MTS

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DUE DILIGENCE ON BUSINESS SALES

Federal Election – Tax Washup

All the latest TAX NEWS

1 July Tax Considerations

MyTaxSavers

JULY/AUG

2019

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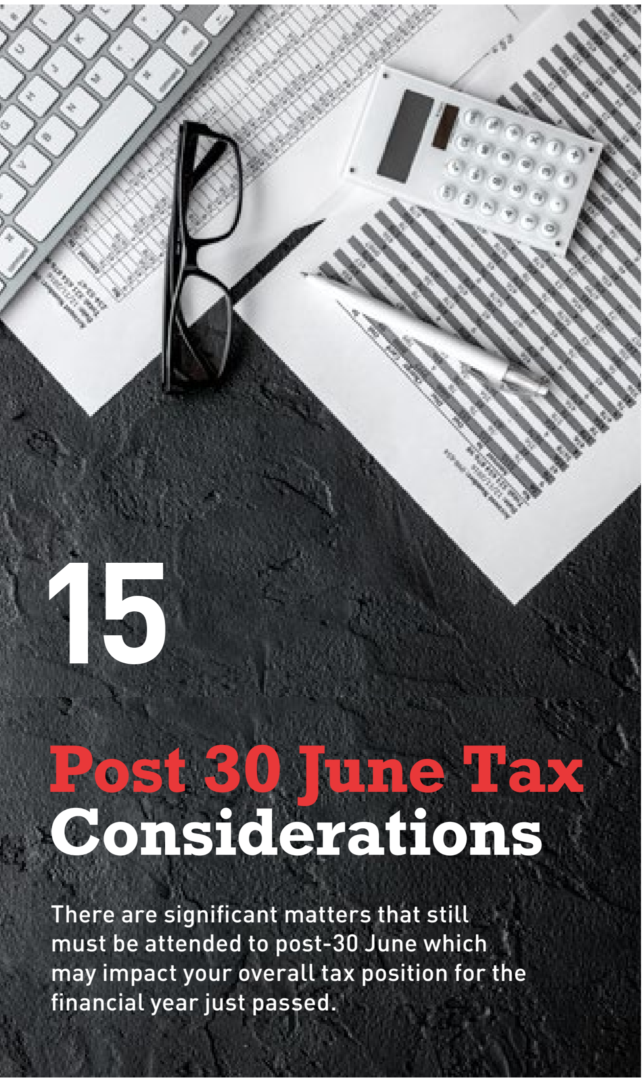

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1 July changes, and a review of your cashflow are two key issues as we enter the new financial year.

KEY DATES

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

JULY 2019

1 JULY
First day of the 2019/2020 financial year

1 JULY
Employers with less than 20 employees should start transitioning to Single Touch Payroll

14 JULY
2018/2019 Payment Summaries – due date to issue to employees

21 JULY
Monthly Activity Statements (June 2019) due for lodgement and payment

28 JULY
Quarterly Activity Statements (April-June) due for lodgement and payment (if lodging by paper)

28 JULY
Superannuation Guarantee Contributions (April-June) due for payment to superannuation funds or Clearing Houses

AUGUST 2019

11 AUGUST
Quarterly Activity Statements (April-June) due for lodgement and payment (if lodging electronically)

14 AUGUST
PAYG Withholding Payment Summary Annual Reports – due for lodgement

21 AUGUST
Monthly Activity Statements (July 2019) due for lodgement and payment

21 AUGUST
Final day for eligible monthly GST reporters to elect to report annually

28 AUGUST
2018/2019 *Contractor Taxable Payments* Annual Reports – due for lodgement

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

ARE YOU CARRYING ON A BUSINESS?

The ATO recently finalised its position on when a company will be deemed to be carrying on a business. This is important for the purposes of accessing a range of tax concessions. Does your business qualify?

INTRODUCTION

On 5 April 2019, the ATO released its long-awaited final ruling, ***Taxation Ruling TR 2019/1***, on when a company carries on a business for the purposes of:

1. *Section 23 of the Income Tax Rates Act (1986)* as it applied in 2015/2016, and 2016/2017. During these years, a lower corporate tax rate applied to taxpayers who were 'small business entities' (SBEs). We note that in years subsequent to this, eligibility for the lower corporate tax rate depends on whether a company meets the definition of "base rate entity" which broadly requires that companies must not receive more than 80% of their assessable income in passive forms (e.g. interest, rent etc.).

2. *Section 328-110* of the *Income Tax Assessment Act (1997)* which contains the criteria for the SBE test. If this test is met, a business can access a range of concessions including:

- **CGT concessions** – (15-year exemption, 50% active asset reduction, roll-over, retirement concession)
- **Income tax concessions** – ($30,000 instant asset write-off, simplified trading stock rules, roll-over for restructures of small businesses, immediate deduction for certain prepaid expenses, and the small business income tax offset)
- **GST concessions** – (accounting on a cash basis, annual apportionment of GST credits for acquisitions and imports that are partly creditable, and paying GST by instalments)
- **FBT concessions** – (car-parking exemption, and work-related devices exemption).

TAX TIP

Generally, the $10 million SBE turnover threshold applies to these concessions, except for:

- The Small Business Income Tax Offset which has a turnover qualification threshold less than $5 million
- The instant asset write-off which from 2 April 2019 has a turnover qualification threshold of less than $50 million, and
- The CGT concessions which continue to have a turnover qualification threshold of less than $2 million (or alternatively, net assets of less than $6 million).

We can see therefor the importance of this final ruling – if you are carrying on a business, then you potentially have access to a vast range of tax concessions.

GENERAL POSITION

The final ruling provides that it is not possible to state with absolute precision whether a company is carrying on a business. Rather this is a question of fact, which ultimately turns on an overall impression of the company's activities, having regard to the indicia of carrying on a business (as identified by the courts) including:

- Whether there is an intention to carry on a business
- The nature of the activities, in particular whether they have a profit making purpose
- Whether the activities are:
  - repeated and regular
  - organised in a business-like manner, including the keeping of books, records, and the use of a system
- the size and scale of the activities including the amount of capital employed in them, and
- whether the activity is better described as a hobby, or recreation.

With these broad indicators set down, the ruling defines carrying on a business quite widely, to the extent that where a taxpayer merely has a profit making purpose, it is accepted that it is likely the other above indicia will support a conclusion that the taxpayer is carrying on a business. In the case of limited, proprietary limited and no liability companies, the final ruling accepts that these companies would normally be carrying on a business in a general sense if they are established and maintained to make a profit for their shareholders, and invest their assets in gainful activities that have both a purpose and prospect of profit. As stated, this is a very broad interpretation.

EXAMPLES

With these broad parameters laid down, the final ruling then provides a number of useful examples, the first of which involves an inactive company which ceased trading in 2015/2016 with several hundred thousand dollars in retained profits in its bank account. In subsequent income years, the company's income consisted solely of $12,000 interest per year. Despite having no intention of resuming trading, because the company's income was consistently greater than its expenses (which consisted only of an ASIC company fee), it had a purpose and prospect of profit each year, and accordingly is deemed to be carrying on a business in subsequent years. As the following example from the final ruling illustrates, holding companies can also be carrying on a business:

ATO EXAMPLE

HoldCo is a company incorporated in Australia. HoldCo owns all the shares in SBE Co, which carries on a profitable trading business in Australia.

Possibility A: holding company only holds shares in subsidiary

HoldCo's only asset is its shares in SBE Co. HoldCo's activities consist of investing in shares in SBE Co and managing the company group. HoldCo's activities are carried on with a purpose and prospect of profit and reflect a normal commercial business structure. HoldCo carries on a business.

Possibility B: holding company holds shares in, and provides loan to, subsidiary

In addition to owning all the shares in SBE Co, HoldCo provides an interest-free loan to SBE Co and provides plant and capital equipment that SBE Co uses in its business rent free.

HoldCo's income consists of dividend income derived from the shares it holds in SBE Co. While it does not derive a direct return on the loan or provision of equipment, these enhance SBE Co's profitability and improve the return on Holdco's shares in SBE Co. The profits are distributed by HoldCo to its shareholders.

HoldCo's activities consist of investing in shares in SBE Co, managing the group, providing a loan to SBE Co and deriving interest income from the loan. HoldCo carries on a business.

The ruling then provides the following further examples, all of which constitute the 'carrying on of a business':

- A company engaged in the preliminary activity of investigating the viability of carrying on a particular business, and invests its share capital of $300,000 in interest-bearing bank accounts, earning $9,000 per year. No decision has been made to carry on the business under investigation.
- Property investment company owns a single commercial property which it rents out for profit to a third-party. It does not service the property, or conduct any other activities.
- A share investment company solely set-up for this purpose. $400,000 of investments generating $20,000 per year after expenses. Even where a third-party manages the portfolio.
- Leasing passenger boats to an unrelated party under a commercial lease agreement. Three boat business. Even where a management company undertakes the chartering.

Perhaps one of the flaws of the final ruling is that – unlike the draft ruling it replaces - it fails to provide clear examples of what does not constitute the carrying on of a business. In the draft ruling, these included:

- Dormant companies with retained profits and a bank account in which it earns small amounts of interest sufficient only to cover its ASIC fees (as opposed to a large amount of interest in the earlier example in the final ruling)
- Companies engaged in the preliminary activity of investigating the viability of carrying on a particular business (by contrast, the final ruling – see earlier – the company invested its share capital, earning significant interest)
- Family companies with an unpaid present entitlement (UPE) from a family trust that have not demanded payment from the trust and also not entered into any arrangement with the trust to receive any profit from the UPE
- Family companies whose only income is trust distributions from a discretionary trust which it distributes partly in cash to the shareholders with the balance held in a non-interest bearing bank account pending distribution to other shareholders. The company also has no other assets.

By failing to provide such examples of what does not constitute the carrying on of a business, the parameters of the carrying on a business test are not as well fleshed out as they could be.

TAKE-HOME MESSAGES

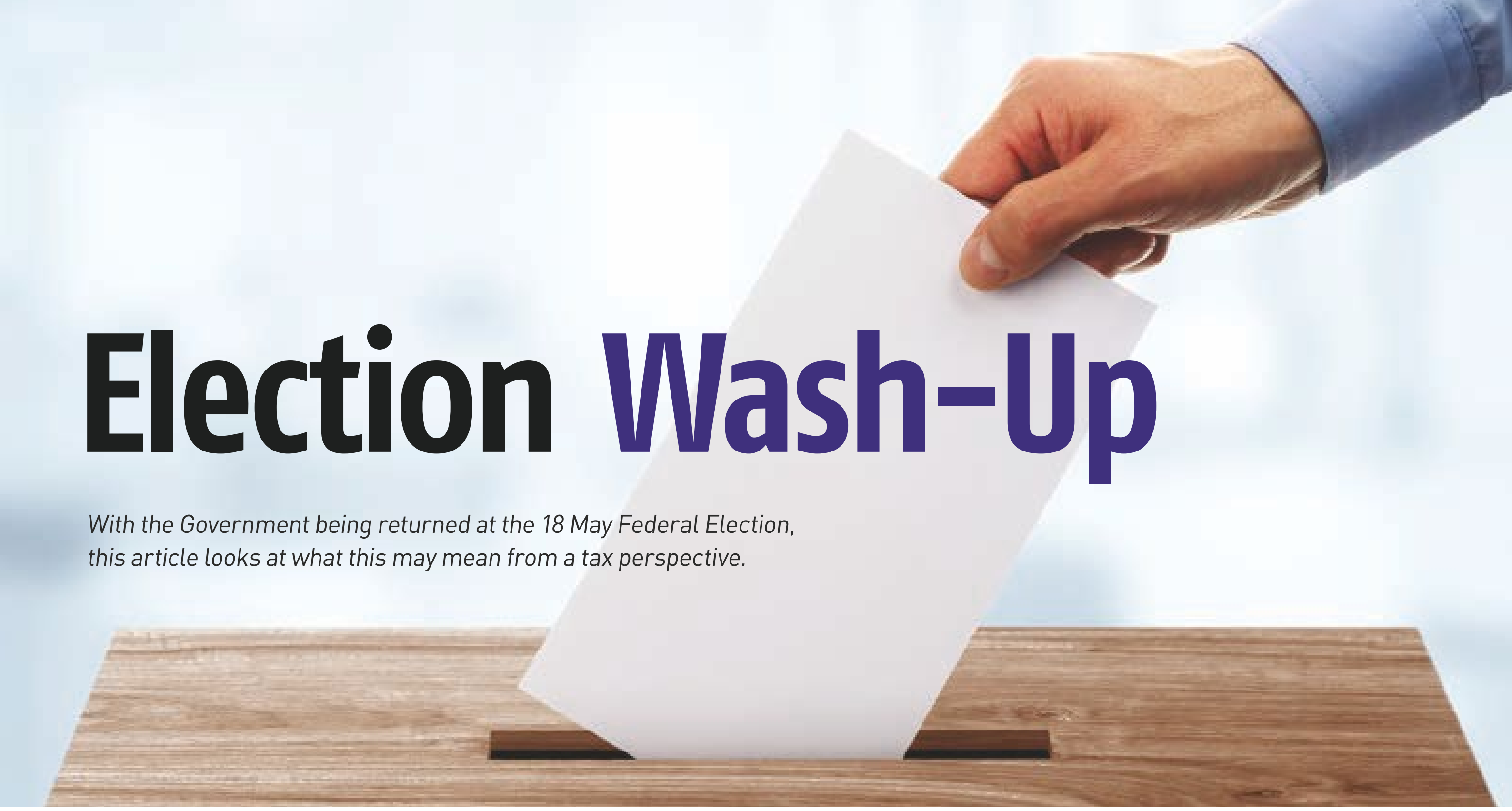
All told, the finalised ruling provides a very wide definition of 'carrying on a business' for Section 328-110 and Section 23 purposes. It applies to income years both before and after its date of issue. Business owners in consultation with their advisors should:

- Review 2015/2016 and 2016/2017 tax returns (if within the amendment period) for eligibility for the lower corporate tax rate
- If necessary, issue revised distribution statements for these years
- Review eligibility for access to the Small Business Concessions for prior years, and moving forward.

ACCOMPANYING DRAFT RULING

Released at the same time as *TR 2019/1*, was draft tax determination *TD 2019/D4*. This draft determination indicates that a company whose only business activity is renting out an investment property is not eligible to claim the CGT small business concessions in relation to the disposal of the property, notwithstanding that it may carry on a business in the general sense for TR 2019/1 purposes.

The requirement to 'carrying on a business' is only one of a number of criteria to be able to access the CGT small business concessions. Importantly, the relevant asset also needs to be an 'active asset'. However, an asset cannot be an active asset if its main use is to derive rent. As such, the draft determination states that the small business CGT concessions would not be available upon disposing of the investment property.



Election Wash-Up

With the Government being returned at the 18 May Federal Election, this article looks at what this may mean from a tax perspective.

PERSONAL INCOME TAX

INCREASED TAX OFFSET

The centrepiece of the recent Federal Budget was immediate tax relief for individuals earning up to $126,000. This is in the form of the Low and Middle Income Tax Offset (LMITO) which the Opposition also states that it supports.

This will come into almost immediate effect, in that it will apply to upcoming tax returns lodged for 2018/2019. Under the changes, the reduction in tax provided by LMITO will increase from a maximum amount of $530 to $1,080 per year and the base amount will increase from $200 to $255 per year for the 2018/2019, 2019/2020, 2020/2021 and 2021/2022 financial years. Those on incomes between roughly $48,000 and $90,000 per year will receive the full $1,080 offset, while for individuals with incomes of $90,000 to $126,000 the offset will taper off at a rate of 3 cents per dollar for every dollar over $90,000. Those who earn less than $37,000 will receive an offset of $255.

This offset does not need to be claimed separately in tax returns. Rather it will automatically be processed and provided to taxpayers when they lodge their upcoming 2018/2019 income tax returns. If the legislation is not in place by 1 July 2019 when people first start lodging their tax returns, the ATO is at this stage proposing to process amended assessments to those who lodged before the law is passed to include the LMITO entitlement.

TAX TIP

Once the law is passed (expected to be early July) you may wish to get your 2018/2019 records to your Tax Agent and instruct them to lodge early rather than in the first part of the 2020 calendar year (which is the normal lodgement time if lodging with a Tax Agent). By doing so, all other things being equal, you will bring forward your LMITO entitlement with a potential additional refund of up to $1,080 (subject to the above income limits, and subject to not otherwise having underpaid tax during the year).

DEFICIT LEVY

With the Opposition losing the election, the Deficit Levy will not be re-introduced. This was originally introduced by the Abbott Government in the form of a 2% increase to the top marginal tax rate which kicks in at $180,000, increasing that top rate from 45% to 47% (not including Medicare levy). With the Government being re-elected, the top marginal tax rate will remain at 45% going forward.

INCOME TAX REDUCTION

On Budget night, the Government also proposed that from 1 July 2022, it would increase the top threshold of the 19% personal income tax bracket from $41,000 (as currently legislated) to $45,000. The Federal Opposition announced that it supports this change, meaning that the following rates will likely apply from 1 July 2022:

Resident Individuals – Proposed Tax Rates

2018/2019		2022/2023	
Income threshold $	%	Income threshold $	%
0-18,200	0	0-18,200	0
18,201-37,000	19	18,201-45,000	19
37,001-90,000	32.5	45,001-120,000	32.5
90,001-180,000	37	120,001-180,000	37
180,001- above	45	180,001- above	45

INVESTORS

CGT DISCOUNT UNCHANGED

The CGT discount will remain at 50% for assets held for 12 months or more. The Federal Opposition had proposed to reduce the discount to 25% for assets purchased on or after 1 January 2020.

Only the following taxpayers are eligible for the 12-month discount:

- Individuals (50% discount)
- 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%).

On taxable capital gains where the asset is held for 12 months or more, the maximum effective tax rate payable for superannuation funds is 10% (the standard superannuation concessional tax rate of 15% is reduced by 1/3rd). On the other hand, for both individuals and trusts, the discount halves your capital gain (50%). Therefore, even if you are on the top individual 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% (i.e. 50% of the 47% marginal rate). The notable exclusion here are companies. They are not eligible for the discount, however they may be eligible for the CGT Small Business Concessions.

TAX TIP

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 and, in doing so, reduce any capital gain by 50%. To reiterate, for CGT purposes, the sale date is the contract date or change in ownership date - not the settlement date!

NEGATIVE GEARING

With the Government being re-elected, there will be no changes to the existing negative gearing rules.

Negative gearing is an often-used and sometimes misunderstood phrase in relation to property and borrowings. When boiled down to its basics, negative gearing refers to the practice of accepting a loss from an investment with a view to trading that loss off against a capital gain. Therefore, for a negative gearing exercise to work, it is important to select an asset that will have capital growth – otherwise all those losses you have been absorbing while holding the negatively geared investment will not have been worthwhile.

An investment is said to be negatively geared if, after taking into consideration all of the income and expenses associated with holding the asset (i.e. property, shares), the investment shows a negative net return i.e. a loss. Whilst all taxpayers can negatively gear, it is typically more appealing to taxpayers with higher marginal rates of income tax. This is because the ATO allows an offset of the loss from the holding of a negatively geared investment against other income. Therefore, the higher a taxpayer's marginal tax rate, the greater the benefit from a gearing strategy.

The Opposition had proposed to limit negative gearing to new housing from 1 January 2020. All investments made before this date were not to be affected by this change and would have been fully grandfathered.

FRANKING CREDITS

Investors (including superannuation funds) will continue to be entitled to a refund of excess franking credits in circumstances where their own tax payable sits at zero.

SUPERANNUATION

The Government committed to no new taxes on superannuation last month. However, it's unclear how long this guarantee is in place for.

Going forward, the Government intends to implement the following superannuation policies, most of which were proposed in the recent Federal Budget:

REMOVAL OF THE WORK TEST FOR SOME OLDER AUSTRALIANS

The Government proposes to remove the superannuation 'work test' for individuals aged 65 and 66 from 1 July 2020. This will align the work test with the eligibility for the Age Pension, which is slated to increase to 67 from 1 July 2023. The change will enable an additional estimated 55,000 individuals to make concessional and non-concessional (after tax) voluntary contributions even if they are not working. The work test – which requires older Australians to work a minimum 40 hours over a 30-day period in order to make a voluntary superannuation contribution – will remain in place for those aged 67-74.

The suspension of the work test, will enable taxpayers aged 65 and 66 who are no longer working, or only working a few hours per week, to contribute to superannuation and enjoy the tax concessions that it provides. Taxpayers in this age bracket will also have automatically met a condition of release (i.e. turning 65), and therefore will be able to withdraw these contributions as and when they please.

We note that there is already a one-year exemption in place from the work test to allow recent retirees to boost their superannuation balances. That is, from 1 July 2019, individuals aged 65 to 74 years with total superannuation balances below $300,000 can make voluntary contributions to superannuation for 12 months from the end of the financial year in which they last met the work test.

EXTENDING ELIGIBILITY FOR THE BRING-FORWARD CAP

In a measure designed to complement the above removal of the work test, from 1 July 2020, access to the bring-forward cap will be extended from taxpayers aged less than 65 years of age to those aged 65 and 66. This will enable these individuals to make up to three years' worth of non-concessional contributions, normally capped at $100,000 per year, to superannuation in a single year (but no more than $300,000 over the three-year total period). This will give older taxpayers increased flexibility to save for retirement. Taxpayers in this age bracket will be able to contribute lump sums that they have on hand into superannuation more quickly; bringing forward the accompanying tax concessions – rather than a maximum of $100,000 per year under the current rules that apply.

INCREASE TO AGE LIMIT ON SPOUSE CONTRIBUTIONS

From 1 July 2020, the Government proposes to increase the age limit for spouse contributions from 69 to 74 years. Currently, individuals aged 70 and over cannot receive contributions made by another person on their behalf. Therefore, individuals up to and including age 74 will be able to receive spouse contributions, with those aged 65 and 66 no longer needing to meet a work test. As has been the case in the past for recipient spouses aged between 65 and 70, a recipient spouse aged 67 to 74 will need to satisfy the work test in order for the super fund to accept the contribution. Providing taxpayers with greater ability to contribute on behalf of their spouse, can be particularly advantageous where:

- the recipient spouse is significantly older (as they be may able to access a tax-free superannuation pension earlier than the contributing spouse) or
- has a low income (as the contributing spouse may be entitled to a spouse tax offset) or
- where the contributing spouse is unable to contribute personally (as they may have already met their contribution limits).

SMSF MEMBER INCREASE

The Government will again move to have six-member self-managed superannuation funds (SMSFs) legislated (up from the current limit of four members) despite the proposal being removed from a bill introduced earlier this year. This will enable more of your family members or other close associates to join your SMSF. On the plus side, the greater the pool of funds (that may result from additional individuals) the greater the ability to invest. On the downside however, it may be more difficult to manage competing interests of a larger group of members. For example, younger people may prefer a higher risk investment settings than an older person in that SMSF who is nearing retirement.

DEFEATED PROPOSALS

With the Opposition being defeated, their following superannuation changes will not proceed:

- Individuals under 75 will still be able to claim a deduction for their after-tax contributions. The Opposition had proposed to reinstate the 10% rule whereby a deduction could only be claimed if less than 10% your income was earned from employment-related activities. Therefore, if you were thinking of making a personal after-tax contribution, you may continue to enjoy a tax deduction
- The non-concessional contribution cap will not be reduced to $75,000. It will remain at $100,000 per year.
- Limited Recourse Borrowing Arrangement (LRBAs) will not be banned. LRBAs are a highly conditional form of SMSF borrowing which enable SMSFs, via a separate holding trust, to acquire shares and property.
- The Division 293 tax threshold will not be lowered to $200,000 – it will remain at $250,000 Division 293 tax reduces the tax concession on super contributions. An individual's income is added to certain super contributions made during the year, and compared to this dollar threshold. Division 293 tax is payable on the excess over the threshold, or on the super contributions, whichever is less. The rate of Division 293 tax is 15%
- The Superannuation Guarantee rate of 9.5% will not be increased. The Opposition had proposed to gradually increase the rate to 12%.

HOUSING DEPOSIT SCHEME

During the Election campaign, the Government pledged to help first home-buyers into the market by topping up their 5% deposits with a Government guarantee for 15% of the loan.

Single people earning up to $125,000 or couples earning up to $200,000 will be eligible for this first-home loan deposit scheme if they have saved 5% of the value of the home.

The Government will set aside $500m of equity through the National Housing Finance and Investment Corporation to guarantee loans up to a value of 20% of the home. Buyers won’t need to have a full 20% deposit and will save around $10,000 by not having to pay lenders mortgage insurance.

The scheme is limited to 10,000 first homebuyers, roughly one-in-10 of the 110,000 Australians who bought their first home in 2018.

The Government has suggested there will be regional caps on the value of homes for which it will guarantee a deposit.

Once the first homebuyer has borrowed 95% of the value of the house, the Government guarantee lasts until the homeowner refinances.

The Opposition also adopted this policy after it was announced, so therefore there is a high likelihood that it will pass into law when Parliament resumes.

BUSINESS

DEPRECIATION

In the Election campaign, the Opposition announced that it would introduce an Australian Investment Guarantee, allowing all Australian businesses to immediately deduct in the year of purchase and installation, 20% of any new eligible asset. The remaining balance was to be depreciated under existing rules.

With the Government winning however, the major depreciation reform that was implemented just prior to the Election will remain in place. That is, going forward, new purchases of assets under $30,000 can be written off immediately if your business has a turnover of less than $50 million.

TREASURY EXAMPLE

Mark owns a company, Lat Val Pty Ltd, through which he operates a food manufacturing business in the Latrobe Valley employing 60 staff. Lat Val Pty Ltd has an aggregated turnover of $25 million and a taxable income of $900,000 for the 2019/2020 income year. Ordinarily Lat Val Pty Ltd would be too large to access the instant asset write-off, but the new law means it can now benefit.

Lat Val Pty Ltd purchases 10 new commercial ovens 31 December 2019, at a cost of $12,000 each, exclusive of GST, to allow Lat Val Pty Ltd to expand its business and improve efficiency.

Under the old law, Lat Val Pty Ltd would depreciate the new ovens using an effective life of 15 years. Choosing to use the diminishing value method, Lat Val Pty Ltd would claim a tax deduction of $400 per oven, a total deduction of $4,000 for the 2019/2020 income year.

Under the new $30,000 instant asset write-off, Lat Val Pty Ltd would instead claim an immediate deduction of $120,000 for the purchase of the 10 ovens in the 2019/2020 income year, $116,000 more than under the old arrangements. This will help the business to invest, grow and employ more workers.

This example on the Treasury website, then goes onto state that "the Government's changes mean that Lat Vat Pty Ltd. pays less tax, increasing its cash-flow by $31,900". This amount is the tax value of the brought-forward deduction ($116,000 x 27.5% corporate tax rate = $31,900).

The Treasury statement is somewhat misleading, however, because while the company will be paying "less tax" under the new law, it would pay more tax in subsequent years (but no more overall) because no depreciation claim is available as it has been exhausted. Consequently, business owners should not let tax distort or blur their commercial instincts – as they don't get any extra cash than they would otherwise have under the old rules (they just get it sooner) they should continue to only buy assets that fit within their business plan. However, a return on investment calculation will be more favourable due to the time value of money. This might make the difference between making a purchase and not making a purchase. So while you are paying no more or less tax overall, the ability to write-off an asset immediately, means you will enjoy a significant cash flow benefit under the changes. Cash flow is one of the leading causes of small business failure.

FURTHER TAX CUTS?

The Government has abandoned plans to extend the corporate tax cuts to companies with a turnover in excess of $50 million. This means that moving forward the company tax rates will remain as legislated.

Income year	Aggregated turnover threshold	Tax rate for base rate entities under the threshold	Tax rate for all other companies
2018–19 to 2019–20	$50m	27.5%	30.0%
2020–21	$50m	26.0%	30.0%
2021–22	$50m	25.0%	30.0%

As well as having a turnover of less than $50 million, eligibility for the lower corporate tax rate (currently 27.5%) depends on the company being a 'base rate entity' (see our article on page 4 for a new development in this area).

TAXABLE PAYMENTS REPORTING EXPANDED

The Taxable Payments Reporting System has recently been expanded to several more industries. This article informs business owners whether they will be caught within these new rules and be required to report.

BACKGROUND

The Taxable Payments Reporting System (TPRS) is a Black Economy / Cash Economy transparency measure that requires businesses that operate within prescribed industries to report payments they make to contractors who operate within that industry. The TPRS was originally implemented in 2012 to apply to businesses operating primarily in the building and construction industry.

With the success of TPRS in the building and construction industry (in its first year of operation alone, additional income tax and GST liabilities of more than $2 billion were voluntarily reported to the ATO by businesses whose incomes were reported under the regime), the Government has expanded the regime with legislation now passed to include the following industries:

- Security providers and investigation services;
- road freight transport; and
- computer system design and related services (for payments made from 1 July 2019, with the first report due on 28 August 2020).

Use the following ATO flowchart to determine whether a client is required to report under the latest expansion to the regime.

Do you have an Australian business number (ABN)?

YES

Have you supplied a 'relevant service'?
- road freight service
- secruity, investigation or surveillance service
- information technology service

YES

Have you made payments to one or more contractors to provide the relevant service on your behalf?

YES

You must report the payments you made to these contractors in a *Taxable payments annual report*, unless a reporting exemption applies to you (see Appendix 1 of this Ruling).

TAX TIP

Where you determine that you are required to report (regardless of industry), the reporting process can be automated with software. Latest versions of accounting software can be set up to capture the relevant payments made during the year. At year-end, the software can generate a complying report that can then be lodged electronically with the ATO. Talk with your Accountant or software provider about how you can set this up.

ROAD FREIGHT

Road freight services have been added to the TPRS along with courier services; ensuring that any service where goods are transported over road are covered by the TPR regime (but note the different commencement dates – payments made to contractors for road freight services are not required to be reported until 1 July 2019). Being such a large country, with vast distances between population centres, road freight services are widespread. Every day, for example, more than 4,000 heavy trucks make the 12-hour trip between Sydney and Melbourne.

'Road freight' refers to the transport of goods by freight over road, which is not included in the meaning of a 'courier' service. Typically, goods will be sent by road freight where the goods are transported in bulk usually using larger vehicles as per the following table:

Reportable	Non-Reportable (in this report)
Furniture removal service	Passenger transport services
Log haulage	Courier services
Road freight forwarding	Operation of road freight terminals
Truck hire (with driver)	Providing crating and packing for road freight transport
	Leasing or hiring trucks without drivers

A road freight service does not however need to include the whole of a service offering but may include only part of a road freight service. For example, you may be required to report details of transactions where you have engaged specialist drivers to deliver freight goods using a vehicle owned by the reporting entity (despite not providing the vehicle, the contractor has provided the driving component of the service).

The use of the word ‘road’ in relation to freight limits the requirement to report to only those freight services that relate to road transport, and excludes other modes of freight transportation, such as by boat or aeroplane. However, this qualification is not intended to apply to courier services, which may involve the transportation of goods other than on road, such as by bike.

Real-life examples of road freight services would include, for example, where contractors:

- Pick up imported cars from ports, and then transport them in bulk via heavy vehicles to a car company’s headquarters
- Transport bulk groceries from grocery suppliers to supermarket stores
- Transport of bulk livestock / cattle via “triple-trailer “road trains” from the sale yard or breeders to various destinations.

Payments for the relevant part of a mixed supply must be reported, whereas payments in respect of composite supplies do not need to be reported.

ATO EXAMPLE

A large masonry manufacturer has a number of separate divisions to its operations. One division manufactures concrete bricks. Although these can be picked up in small quantities by builders, they are regularly delivered to landscape suppliers in bulk. The cost of delivery is added on to the cost of the bricks. The delivery is not incidental to the supply of the bricks but rather is a mixed supply. Therefore, payments made contractors who deliver the bricks to landscape suppliers must be reported.

By contrast, the business also supplies ready-mix concrete. The concrete is sold at an agreed price per cubic metre. The distance which it can be transported (due to the nature of the product) for delivery is short. The nature of the ready-mix concrete is that it is designed to be ready to use at the place and time it is delivered. The delivery of the concrete is integral to the supply of the ready-mix concrete. Therefore, as this constitutes a composite supply, payments made to contractors in respect of this freight service are not reportable.

SECURITY, INVESTIGATION OR SURVEILLANCE SERVICES

Security” refers to protection from, or measures taken against, injury, damage, espionage, theft, infiltration, sabotage etc.

An investigation refers to a searching inquiry in order to ascertain facts. This is usually conducted by a detective or an enquiry agency, and may be about matters that are not necessarily related to security. For example, it could refer to investigations conducted or enquiries made to assess the veracity of insurance claims. As per the Explanatory Memorandum to the legislation, generally, investigation services involve a person making specific investigations into persons or matters. However, an investigation service does not refer to any service which may be used to compile or gather information, such as online search engines or databases which are maintained to perform checks. Where a person merely checks an existing database for information (such as for the purpose of preparing a police check or credit score), generally this does not constitute an investigation service. An investigation service also does not include the making of general enquiries, such as requesting a person’s name, date of birth, or address.

Finally, a surveillance service refers to a general watch or observation maintained over an area or location, by one or more people or alternatively by using devices such as motion detector alarms, cameras or recorders. This includes watchmen services, alarm monitoring and services that involve the use of closed circuit television (CCTV) cameras for the purpose of surveillance or maintaining security.

The following table sets out examples of what is included in this broad category of service:

Reportable	Non-Reportable
Locksmithing	Policing
Burglary protection	Operation of detention facilities
Body guards	Country border surveillance
Security guards	Aerial surveying or mapping services
Armoured car service	Academic or market research
Alarm monitoring and response	Manufacture, retail, installation, maintenance or repair of fire alarm systems
Detective agency service	Manufacture, installation or retail of security, investigative or surveillance devices (e.g. security alarms or cameras, or voice recorders)
Night watch service	Providing key cutting/ duplication services
Crowd, event or venue control	Checking/searching of existing databases
Operating security control rooms or monitoring centres	General enquiries (name, date of birth etc.)
Operating security screening equipment (e.g. x-ray scanners)	

Often it will be the case that an organisation installs security alarms and cameras, and then monitors these. In the case of such mixed supplies, only payments to contractors for the monitoring services are reportable.

INFORMATION TECHNOLOGY (IT) SERVICES

'IT' services involve the provision of expertise in relation to computer hardware or software to meet the needs of a client. These services may be performed on site, or may be provided remotely through the internet, and include services that support or modify the operation of hardware or software.

This service does not include the mere sale or lease of hardware or off-the-shelf software. However, if the seller or lessor of the hardware or software modifies it for the purchaser or lessee, or develops specific software for them, then those services will be an IT service.

If computer software is used by the entity to provide a service other than an IT service, the mere use of software in these circumstances does not make the service an IT service. For example, the use of software to provide an accounting, project management, or word processing service is not an IT service. The following table lists examples of services in this space, and whether payments made to contractors for the provision of those services are reportable:

Reportable	Non-Reportable
Technical support	Mass producing computer software
Computer facilities management	Leasing or hiring computers or other data processing equipment
Internet and web design consulting	Providing data processing services or computer data storage and retrieval services
Computer hardware consulting	Installing computer cables
Customised software development	
Computer network systems design and integration	
Software installation	
Computer programming	
Software simulation and testing	
Computer software consulting	
Systems analysis	

One of the key points in determining whether reporting is required in this sector is distinguishing between the selling of a product on the one hand, and a service on the other. Where contractors are engaged to write software, for example, which is to be made available to consumers generally, then payments that they receive for this service are not reportable. This is because the software is not designed for a particular client. Rather, it is being sold to consumers at large as a product – it is not tailored to a particular client need.

REPORTING EXEMPTIONS

1. DE MINIMIS RULE

While generally all businesses who make payments to contractors for the above services are required to report those payments, a de minimis exception applies for the payer. That is, a business is exempted from reporting where payments received by the entity for services are less than 10% of your current GST turnover.

2. CONSOLIDATED GROUPS

The second exemption is that payments for contractor services within consolidated groups are not required to be reported. This exemption does not however apply to payments made by a member of a consolidated group to contractors outside the group even where that contractor is paid to provide services to another member of the consolidated group. This is because the focus of TPR is not the recipient of the service but of the service provider who receives the payments. If the service provider who receives the payments is outside the consolidated group, then that payment will need to be reported (unless an exemption applies).

3. OTHER GENERAL EXEMPTIONS:

- Payments for materials only (however where an invoice is for both labour and materials – whether the amounts are itemised or combined – you are required to report the whole amount of the payment.
- Invoices unpaid at the end of the income year
- Payments subject to PAYG withholding
- Payments made by individuals for private and domestic reasons
- Payments where the payer does not have an ABN.

New Tax Whistleblower Laws

New laws now protect those who wish to blow the whistle on other taxpayers for non-compliance with the tax laws. This has implications for taxpayers, business and tax agents.

BASICS

The Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019 was passed by the House of Representatives on 20 February 2019 and received Royal Assent on 12 March. On becoming law from 1 July 2019 it will, among other things, introduce protections and remedies for tax whistleblowers who make a protected disclosure about breaches or suspected breaches of the tax laws or misconduct in relation an entity's (including an individual or business) tax affairs. Currently, there is no specific legislative regime for the protection of such individuals (tax whistleblowers).

At the moment, there is the ability to make anonymous disclosures to the ATO via their Tax Evasion Reporting Centre by phoning **1800 060 062**. However, where you reveal your identity or your identity becomes known, there is no obligation on the ATO to protect your identity and no protection for you from adverse consequences that flow from that flow from your identity becoming known, such as your employment being terminated or your business's reputation being targeted.

Before we turn to the legislation, we note that there is no requirement under the current law (or in this new legislation) for tax practitioners to report to the ATO any illegality or suspected illegality by clients in respect to the tax laws or any other aspect of their business. The ATO, Fair Work Australia, the Tax Practitioners Board and professional associations generally do not require you to report any illegal or suspect client conduct. Rather, you are only required to not participate in that conduct and to act in accordance with taxation laws even where your client instructs or encourages you to do otherwise.

Likewise, there is no requirement for individuals (such as employees, contractors, business associates etc.) to report tax non-compliance.

QUALIFYING DISCLOSURES

A disclosure to the Commissioner of Taxation qualifies for protection under the new rules if the tax whistleblower has "reasonable grounds" to suspect that the information indicates misconduct or an improper state of affairs or circumstances, in relation to the tax affairs of an entity. This includes income tax (including CGT), GST, and FBT etc. Therefore, breaches relating to workplace laws (such as the underpayment of workers) or other taxes such as those administered by State Revenue Offices, are not covered. Information provided by tax whistleblowers may include, for example, details of non-compliance with a tax law, tax evasion, a scheme set up to avoid tax, unexplained wealth, or any other tax-related misconduct.

The 'reasonable grounds' threshold means that whisteblowers are not required to have definite knowledge of a breach of the tax laws. This is designed to encourage whistleblowers to come forward. However, the requirement that the grounds be 'reasonable' guards against vexatious or baseless complaints.

Aside from the Commissioner, a whistleblower may also make a disclosure qualifying for protection to an 'eligible recipient'. These can generally be described as recipients who are in a position to take some action in relation to the issues raised in a disclosure. This includes tax practitioners (tax agents and BAS agents) and auditors.

ELIGIBLE WHISTLE-BLOWERS

Those eligible for protection are generally internal to the entity about which the disclosure is made, or have a relationship with that entity that is relevant to its tax affairs. The legislation lists the following individuals:

- an officer of the entity (within the meaning of the Corporations Act)
- an employee
- an individual or their employees who supplies paid or unpaid goods or services to the entity (including tax practitioners)
- an individual who is an associate of the entity (see later example)
- a spouse or child of any of these listed individuals, and
- a dependant of an individual referred to above or a dependant of the individual's spouse.

This includes where these individuals had a prior relationship with the entity about which they are making disclosures. For tax practitioners, this includes former clients. For individuals, it includes former employers.

TREASURY EXAMPLE – AN ASSOCIATE OF THE ENTITY

Lyn is an employee of Company A. Company A is an associate of Company B because Company A is reasonably expected to act in accordance with the wishes of Company B. Company A is not involved in the day-to-day running of Company B, the companies lodge separate tax returns and have separate auditors. Lyn becomes aware that Company B is not correctly reporting its sales income, in breach of the taxation laws. Lyn discloses this information to a member of Company A's audit team.

Lyn is eligible for protection in respect of this disclosure.

CONFIDENTIALITY

Disclosure to the Commissioner or an eligible recipient (including, as per earlier, tax practitioners) can be made anonymously. In cases where the whistleblower's identity is known by the recipient, it is an offence for a person to disclose an eligible whistleblower's identity or information that is likely to lead to the identification of the whistleblower. This is designed to protect eligible whistleblowers from victimisation, career damage, or other harm as a result of making a protected disclosure, and is common to most whistleblower regimes. Breaches of this confidentiality requirement can result in six month's imprisonment and/or fines of up to $200,000 for an individual or $1 million for a corporation.

As stated, tax practitioners and auditors are among the listed recipients. Therefore, they may receive information from eligible tax whistleblowers in respect of your clients (e.g. from their employees, contractors etc.). Where this is the case, the tendency may be to pass on that information to your client. However, doing so would expose yourself or your practice to criminal liability – large fines and/or imprisonment for revealing the identity of the tax whistleblower, see earlier – under the new regime. Therefore, to avoid breaches, it's recommended that internal procedures for your employees be put in place within your practice in the event that qualifying disclosures are made by eligible whistleblowers (acknowledging that most disclosures will be made to the ATO).

Importantly, even where eligible disclosures are made to tax practitioners, they are under no obligation to refer the matter to the ATO. As a recipient, the extent of their obligations is to protect the identity of the tax whistleblower who provided them with the information.

Whilst there are identification protections built into the legislation, in some cases it may be obvious to clients who has disclosed the information. For example, as their tax practitioner you may be the only person privy to certain financial aspects of the client's affairs. To this end, the protections under the legislation prohibit any form of victimisation. That is, it is an offence for a person to victimise a whistleblower or another person by engaging in conduct that causes detriment, where the conduct is based on a belief or suspicion a person has made, may have made, proposes to make or could make a disclosure that qualifies for protection. Detriment is defined very broadly and includes:

- dismissal of an employee
- injury of an employee in his or her employment
- alteration of an employee's position or duties to his or her disadvantage
- discrimination between an employee and other employees of the same employer
- harassment or intimidation of a person
- harm or injury to a person, including psychological harm
- damage to a person's property
- damage to a person's reputation
- damage to a person's business or financial position; and
- any other damage to a person.

PROTECTION

The scope of the protection afforded to a tax whistleblower is comprehensive. The new law ensures that eligible whistleblowers are not subject to any civil, criminal or administrative liability (including disciplinary action) for making the disclosure, and that no contractual or other remedy may be enforced against them on the basis of the disclosure. In the tax practitioner context, should you make an eligible disclosure to the ATO in respect of a client or former client, this would mean immunity from:

- Fines or other sanctions imposed by the Tax Practitioners Board for breaching the Code of Professional Conduct in respect of:
  - » Code item 6 – duty of confidentiality
  - » Code item 4 – act in the best interests of your client
- Penalties contained in the Privacy Act
- Any civil action taken by your clients, such as for breach of a fiduciary duty owing to the client
- Any contractual, common law action such as for breach of contract pursuant to your Engagement Letter.

The new law therefore provides a 'use immunity' for individuals (including tax practitioners) by preventing potentially incriminating information that is part of a disclosure from being admissible as evidence against you in civil or criminal proceedings for the imposition of a penalty.

OBSERVATIONS

- The legislation commences 1 July 2019
- You are now free to make anonymous disclosures relating to tax affairs and are somewhat protected from any detriment that may flow from that
- Tax practitioners may be a recipient of a disclosure. Ensure that employees and senior staff in your practice are aware of the whistleblower confidentiality requirements
- While the regime offers some welcome protection to tax payers and tax practitioners who are contemplating making disclosures, we would urge caution before making a disclosure. You need to carefully weigh any potential consequences, and indeed whether your particular disclosure is covered by the new regime. Even with protections from victimisation, there could nonetheless be some unpleasantness involved in disclosing if it is obvious that you were the person who disclosed.

Post 30 June
Tax considerations

While the arrival of 1 July means that your tax position for 2018/2019 is largely now determined, there are significant matters that still must be attended to post-30 June which will impact your overall tax position for that year.

SUPERANNUATION DEDUCTIONS

If you made a superannuation contribution in 2018/2019 for which you can claim a deduction, then you will need to complete paperwork to ensure its deductibility.

To be eligible to claim a deduction for contributions made to superannuation, the contribution must be made between 1 July 2018 and 30 June 2019. In terms of timing:

- A contribution in cash is made when received by the fund
- A contribution by electronic funds transfer is made when the amount is credited to the superannuation fund's bank account – this may occur some time after you have done what is necessary to effect the payment, and
- A contribution by cheque is made when the cheque is received by the fund unless it is dishonoured.

Most individuals up to age 75 can claim an income tax deduction for personal after-tax superannuation contributions. Up until recently, you could only claim a deduction for your personal contributions where less than 10% of your assessable income, your reportable fringe benefits and your reportable employer superannuation contributions (e.g. salary sacrifice contributions), for the year were from being an employee – this was known as the '10% Rule'. This rule prevented most employees from claiming a tax deduction for this type of contribution. This rule no longer exists.

With the scrapping of the 10% Rule, to claim a deduction only the following conditions need to be satisfied:

- **Age** – All individuals under the age of 65 are eligible. Those aged 65 to 74 who meet the superannuation 'work test' (work for at least 40 hours in a period of not more than 30 consecutive days in the financial year in which you plan to make the contribution). For those aged 75, the contribution must be made no later than 28 days after the end of the month in which you turn 75. Older taxpayers are ineligible.
- **Minors** – If the individual is under 18 at the end of the income year in which the contribution is made, they must derive income in that year from being an employee or carrying on a business.
- **Complying Fund** – The contribution must be made to a complying superannuation fund.

A deduction is only allowable however if you have given a notice to the trustee of your superannuation fund or to the Retirement Savings Account (RSA) provider stating your intention to claim a deduction for the whole or part of a contribution covered by the notice, and an acknowledgement of that notice has been received. In practical terms, this requires you to complete a *Notice of intent to claim or vary a deduction for personal superannuation contributions* and then send it to your superannuation fund or RSA. Copies of this notice are available on the ATO website. The notice must be given by the earlier of:

- The day you lodge your 2018/2019 personal tax return, and
- The end of the financial year following the year in which the contributions are made (i.e. 30 June 2020).

TAKING MONEY FROM YOUR PRIVATE COMPANY

Where you operate a private company the following time-sensitive actions must be considered following 30 June 2019:

LOANS

Where the company has made a "loan" (this has a broad definition) or payment that is not a legitimate dividend during 2018/2019 to a shareholder or an associate (e.g. spouse) a deemed dividend may arise in 2018/2019

unless the amount is repaid or made subject to a complying Division 7A loan agreement (with minimum interest and principal repayments) ***before the company's lodgement day for its 2018/2019 tax return***. Thus, before you lodge your company's return (or before it is due) you will need to assess whether a loan has been indeed been made and, if so, how you wish to deal with that loan.

UNPAID PRESENT ENTITLEMENT (UPE)

Where a private company and a discretionary trust are in the same group of entities and the private company is an unpaid presently entitled income beneficiary of the trust in 2018/2019, you will need to consider how to deal with this amount. Division 7A may apply to these unpaid present entitlements unless:

- » The present entitlement has been paid out by the lodgement day of the 2018/2019 tax return
- » The funds are held on sub-trust by the lodgement day of the 2018/2019 tax return, or
- » A complying Division 7A loan agreement is entered into by the lodgement day of the 2018/2019 tax return.

Therefore, whatever course you choose, if you fail to take action by the lodgement day for the company's 2018/2019 tax return, then pursuant to Division 7A the company will be deemed to have paid an unfranked dividend to the trust. This can be a complex area, and accordingly advice should be sought from your Accountant.

TAX AGENT

If, like many taxpayers, you use the services of a Tax Agent to prepare your personal Income Tax Return you should ensure you are on their lodgement list by 31 October 2019. If you are not on a Tax Agent's Lodgement List, your tax return will be due on this date, and you will not enjoy the extended due date that you usually would when you lodge with a Tax Agent. Other points to be mindful of when using a Tax Agent include:

- Ensure they are registered with the Tax Practitioners Board (go to https://www.tpb.gov.au/search-register)
- Ensuring that you provide the Tax Agent with all of your relevant tax records for 2018/2019 (receipts etc.). Failure to do may result in delays in lodging your return, and you possibly paying more tax than you are liable for. Ask your Tax Agent for a checklist of the records that you need to provide.
- Tax return preparation fees are tax deductible, so ensure that you retain evidence of your payment.

FIRST-TIME SUPER OPPORTUNITIES

From 1 July, two first-time superannuation opportunities present themselves. The first allows older, retired Australians to potentially make additional contributions to super, while the second may allow additional after-tax and salary sacrifice contributions to be made during this financial year.

CATCH-UP CONTRIBUTIONS

From 1 July 2018, if you have a total super balance of less than $500,000 on the previous 30 June and you make or receive concessional contributions of less than the concessional contributions cap of $25,000 pa, you may be able to accrue unused amounts for use in subsequent financial years.

2018/2019 is the first financial year you can carry forward unused cap amounts and these amounts can be used from 1 July 2019. Unused cap amounts can be carried forward for up to five years.

Before this change to the law, the concessional operated on a year-by-year basis – any unused amounts from a previous year could not be carried forward and used in subsequent years. You either used it, or you would lose it! Practically speaking, the first year that you can take advantage of this reform is 2019/2020 (for any unused 2018/2019 cap).

EXAMPLE – Carry-Forward Concessional Cap

Catelyn is a lawyer who earns $95, 000. As a result her employer would normally contribute $9, 025 in Superannuation Guarantee on her behalf. From 1 July 2018, she was on unpaid Maternity Leave, and returned to work exactly 12 months later.

Under the old rules, unable to carry-forward her unused concessional caps from previous years, in 2019/2020, Catelyn's concessional cap would be $25 000 and not take into account her unused 2018/2019 cap.

Assuming she made no contribution while on Maternity Leave, under the new rules Catelyn would be able to make a personal contribution of up to $40 975 in 2019/2020 (the unused $25 000 cap + $15 975 of the unused 2019/2020 cap, taking into account the $9 025 in Superannuation Guarantee paid by her employer). This would give her extra capacity to catch-up on her superannuation contributions that were not made during her time off work – either by salary sacrificing, or making an after-tax contribution for which she could claim a tax deduction. The maximum amount of the tax deduction allowed in 2019/2020 would also increase by $25 000 (being the unused cap amount from the previous year).

The ability to carry forward the unused portion of superannuation concessional contribution cap may come in particularly handy for:

- Those who are returning to the workforce, such as parents who have taken time out to look after new-born children
- Those whose income has increased from prior years, such as individuals who now work full-time or who have been promoted
- Those who have received a one-off windfall gain.

SALARY SACRIFICE

One of the main forms of concessional contributions that an employee could utilise for a catch-up contribution is salary sacrifice.

The following steps are involved in salary sacrificing to superannuation.

1. The employee and the employer enter into a written salary sacrifice agreement, setting out the name of each party, the commencement date of the arrangement (it cannot be backdated), the amount to be sacrificed each pay period etc.

2. Each pay period, the employer pays the nominated sacrificed amount directly to the employee's superannuation fund. No tax is withheld from this amount, and the employee must have no access to this amount.

Because the amount sacrificed is not subject to income tax, employees will improve their overall tax position by implementing a salary sacrifice strategy.

AFTER TAX

If your employer does not offer salary sacrifice, or you do not wish to be locked into a salary sacrifice agreement, the other main form of concessional catch-up contribution you could make is an after-tax contribution that you can claim as a deduction (see page 15).

Having met the conditions, you can claim the full amount of the contribution (up to the concessional contribution caps – see later) in your personal tax return at Label **D12**.

RELAXATION OF THE WORK TEST

Treasury Laws Amendment (Work Test Exemption) Regulations 2018 (the Regulations) was registered on 7 December 2018. **It** provides a one-year exemption from the work test for superannuation contributions to allow recent retirees to boost their superannuation balances. Currently, individuals aged 65 to 74 years must work a minimum number of hours during a particular period in the financial year in order to keep making voluntary contributions to superannuation (known as the work test). From 1 July 2019, individuals aged 65 to 74 years with total superannuation balances below $300,000 can make voluntary contributions to superannuation for 12 months from the end of the financial year in which they last met the work test.

TAX SAVINGS

Tom is a 68-year old former engineer who retired in January 2019. He spends his days tending to his garden, and playing golf at his local course where he also does some unpaid work in the pro-shop. He has a range of passive investments which take his taxable income to $110,000 per year. He recently sold a bundle of bank shares for $290,000.

Under the current rules, Tom could not contribute the sale proceeds to superannuation as he is 68 and does not work the required 40 hours over a 30 day period (unremunerated, volunteer work does not count). The $290,000 would therefore be trapped outside of superannuation, unless Tom returned to the workforce and met the work test by age 75.

Under the Government's new law, however, without having to meet the work test, Tom would be permitted to invest the proceeds inside superannuation. Assume those proceeds earned 9.4% per annum (the median growth investment option for super funds in 2017-18). The tax payable on those earnings would be $4,089 ($27,260 x 15%). If Tom's account was in pension mode, the earnings would be tax free.

Under the old law, with the proceeds outside superannuation,assume Tom found an equally attractive investment vehicle with the same rate of return. He would pay $10,631 in tax per year ($27,260 earnings x 39% personal tax rate, including Medicare levy). Thus, under the new law, Tom would more than $6,500 better off per year (or $10,631 if his account is in pension mode).

The suspension of the work test, will enable taxpayers aged 65 to 75 who are no longer working, or only working a few hours per week, to contribute to superannuation and enjoy the tax concessions that it provides.

DUE DILIGENCE

Due Diligence is an integral step in the purchase and sale of businesses and, for that matter, the completion of any transaction of substantial value. The Due Diligence process can be an exceptionally tense period for both vendor and purchaser. For the vendor, the Due Diligence is often the last hurdle that must be crossed in order for a proposed sale transaction to proceed. For the purchaser, the Due Diligence is the last frontier before committing serious sums of money to a decision. In this article, we examine the Due Diligence process and provide an indication to purchasers and vendors alike of the sorts of issues likely to be covered in the Due Diligence process.

WHAT?

Due Diligence can be defined as the process of systematically evaluating information, to identify risks and issues relating to a proposed transaction. Due Diligence is carried out by a purchaser, usual with the close co-operation of a vendor. One way of thinking about Due Diligence is to view it as the last stage in the buying process. It is the time when a purchaser will typically have access to all of the company's books, records and files. There will normally be a pre -determined Due Diligence period in which to investigate information to ensure that it is true and accurate.

THE PROCESS

Due Diligence is normally an exhaustive research process that purchasers undertake when trying to determine whether, at what valuation, and under what terms to invest in a company or business. A Due Diligence process can last as little as a few weeks and as long as several months.

During Due Diligence, purchasers may ask for financial statements, budgets, legal documents, operations schedules and plans, sales and marketing materials, and request to have meetings with the vendor's board, management team, and staff members. They may ask to speak to existing and former clients, vendors and investors. In essence, anything is fair game and, more often than not, vendors are baring their soul in every respect. For this reason, legally tight confidentiality agreements are an important, if not failsafe, mechanism to put in place.

There is little doubt that the more open the communication channels, the more likely a Due Diligence process is to run smoothly. Vendors can help the process by being organised, responsive and honest and by asking the purchaser for a prioritised list of Due Diligence items in advance of the commencement of the process.

Purchasers, and their representatives, will work through a long and sometimes unwieldy Due Diligence checklist and will normally require staff of the vendor to be at their beck and call to gather documentation and put together Work papers. The vendor's accountant will also be a key person in the provision of information and in addressing the many questions that flow from the Due Diligence process. Once the Due Diligence process is complete, a shortlist of issues will typically arise which will need to be worked through between the parties and, depending on their nature, may give rise to an adjustment in the proposed transaction amount, or an adjustment to what is and isn't being provided as part of the transaction. Where stock and fixed assets are being acquired, it is also customary for a stocktake and fixed assets inventory to take place. These are among the final steps in the process and sometimes will not be performed until all other issues have been agreed upon.

CRITICAL ISSUES

Hundreds of issues comprise a typical Due Diligence, however, at a broader level, three critical issues should be noted.

Firstly, as alluded to in the previous section, preparation is the key. A purchaser must have their thoughts in order before the Due Diligence process begins and should start the Due Diligence preparation and information gathering from the moment they decide they are interested in a particular business. A vendor needs to pre-empt the purchaser's requirements and do their best to have everything in readiness.

A purchaser should begin by compiling the following:

- A detailed listing of the exact Due Diligence steps to follow
- A checklist of everything to complete in each Due Diligence area
- Specific Due Diligence tasks that need to be completed
- All of the materials needed from the vendor before commencement.

Secondly, sufficient time should be allowed for the process to be done properly. Vendors typically lobby for the shortest Due Diligence period possible to minimise the risk of detection of undesirable issues and also to limit costs. However, if a purchaser is not afforded sufficient time to learn almost all there is to know about the business, it is unrealistic to expect them to acquire it. The message is that purchasers should devote ample time to the process and vendors should be understanding of that allowance. Vendors will enhance their perception in the eyes of the purchaser if they are seen to be supporting, rather than rushing, the process.

Thirdly, there is a lot more to a business than the contents of the financial statements and tax returns. Although the financial history of a company is extremely relevant, most Due Diligence processes will go far beyond financial analysis. The financial health and prospects of the business should be viewed as a necessary, but not the only, condition for purchase.

CULTURAL ISSUES

The vendor must also manage certain cultural issues surrounding the process, not least of which is the decision as to who inside the organisation is to be made privy to what is going on. It will be impractical to keep Due Diligence a total secret as the purchaser, understandably, will want to meet and make enquiries of a raft of key personnel throughout the organisation.

By the same token, vendors are understandably reticent to tell more people than what is necessary, as the mere fact that owners are looking at selling can be a disruptive and morale-destroying factor. In essence, a balance needs to be struck between those who reasonably need to be made aware and those who don't. Importantly, the issue of who is in the know and who is not needs to be clearly communicated (preferably in writing) to the purchaser so that they do not err by leaking the news to the wrong person. What a vendor does not want to see happen is a staff member, particularly a senior one, finding out second hand of a proposed transaction.

A further cultural issue surrounds the inevitable uncertainties that staff members will have about their own tenure once they discover a change of ownership is in the wings. In some cases the purchaser will take over the existing staff list, assuming leave liabilities in the process. In other cases, they will not. If it has been made clear by the purchaser that they will not be wielding the axe, then the vendor should take every possible step to allay the fears of staff. The better the frame of mind which staff members are in, the more likely they are to provide truthful and enthusiastic information to the purchaser making enquiries of them. A cynical staff member who is resentful of a change of hands and fears for their future, could be damaging to the process and, in some cases, fatal to the cause.

ITEMS TYPICALLY SOUGHT

An important thing to understand about Due Diligence is that every process is different. The size of the transaction, the nature of what is being purchased (e.g. an asset, a business, a company, a group of companies), the size of the purchaser and vendor, the history between the purchaser and vendor and the degree of government regulation surrounding the transaction all play a role in determining the scale, scope and duration of the Due Diligence process. Despite Due Diligence being a varied process, the following sample Due Diligence checklist for the acquisition of a business will provide a useful insight into the extent of a purchaser's requirements.

✔ FINANCIAL RECORDS

- Copies of financial statements for the past three financial years
- Copies of income tax returns for the past three financial years Reconciliations to show how source accounting data from the vendor's system was evolved into the financial statements
- Reconciliations to show how the profit or loss in the financial statements was evolved into the taxable income per the income tax return
- Copies of Business Activity Statements for the past three financial years

- Reconciliations of income and expenses per the financial statements to supplies and acquisitions declared on Business Activity Statements
- Copies of external accountant's reports
- Copies of internal management reports
- Copies of projections and budgets.

✔ TAXATION

- Evidence that the company has no outstanding amounts of tax, typically through production of an ATO Running Balance Account
- Evidence that all past returns have been lodged
- Copies of fringe benefits tax returns and payroll tax returns for the past three years
- Copies of any private rulings obtained, and relied upon, by the company
- Details of any income tax assessments still under review
- Disclosure of any past or present audits conducted on the business by the tax authorities.

✔ DEBTORS

- Aged listing of trade debtors as at current day, and at various stages over the past years (this is used to gain an insight into whether collection policies have strengthened or weakened over time)
- Listing of debtors over 90 days with comments on the likelihood of recoverability
- History of bad debts with reasons for write-offs and comments on the adequacy of provisions for bad debts
- Details of any debtors presently the subject of recovery proceedings or litigation
- Copies of contracts or agreements in place with debtors and listing of terms of trade.

✔ CREDITORS

- Aged listing of trade creditors as at current day, and at various stages over the past years (this is used to gain an insight into whether cash flow difficulties may have been present at various times necessitating a slow payment of creditors)
- Listing of creditors over 90 days with comments as to why they are in existence
- History of bad or disputed creditor amounts with reasons
- Details of any creditors presently the subject of dispute proceedings or litigation
- Copies of contracts or agreements in place with creditors, rebate agreements and listing of terms of trade
- Details of any foreign currency hedge contracts which may be in place.

✔ INVENTORY

- Listing of all stock items including description, quantity on hand, unit price and extended value
- Supplier invoices supporting unit costs for major lines
- Details of any consignment stock including documentation surrounding the arrangement;
- Listing of slow moving or obsolescent stock including details of any provisioning policies the business might have in this regard
- Listing of average gross margin per product line and supporting documentation (e.g. purchase invoice and sales invoice)
- Explanation of how stock is costed (e.g. Purchase price, purchase price plus freight, purchase price plus full absorption costing, etc.).

✔ FIXED ASSETS

- Copy of Fixed Assets Register and copy of depreciation schedule forming part of the financial statements. These documents will sometimes be one and the same; where they are not, a reconciliation between the two is likely to be sought
- Reconciliation between the fixed asset register or depreciation schedule and the general ledger
- Copies of invoices supporting the acquisition cost of material assets forming part of the fixed assets register
- Details of any fixed assets not featuring in the fixed assets register, perhaps because they were expensed outright in an earlier year, are leased, or have been
- written down to zero
- Details as to the appropriateness of written down values of assets in the fixed assets register, and whether any are materially understated or overstated based on their wear and tear and current replacement values.

✔ EMPLOYEES

- Detailed listing of staff, position, responsibilities, current remuneration package, next salary review date, and fringe benefits provided
- Contracts of employment
- Copies of Industrial Awards which affect current staff and a list of those staff to whom each award applies;
- History of workplace accidents
- History of legal disputes with employees including sexual harassment, workplace discrimination, asbestos claims etc.
- Details of accrued liabilities for annual leave, sick leave and long service leave.

✔ STATUTORY RECORDS

- Company Constitution
- Company Minutes
- Register of Members
- Copy of ASIC Lodgements.

✔ PREMISES

- If the trading premises are also being acquired, a copy of the deed of title
- If the trading premises are being leased, copies of all leases and licences to occupy, including bank guarantees of the lessee's obligations
- Details of any applicable searches and zoning certificates on the property
- Details of any breaches or disputes with Government authorities pertaining to the property.

✔ FINANCE OBLIGATIONS

- Details of any finance facilities in place including
- amount borrowed, term, security, rate and repayments
- Details of any assets which are the subject of a lease, hire purchase or similar instrument showing date financed, principal outstanding, repayment amount and approximate payout figure.

✔ INTELLECTUAL PROPERTY

- Details of any patents (existing or pending) used by the business
- Details of any licence used or granted
- Listing of trade marks (registered or unregistered) owned or used under licence and copies of all such registrations
- Business Name certificates
- Listing of registered designs owned or used under licence
- Details of any copyright material owned or used
- List of software licences or user agreements
- List of registered domain names and proof of ownership from the domain registry
- Details of any litigation, current or threatened, in respect to intellectual property.

✔ RELATED PARTY TRANSACTION

- Whether any arrangements (written or otherwise) are in force between the business and related parties, an estimate of the value of such arrangements, and a notification as to whether these arrangements are at non-commercial rates
- Details of any related party loans which may be in existence.

✔ COMPUTER SYSTEMS

- Summary of the information technology platform of the business, its history, and planned changes
- Management opinion as to the strengths and weaknesses of the current information technology platform
- Information on security policies, privacy policies, and recovery systems.

✔ OTHER REGULATORY ISSUES

- Details of any authorisations or complaint notices which may be in force between the business and the ACCC
- Copy of the business' privacy policy and explanation of the steps taken by the business to comply with the Privacy Act.

TAX TAKE-AWAYS FOR JULY AND AUGUST

1. JULY CHANGES

Focus in on the tax changes commencing this financial year. In addition to the expansion of the taxable payments reporting regime, the new tax whistleblower legislation, and super catch-up contributions (we've previewed all of these earlier), there are other changes including:

SINGLE TOUCH PAYROLL

This new payroll reporting regime has now commenced for employers with 19 or fewer employees. Some key points to note as follows:

- July to September is a transition period. Employers are not expected to be compliant until 1 October
- No penalties will be imposed for incorrect reporting
- For businesses with 5 or more employees, your reporting solution will generally be in the form of payroll software
- Micro employers (those with 1 to 4 employees) can adopt low cost, simple solutions. See ATO website www.ato.gov.au then type "STP low cost solutions" into the search box

NO DEDUCTION FOR NON-COMPLIANT PAYMENTS

As we touched on in the previous edition of this publication, from 1 July 2019, you can only claim deductions for payments you make to your workers (employees or contractors) where you have complied with the pay as you go (PAYG) withholding and reporting obligations for that payment. If the PAYG withholding rules require you to withhold an amount from a payment you make to a worker, you must:

- withhold the amount from the payment before you pay it
- report the amount to the ATO.

Any payments you make where you haven't withheld or reported the PAYG tax are called non-compliant payments. You won't be able to claim a deduction if you don't withhold any PAYG tax or report the PAYG tax to the ATO. If you make a mistake and withhold or report an incorrect amount, you will not lose your deduction. The take-out for employers is to ensure that your payroll processes are operating correctly, and that you are correctly withholding and remitting the required amounts from the payments that you make to employees, and also contractors who do not provide an ABN.

2. REVIEW CASHFLOW AND TRADING STRUCTURE

The new financial year is typically a time where people like to review their cashflow and the structure through which they operate their business.

CASHFLOW

The old adage that "cash is king" still rings true. Whether it be suppliers, the ATO, employee wages, the landlord or insurance, you need cash on hand at all times in order to discharge your bills.

With many studies suggesting that the failure to plan cash flow is one of the leading causes of small business failure, to overcome this, it's imperative to prepare with your accountant a cash flow forecast. A cash flow forecast tracks the sources and amounts of cash coming into and out of your business over a given period. It allows you to foresee peaks and troughs, and therefore whether you have sufficient cash on hand to discharge your debts at a given time. This in turn alerts you to when you may need to take action – by discounting stock or getting an overdraft for example – to make certain that your business has sufficient cash to meet its needs. The forecast also allows you to foresee when you have large cash surpluses which may indicate you have borrowed too much or have money that ought to be ploughed back into the business.

Approach your Tax Agent and in consultation with them, prepare a detailed cash flow forecast.

BUSINESS STRUCTURE

When we talk about "trading structures", we are referring to a decision between sole trader, partnership, trust or company. Every circumstance is different and the right answer will sometimes be a combination of more than one entity. Utilising the wrong structure can cost you significantly in terms of tax. It pays to seek professional advice to come up with a structure that suits your circumstances, and is scalable and effective.

Among the considerations when choosing a trading structure are:

- Income Tax effectiveness
- Capital Gains Tax (CGT) friendliness in the event of a future sale
- Asset protection (both personal and for the business)
- Estate and succession planning
- Cost (establishment and ongoing)
- Complexity

As we enter the new financial year, talk with your Accountant about the suitability of your current trading structure. We note that Small Businesses with a turnover of less than $10 million can now, subject to a range of conditions, restructure without incurring CGT or income tax costs.