrong $44,792 (tax of $6,672 including Medicare levy and low income tax offset)
- Mrs. Armstrong - $44,792 (tax of $6,672 including Medicare levy and low income tax offset).

WITH BUCKET COMPANY

By contrast, if there was a bucket company, the maximum tax payable could be reduced to $12,409 by way of the following distributions:

- Brock - $416 tax-free
- Mr. Armstrong $37,000 (tax of $3,867 including Medicare levy and low income tax offset)
- Mrs. Armstrong $37,000 (tax of $3,867 including Medicare levy and low income tax offset)
- Bucket Company $15,584 (tax of $4,675).

This is a saving of almost $1,000 in tax.

The savings are even greater where the business is more profitable, or the individual beneficiaries have higher rates of tax. For instance, assume Mr. and Mrs. Armstrong had other income for the year of $100,000 and $90,000 respectively. If the same $44,792 was distributed to them each, then the tax payable on the business income would be $33,146. If instead there was a bucket company that received the entire $89,584 the tax payable would be $26,875 (a tax saving of more than $6,000).

Aside from the tax savings, an additional benefit of the bucket company is risk management/ asset protection. Investments that the bucket company makes are separate from the trust which is carrying on the business and separate from the individual beneficiaries. Shares of the bucket company should ideally be owned by a low-risk party e.g. non-working spouse or adult child or possibly even a separate trust.

TAX SCENARIO 1 – PAYING A DIVIDEND IN THE SAME YEAR

If the bucket company was to pay the entire distribution of the company's income to its shareholders as a dividend (subject to franking credits) to either Mr. or Mrs. Armstrong in the same year, then this would defeat the purpose of the exercise, as Mr. and Mrs. Armstrong would be required to pay "top-up" tax (being the difference between the imputation credit they receive from the company) at their marginal tax rate. In essence, this would be no different to Mr. and Mrs. Armstrong receiving all the distribution from the trust, so there are no tax advantages in doing this.

TAX SCENARIO 2 – PAYING A DIVIDEND IN A SUBSEQUENT YEAR

If the distribution of the business earnings was paid as a franked dividend in a subsequent year to Mr. and Mrs. Armstrong and they were on the same marginal tax rate, all this would achieve is a cash-flow benefit. Mr. and Mrs. Armstrong would once again receive a 30% imputation credit representing the tax already paid by the company, and then would pay 'top-up' tax (the difference between the 30% company rate already paid and their marginal tax rate in the year of the distribution). The cash-flow benefit arises as the top-up tax payable by Mr. and Mrs. Armstrong is deferred to a subsequent year. That is, if the money was distributed to them and there was no bucket company, then the full tax amount would be payable in the first year rather than the tax being deferred to subsequent years.

However, if Mr. or Mrs. Armstrong were on a lower rate of tax in the subsequent year in which the dividend is paid or it was paid to other shareholders on a lower marginal tax rate, then a real tax saving could be achieved as compared to no bucket company being in existence. In this respect, bucket companies can be advantageous where your income is 'lumpy' from one year to the next. Where this is the case, you can time the dividend payment to coincide with a low income earning year for yourself or other shareholders.

TAX SCENARIO 3 – THE DISTRIBUTION IS INVESTED

If distributions to the bucket company are invested into shares or property, then the tax on any income such as dividends or rent is capped at the 30% corporate rate. This may be less tax than if an individual including Mr. and Mrs. Armstrong were to invest this money personally and be taxed on the earnings at their marginal tax rate.

One of the problems however in using a company as an investment vehicle and purchasing shares or property is that companies are not eligible for the 50% CGT discount when they eventually sell those assets. By contrast, other structures such as trusts and individuals (50%) and superannuation funds including SMSFs (33% discount) are eligible for a CGT discount.

TAX TIP

The best course of action for the company in this situation may be to lend the cash to another related entity under a complying Division 7A loan agreement. That entity can then invest the cash and thus qualify for a deduction on the interest paid back to the company under the Division 7A agreement. (If it invests the cash in shares or property it will generally be entitled to the 50% CGT discount unlike the bucket company).

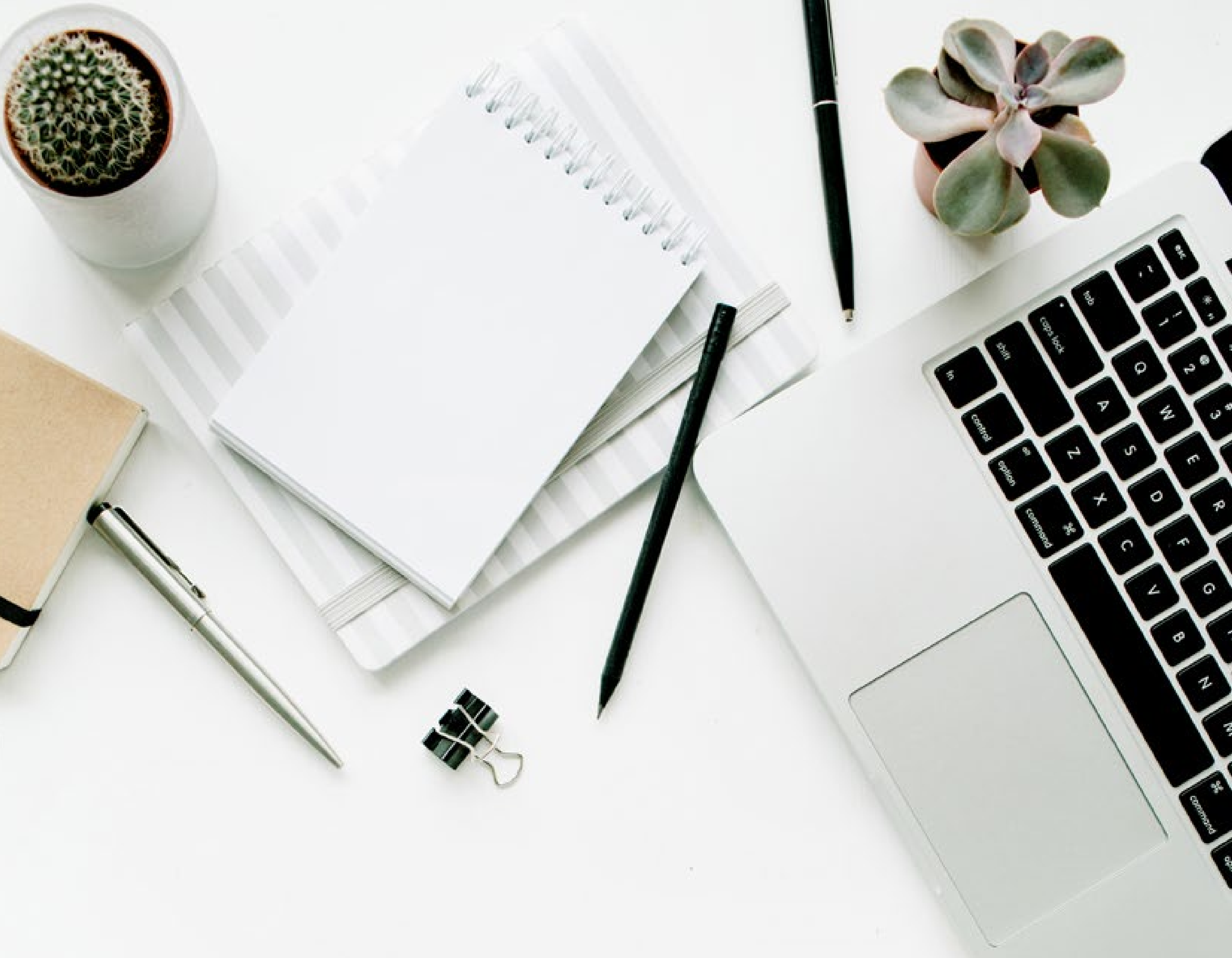
The company can then pay a series of dividends over time to enable the recipient entity to fund the repayments of principal it is required to make under the Division 7A loan.

TAX SCENARIO 4 – THE DISTRIBUTION IS NOT PAID TO THE BUCKET COMPANY AT ALL

A common tax minimisation strategy – more common a few years ago than now – is for the trust to make the bucket company presently entitled to receive the business income (this is done by making a Trust Resolution to pay a dividend to the company) but not actually pay the amount across to the company. The outcome is that the trust now owes the bucket company an amount which is referred to as an unpaid presentment entitlement or UPE.

By employing this strategy, a tax saving can be achieved by the company by paying tax at the corporate rate of 30%, instead of the individual beneficiary receiving the amount and paying tax at their marginal tax rate (which can be as high as 49%). On top of this benefit, the trust is then free to invest the retained amount to earn extra income for the wider trust fund and take advantage of the 50% CGT discount (which a company is not entitled to) if it were to invest in shares or property. This retained amount is a UPE (unpaid present entitlement) – it is unpaid to the bucket company beneficiary but the company will be assessed on the amount as it is presently entitled to receive the amount under a resolution made by the trustee.

However, the downside to this strategy is that Division 7A will typically apply to such an arrangement. This means that the UPE amount will be assessed to the bucket company as an unfranked dividend under Division 7A. As the dividend is treated as unfranked, the effective rate on the trust income can exceed 60%. This will be the case unless a Division 7A loan agreement is put in place by the lodgement day for the company's tax return for the year in which the UPE arose. Under the agreement, minimum interest and principal repayments will need to be made, and the loan will need to be completely repaid (by the trust to the company) over seven years (for unsecured loans) or 25 years (for secured loans). In simple terms, over this 7 or 25-year period, the trust will need to repay the loan (the equivalent of the UPE) back to the company plus commercial interest.



Maximum Net Asset Value Test:

A CLOSER LOOK

This article examines the Maximum Net Asset Value (MNAV) test contained in the CGT Small Business Concessions provisions of the Income Tax Assessment Act. How is this test relevant? Are there any strategies to bring your assets under this value?

RELEVANCE

The CGT Small Business Concessions allow business owners to reduce and in some cases eliminate any CGT payable on the sale of business assets or the business itself. To access the concessions, there are two alternative gateways:

1. Your businesses aggregated annual turnover (including the turnover of any connected entities or affiliates) is less than $2 million, or
2. The MNAV of your business's assets is less than $6 million just before the CGT event (e.g. sale) takes place.

If you fail to satisfy either of these conditions, then your business can not access the concessions.

BASICS

A business that fails the $2 million turnover test still has recourse to access the concessions if it satisfies the MNAV test. Broadly speaking, the MNAV test will be met if the total net value of CGT assets owned by:
(a) the taxpayer
(b) and any of its connected entities, and
(c) the net value of CGT assets of affiliates of the taxpayer and entities connected with the taxpayer's affiliates, insofar as those assets are used in a business carried on by the taxpayer or a connected entity

…does not exceed $6 million just before the CGT event.

To avoid double-counting, in calculating the net value of **(c)**, the value of any assets taken into account by **(b)** is excluded. We now examine each of these different entities and which of their assets to include:

A) THE TAXPAYER

When determining eligibility for the CGT Small Business Concessions, it is of utmost importance to determine who the Taxpayer actually is! Only then can you correctly determine who is connected and affiliated with them. The Taxpayer will be the entity that has made the gross capital gain (usually by selling a CGT asset) and is seeking to access the concessions. This may be a company, individual, or a trust etc. Focus on who actually owns the underlying CGT asset that is being sold!

The business assets of the Taxpayer to be taken into account include CGT assets, pre-CGT assets, depreciating assets including motor vehicles, buildings, vacant land, and any cash held in an interest-bearing bank account. Also included would be property not used in the business for example vacant land or shares held by the Taxpayer.

However, if the entity is an individual, the following assets should be excluded:
- Life insurance policies
- Main residence (to the extent it is non-income producing)
- Superannuation balances
- Assets used solely for personal use and enjoyment (e.g. boats etc.).

The ATO consider the current market value of a taxpayer's Main Residence is included to the extent that it is reasonable, having regard to the amount that the dwelling has been used to produce assessable income which gives rise to deductions for interest payments, or would give rise to deductions for interest if interest had been paid. This is a hypothetical interest deductibility test. It follows that if a portion of the market value of the main residence is included, then the same portion of any loan to acquire the main residence is also deducted.

In respect of assets held "solely for personal use and enjoyment", the recent case of *Altnot v Federal Commissioner of Taxation [2013] AATA 140* considered whether to include a property that the taxpayer had been renting out but ceased to rent out in the months leading to the CGT event as they were intending to use it as their holiday home. The Tribunal held that despite the taxpayer no longer renting out the property, they had not yet commenced using it as their holiday residence. As such, it should be included in the $6 million calculation.

This AAT view would seem to indicate that where the asset was being used solely for personal use and enjoyment just before the CGT event, then it would be excluded from the MNAV test. However, this 2013 AAT interpretation of the law would seem to be in conflict with the ATO's view (as expressed in *ATO ID 2011/37*) where it is stated that "**any** non-personal use of an asset over **any** its ownership period will mean that the asset is not disregarded". Consequently, if a taxpayer is close to the $6 million threshold it would be prudent to obtain a binding private ruling if confronted with this situation in order to provide clarity.

TAX TIP

With the exclusion of superannuation and lifestyle assets from the MNAV test, if you are set to exceed the $6 million threshold, is it worthwhile considering disposing of business assets and purchasing non-business assets, or alternatively making superannuation contributions (with due licensed financial planner advice) if you were already contemplating doing so. Either of these strategies may bring you under the $6 million threshold.

NET VALUE

Before moving on to consider assets of affiliated or connected entities, in calculating the MNAV only the net value of the relevant assets are taken into account. This is the market value less:

(a) Liabilities relating to an asset
This will include any legally enforceable debts, including any liabilities connected to the sale of the asset e.g. agent fees. But it does not include future obligations or expectancies that may arise but have not crystallised at the time of the CGT event.

(b) Provisions made by the taxpayer
This includes provisions for annual leave and long service leave, provisions for unearned income, and provisions for tax liabilities.

EXAMPLE

Thomas is a sole trader who operates a florist business. The market value of his and his business's assets are as follows:
- Depreciating assets - $1.2 million
- Superannuation - $200,000
- ASX shares - $220,000
- Business premises - $450,000
- Trading stock - $100,000
- Main residence - $400,000
- Rental property - $500,000

Thomas's liabilities are as follows:
- Mortgage over the main residence $210,000
- Mortgage over the rental property $400,000
- Provision for tax liabilities $90,000
- Overdraft on the business $300,000.

For the purposes of the MNAV test, the total for Thomas will be: $1,680,000 calculated as follows:
- **$2,470,000**
  Depreciating assets + ASX shares + business premises + trading stock + rental property
- **Minus $790,000**
  Rental property mortgage + provision for tax liabilities + business overdraft

B) CONNECTED ENTITIES

As per the earlier list, this is the second group of assets (less liabilities) to be taken into account. An entity is connected with the taxpayer if:

- Either entity controls the other entity, or
- Both entities are controlled by the same 3rd entity.

DIRECT CONTROL OF A COMPANY

An entity (the first entity) will control a company if that first entity, its affiliates, or first entity and affiliates either:

- Own or have the right to acquire ownership of interests in the company (e.g. shares) that carry between them 40% of either any income distribution by the company, or alternatively any capital distribution by the company, or

- Own or have the right to acquire the ownership of equity interests in the company that carry between them the right to exercise, or control the exercise of, at least 40% of the voting power in the company.

The 40% control percentage is based rather than who benefits from the ownership.

EXAMPLE

Returning to our earlier example, assume that Thomas also has a 35% shareholding in Sutton Pty Ltd. His affiliate (see later for definition) Keith also owns 10% of Sutton. All shares hold equal voting, capital and dividend rights.

As Thomas together with his affiliate own 40% or more of the shares, Thomas has direct control of the Sutton company and therefore the company is connected with Thomas. Therefore, its assets will be taken into account in calculating the MNAV test.

DIRECT CONTROL OF A DISCRETIONARY TRUST

There are two tests for control of a Discretionary Trust. The first test is the "Influence over Trustee Test". The first entity (see earlier) will control a discretionary trust if a trustee of the trust acts or could reasonably be expected to act in accordance with the directions or wishes of the first entity, its affiliates or the first entity together with its affiliates. In determining whether this is the case, you would take into account:

- The past behaviour of the trustee
- The relationship between the parties
- The amount of any property or services transferred to the trust by the entities
- Any arrangement or understanding between the entities and persons who have benefitted under the trust in the past.

EXAMPLE

Following on from our earlier example, assume that Thomas is the beneficiary of Pune Trust of which his two sisters are trustees. Although not a requirement of the trustee deed, before making investment and distribution decisions, Thomas's sisters invariably consult with and take directions from Thomas.

Although not written into the trust deed, the ATO will look at the substance of the arrangement – not what the trust deed says or doesn't say. That the sisters take directions from Thomas, and given the sibling relationship between the parties, Thomas will be taken to directly control the trust. Therefore, its assets will be taken into account in calculating the MNAV test.

The second alternative test, the "Distribution Test", provides that the first entity will control a discretionary trust for an income year if in any of the previous four income years:

- The trustee of the trust paid to or applied for the benefit of the first entity and/or any of the first entity's affiliates any income or capital of the trust, and
- The percentage of income or capital paid or applied is at least 40% of the total income or capital applied by the trustee for that year.

In contrast to the first discretionary trust test, this test is objective. If in any of the previous four income years prior to the income year the CGT event happened, Thomas received or any of his affiliates received 40% or more of the total income or capital applied by the trustee, then the trust's assets will be taken into account in calculating the MNAV test.

DIRECT CONTROL OF A NON-DISCRETIONARY TRUST

The first entity will control a non-discretionary trust if the first entity, its affiliates, or the first entity together with its affiliates own or have the right to acquire ownership of interests in the trust that carry between them at least 40% of any income distribution by the trust or any capital distribution by the trust.

EXAMPLE

Thomas owns 30% of the income units in ACC Trust and his affiliate Tim owns 15% of the income units. Although neither Tim or Thomas hold 40% of either the income or capital units, combined together they own 40% or more of the income units. Consequently, the assets of the trust will be including in the MNAV test.

DIRECT CONTROL OF A PARTNERSHIP

The first entity will control a partnership if the first entity, its affiliates, or the first entity together with its affiliates own or have the right to acquire the ownership of interests in the partnership that carry between them the right to receive at least 40% of the net income of the partnership.

INDIRECT CONTROL

Where a first entity directly controls another entity (the second entity) the first entity will be treated as controlling any entity that is directly or indirectly controlled by the second entity.

EXAMPLE

Following on from the earlier example, assume that Pune Trust owns 45% of the issued share capital in Mount Pty Ltd. Consequently, Pune control Mount Pty Ltd.

As Pune is controlled by Thomas, pursuant to the indirect control test, Thomas will be a controller of Mount Pty Ltd.

Consequently, the assets of Mount will be included in the MNAV test by Thomas.

However, this indirect control test will not apply where the second entity is any of:

- A company whose shares are listed on an approved stock exchange
- A publically traded unit trust
- A mutual insurance company
- A mutual affiliate company
- A company in which all of the shares are beneficially owned by one or more of the above entities.

C) AFFILIATES

Only an individual or a company can be affiliate of a taxpayer. Other entities such as SMSFs, trusts, or partnerships can never be an affiliate.

An individual or company (that carries on a business) will be an affiliate of the Taxpayer if the individual or company could reasonably be expected to act:

- In accordance with the Taxpayer's directions or wishes, or
- In concert with the Taxpayer…

…in relation to the affairs of the business of the individual or company. An individual or company that does not carry on a business can never be an affiliate. The affiliation rules are designed to ensure that genuinely independent businesses (even though they may be operated by a spouse or child) are not grouped with the Taxpayer's business. Instead, the following set of objective factors determine whether an individual or company is an affiliate of the taxpayer:

- Family or personal relationships
- Financial relationships or dependencies
- Relationships created through connections such as common directors, partners, or shareholders
- The degree to which the entities consult with each other on business matters
- Whether one of the entities is under a formal or informal obligation to purchase goods or services or conduct aspects of their business with the other entity, and
- Whether the individual or company has common employees.

EXAMPLE

Daisy and Ethan are married. They each owned their own business before they met, and continue to do so.

Daisy owns a pet shop and Ethan owns a bakery.

Ever since they met, Daisy and Ethan decided to keep their business affairs completely separate from their affairs of the heart.

In calculating their MNAV, they came to the correct conclusion that although (because of their marriage) they are associated with each other, the two businesses are not affiliated with each other because:

- Neither person has a say in the management or day-to-day operational decisions of each other's business, nor do they consult with each other;
- The funds from each business go into separate bank accounts and are not mixed in any way;
- The businesses do not share the same staff.

Thus, the bakery and the pet shop are not affiliated. The key point is that the totality of the factors must be considered – merely having common directors, or merely having family ties is not on its own sufficient.

In calculating MNAV of an affiliate of the Taxpayer or an entity connected with an affiliate of the Taxpayer, you must only include assets that are used or held ready for use in carrying on a business either by the Taxpayer or an entity connected with the taxpayer. Include the net value of assets of your affiliates and entities connected with your affiliates, only if the assets are used/held ready for use in a business carried on by you or an entity connected with you. Do not include an asset if it is used in the business of an entity that is connected with you only because of your affiliate.

ATO EXAMPLE

Colin operates a newsagency business as a sole trader. Simon carries on his own florist business which is unrelated to the newsagency business. Simon owns the land and building from which the newsagency is based and leases it to Colin.

Simon also owns 100% of the shares in Simco Pty Ltd which carries on another separate business. Simon is connected with Simco because he controls the company.

Simon regularly consults Colin for advice in his business affairs and acts according to Colin's wishes – therefore, Simon is Colin's affiliate.

To determine whether he satisfies the MNAV test Colin includes the market value of the land and building owned by Simon (because it is used in his newsagency business) but does not include Simon's other assets used in the florist business (because they are not used in the newsagency business. Nor does Colin include Simco's assets because those assets are not used in his business and Simco is only connected by of his affiliate, Simon.

TAKE HOME MESSAGES

- Correctly identify the Taxpayer who has sold the CGT asset. Only then can you determine who are their affiliates and connected entities.
- If the MNAV is failed, does the Taxpayer qualify as an SBE (turnover of less than $2 million)?
- Are there any strategies you could employ to get under the $6 million threshold (see earlier)?

PLANNING FOR THE $1.6 MILLION SUPER CAP

This article examines the implications of the recently-introduced $1.6 million superannuation transfer balance cap. How does the cap work, and what action do SMSF members need to consider taking leading up to the commencement of the cap on 1 July?

RECAP

From 1 July 2017, there will be a $1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can have to support a retirement phase income stream (i.e. the pension phase). "Retirement phase income streams" include all superannuation pensions and annuities (including Account-Based Pensions, which is the most common form of income stream) other than:

- Transition to Retirement Income Streams
- Non-Commutable Allocated Pensions and Annuities.

This $1.6 million cap is per taxpayer across all of your superannuation accounts – the cap is not per fund. As money is transferred into the pension phase the ATO will apply this against this $1.6 million cap. While the general transfer balance cap for 2017/2018 will be set at $1.6 million, this will be indexed in line with the Consumer Price Index (CPI), meaning that the cap will increase to approximately $1.7 million by 2020/2021. Once an individual has fully utilised their personal cap, they will not be eligible for any further increases where indexation lifts the cap, as their remaining/unused portion will be zero. For example, if Joe commenced his Account-Based Pension with a $1.6 million balance, and there was an increase of $100 000 indexation in the future, this increase would not lift this cap as his unused portion is nil.

WARNING

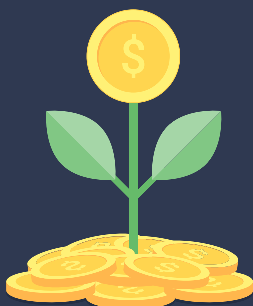
VALUATIONS

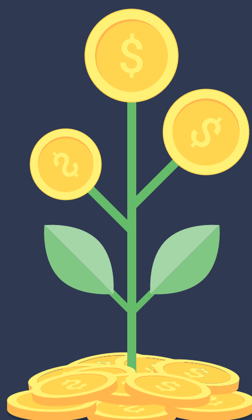
The new $1.6 million pension cap means that SMSF members in pension mode may need to revalue their assets before 1 July 2017. Temptations may exist to 'value low'. To this end, the ATO advises that it will be using 'decreases in market valuation movements' to select audit targets. Thus, great care should be taken. Consult your accountant on the steps you should take in valuing your account.

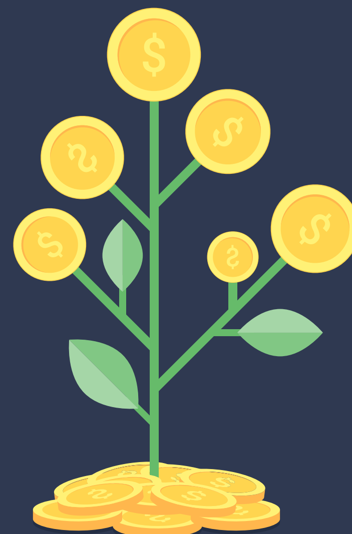
UNDER

Leading up to 30 June, if you determine that the value of your pension account is less than $1.6 million, you can use any remaining amount of the cap to transfer more capital into the pension phase, for example by making a superannuation contribution. With the contribution caps decreasing from 1 July, you may need to act swiftly to contribute as much as possible as soon as possible into the concessionally taxed superannuation environment.

The remainder of this article is dedicated to those whose pension account balance exceeds $1.6 million.







CHOICE

If after a pre-1 July valuation it's determined that your balance exceeds $1.6 million, you are required to withdraw the excess from your pension account generally by 1 July either by:

(a) Transferring the excess to an accumulation account which is still held inside the superannuation fund, or
(b) Withdrawing the excess from superannuation (this will depend on whether a condition of release has been met)
(c) Or a combination of both.

The 1 July 2017 deadline is however subject to transitional arrangements. Amounts less than $100 000 over the cap have a grace period of 6 months until 1 January 2018. Individuals with balances above $1.7 million will not enjoy this six-month transition period, and must take action before 1 July 2017 to bring their account balances below $1.6 million otherwise excess transfer balance tax will apply.

OPTION A

If you commute the excess from your pension account back into an accumulation account, any earnings on that excess will be subject to 15% tax (as opposed to tax-free when inside your pension account).

SMSF trustees who take up this option may be agonising over which assets to place into their accumulation account, and which to leave in your pension account to realise the best tax outcome. You need not worry! SMSF members with excess superannuation assets will not be permitted to segregate assets for tax purposes. Rather all of the fund's assets will be taken to be held in a single unsegregated pool – with a proportion of all fund earnings tax-exempt and the other proportion subject to 15% tax. An Actuarial Certificate will be needed to determine these proportions.

CGT RELIEF

If you do choose Option A, SMSF members may also need to transfer assets back to accumulation phase to support the value transfer. Consequently, these funds may incur a CGT liability on those assets when they are eventually sold. However, to ensure any gains that accrued on assets prior to 1 July 2017 do not become taxable, there is transitional CGT relief which in simple terms allows members to reset the cost base on those assets to their current market value at 30June 2017. Any members contemplating this should speak to their Accountant as it is a complex part of the legislation but a very important one for assets with large capital gains currently in pension mode and members who have balances over $1.6 million to deal with.

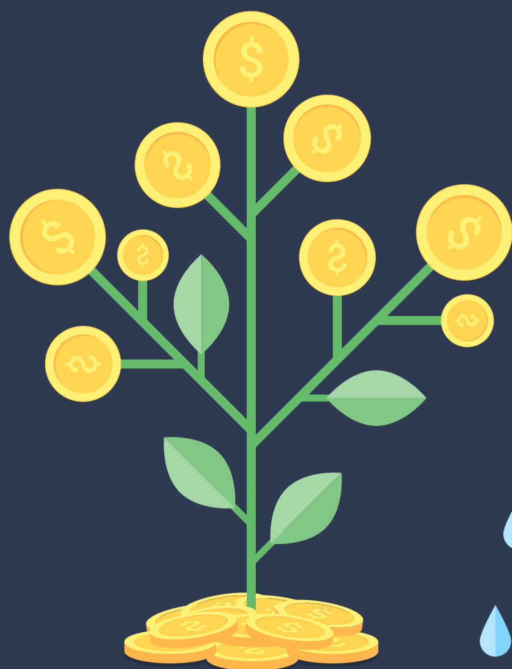
OPTION B

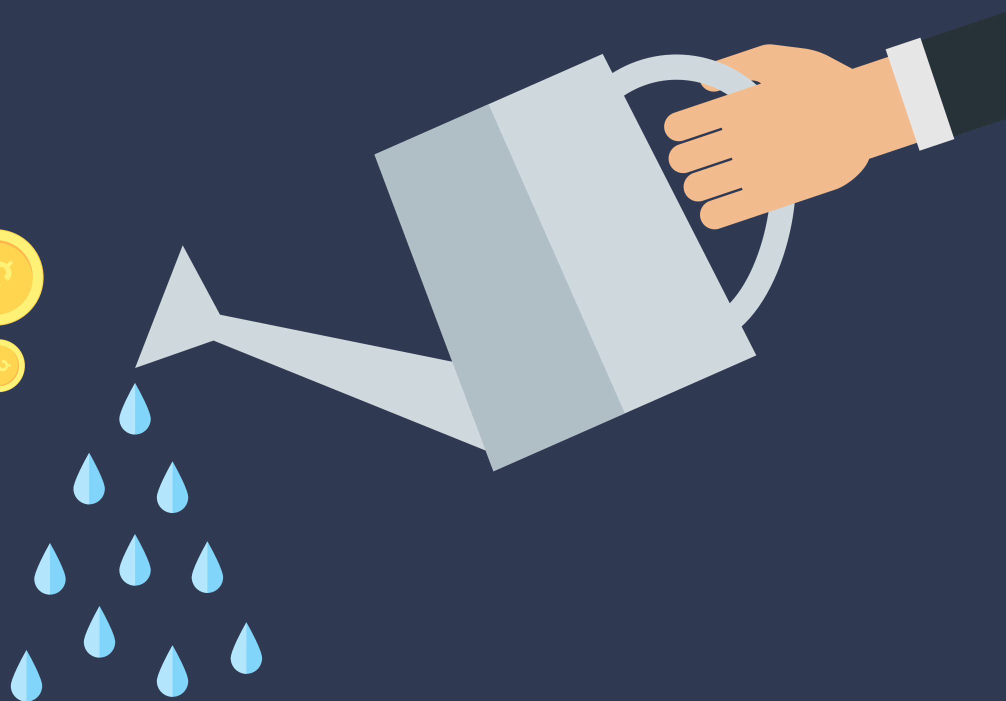
Where you elect to withdraw the excess from superannuation altogether, earnings made on the excess once it is outside superannuation will be taxed at your marginal tax rate. Often this will be more than the 15% superannuation rate, however tax offsets available to pensioners can make their effective tax rate lower than their marginal tax rate.

Another point to consider before withdrawing the excess from superannuation altogether is that with the decreased contribution caps which apply from 1 July 2017 (including the prohibition on non-concessional contributions where you have more than $1.6 million in superannuation) there may be very little ability to contribute the money back inside your superannuation fund in the future.

Of course, tax is not the only consideration. If you are low on cash and were thinking of withdrawing a lump sum anyway, then these changes may make that decision easier.

Finally, where your transfer balance exceeds $1.6 million (and indeed where it's under this) and you decide to sell assets supporting your pension before 1 July, these will continue to be CGT-free as your account is in pension mode.





What the Taxman IS THINKING

In this edition we examine the latest ATO Taxpayer Alerts – in relation to diverting personal services income and re-characterising trading income – and examine the tax treatment of ride-sourcing in light of a recent Federal Court ruling.

DIVERTING PERSONAL SERVICES INCOME TO SMSFS

The ATO is currently reviewing arrangements where individuals (typically those approaching retirement age) are diverting personal services income to their SMSF in order to enjoy concessional tax treatment on that income. These arrangements and the ATO's concerns are contained in *Taxpayer Alert TA 2016/6.*

Under these arrangements:

- An individual personally performs services for a client
- The individual does not directly receive any or adequate compensation for the services provided
- Instead the individual is instructed to and proceeds to pay the amount to a company, trust or other non-individual entity. The entity may be an unrelated third-party
- That entity then distributes the income to the individual's SMSF as a return on investment.

The outcome of these arrangements is an underpayment of tax. Rather than tax being paid at the individual's marginal tax rate (as high as 49% including Medicare levy), the amount is being taxed at the concessional superannuation rate of just 15% or indeed treated as exempt pension income if the individual's account is in pension mode.

The ATO states that these or similar arrangements may be ineffective and that tax returns may be amended to include this income as assessable personal services income to the individual. Alternatively, in some cases the amounts may constitute non-arm's length income for the SMSF and therefore not enjoy the concessional 15% tax rate. They may also constitute contributions to the SMSF which may in turn have excess contributions consequences. A final possibility is that the SMSF can be deemed to being maintained other than for the purposes of providing retirement benefits and as such it can be deemed non-complying and consequently its assets can be taxed at 45%.

With the ATO review under way, if you have entered into or are contemplating entering into this or a similar arrangement, the ATO is encouraging you to either phone them, apply for a private binding ruling, speak with your Accountant, or make a voluntary disclosure to the ATO and thereby reduce any penalties that may otherwise be payable.

RIDE-SOURCING IS TAXI TRAVEL

The Federal Court last month dismissed an appeal from Uber, and confirmed the ATO view that ride-sourcing (ride-sharing) does constitute 'taxi travel' for GST purposes. Consequently, the ATO has advised that unless Uber appeals this decision, it will continue to administer the law in accordance with its published guidance. We now detail what this treatment is from a driver's and passenger's perspective.

DRIVER

Ride-sourcing drivers have a range of tax obligations as follows:

- As ride-sourcing constitutes taxi travel, they must register for GST from when they sign up as a driver. The normal $75,000 GST registration threshold does not apply
- They must keep records of their expenses and income
- They must have an ABN
- They must pay GST to the ATO on the full fare (including any commission they pay to the facilitator e.g. Uber) for each trip they provide
- They must lodge Business Activity Statements
- They or the facilitator must provide passengers with a tax invoice where they request it and where the fare exceeds $82.50 (GST-inclusive)
- They must include the fares as income on their tax returns.

On the plus side, drivers are able to claim the GST and income tax deductions on expenses that they incur in driving such as insurance, petrol, registration, the facilitator's commission, and also depreciation of the motor vehicle. However, these claims must be apportioned to take account of any private use of the vehicle.

PASSENGER

From a GST perspective if the fare is work-related, GST registered taxpayers can claim this component of the fare back on their Business Activity Statement. If the amount of the fare is under $82.50 (GST-inclusive) you will not need a tax invoice to do so. If the fare is over this amount, you should request a tax invoice in order to claim GST.

From an income tax perspective, passengers can claim a tax deduction if the fare is work-related and would be deductible if you were driving that route yourself.

RE-CHARACTERISING TRADING INCOME

The ATO has just released *Taxpayer Alert 2017/1*. It explains that the ATO is currently reviewing arrangements where taxpayers are attempting to fragment integrated trading businesses in order to re-characterise trading income into more favourably taxed passive income. The income that might be expected to be subject to company tax is artificially diverted into a trust where, on distribution from the trust, that income is ultimately subject to no tax or a lesser rate than the corporate rate of tax.

The ATO goes onto state that even where these arrangements are effective and lawful under the substantive provisions of the Tax Act, they may nonetheless be caught by the Anti-Avoidance provisions as the dominant purpose for entering into these types of arrangements is to obtain a tax benefit. You can read the full Taxpayer Alert in the legal database section of the ATO website ***www.ato.gov.au***