

## Tax Planning

Put simply, tax planning is the arrangement of a taxpayer's affairs so as to comply with the tax law at the lowest possible cost. A common mistake is to believe that tax planning is optimised when every opportunity to reduce tax is taken. This is because some opportunities to reduce tax rely on strained interpretations of the law. Therefore, tax planning involves much more than taking the option that at first appears to result in lower tax costs. It involves objectively assessing and actively managing tax risk.

Common tax planning techniques include deferring the derivation of assessable income and bringing forward deductions. It is equally important that consideration be given to any pending changes to tax legislation, especially when a proposed amendment will be backdated.

### Part IVA and tax planning

Due to the broad scope of Pt IVA of ITAA 1936 and the consequences of its application, it should form an integral aspect of tax planning rather than exercised as an afterthought.

Before the Commissioner exercises his discretion under s 177F of ITAA 1936 to cancel a tax benefit, the requirements of Pt IVA must be satisfied. These requirements are:

1. a tax benefit was or would have been obtained;
2. the tax benefit was or would have been obtained in connection with a scheme; and
3. the scheme is one to which Pt IVA applies.

The term 'scheme' is defined in s 177A(1) of ITAA 1936 and includes any agreement, understanding, promise or undertaking, whether express or implied, and whether legally enforceable or not. Further, a scheme includes a scheme, plan, proposal or course of action, even if unilateral.

Whether or not a tax benefit has been obtained in connection with a scheme, it requires the consideration of the eight factors listed in s 177D(b). These factors are:

- the manner in which the scheme was entered into or carried out;
- the form and substance of the scheme;
- the time in which the scheme was entered into and the length of the period during which the scheme was carried out;
- the taxation outcomes, including the tax benefit and any other tax consequences arising from the scheme;
- any change in the financial position of the taxpayer that results, will result, or may reasonably be expected to result from the scheme;
- any change in the financial position of any person who has, or has had, connection (whether of a business, family or other nature) with the taxpayer that results, will result, or may reasonably be expected to result from the scheme;
- any other consequences for the taxpayer, or any other person connected with the taxpayer arising from the scheme having been entered into or carried out; and
- the nature of any connection (whether of a business, family or other nature) between the taxpayer and the connected person.

## Exempt income and tax planning

Although exempt income is not assessable income, it cannot be ignored for tax planning purposes. For example, the amount of a dependent rebate may be reduced by the separate net income of the dependent, which includes exempt ordinary income. The derivation of exempt income may also reduce or limit deductions.

Exempt income may also affect the rate of tax applicable to taxable income. For example, foreign employment income that is exempt under ss 23AF or 23AG of ITAA 1936 is taken into account in determining the rate applicable to other assessable income.

## Non-assessable non-exempt income

Non-assessable non-exempt income is not counted in working out taxable income. That is, non-assessable non-exempt income has no effect on the income tax system. The categories of non-assessable non-exempt are listed in s 11-55 of ITAA 1997. They include:

- demerger dividends;
  - fringe benefits;
  - income arising from CGT event in respect of an asset continuously owned for 15 years by a company or trust;
  - a tax-free amount of an early retirement scheme payment, an employment termination payment, a foreign termination payment, a genuine redundancy payment, and an unused long service leave payment (pre-16/8/78 period); and
  - various superannuation benefits, including rollover superannuation benefits, lump sum benefits paid to a person with a terminal medical condition and pensions (paid from a taxed source) to a person aged 60 and over.
- **TIP:** Income Recovery Subsidiary arising from the Victorian bushfires of January and February 2009 are non-assessable non exempt income provided the payment is claimed after 28 January 2009 and before 13 May 2009.
- **TIP:** Income Recovery Subsidiary arising from the North Queensland floods of January and February 2009 are non-assessable non exempt income provided the payment is claimed after 30 January 2009 and before 13 May 2009.
- **STOP:** Capital gains or losses arising from a CGT asset used to produce certain categories of non-assessable non-exempt income may be taxable: see s 118-12(2) of ITAA 1997.

## Deferring Assessable Income

The timing of when income is included in the assessable income of a taxpayer will depend on whether it is statutory income or ordinary income. Statutory income is included in assessable income at the time specified in the relevant provisions dealing with that income. Ordinary income is included in assessable income when it is derived unless a specific provision includes the amount in assessable income at some other time.

Consideration must be given to the nature of an income, ie revenue or capital, because of the difference in their tax treatment, which ultimately will have an impact on a taxpayer's tax position.

## Business income

When ordinary income of a business is derived and to be included in assessable income will depend on whether the business returns income on a cash basis or on an accruals basis.

Where a business uses the cash basis, ordinary income is, generally, derived in the year in which the business receives the income. Conversely, if the business is reporting income on an accrual basis, ordinary income is derived when a recoverable debt is created such that the taxpayer is not obliged to take any further steps before becoming entitled to payment.

### **Payment received in advance**

Income received in advance of services being provided is generally not assessable until the services are provided (the Arthur Murray principle). This principle applies regardless of whether a taxpayer is reporting its income on an accrual basis or on a cash basis.

- **STOP:** For the Arthur Murray principle to apply, a taxpayer's accounting records must classify the unearned income separately from income already earned. This may be done by a single journal entry at year-end or periodically during the year.

### **Work in progress**

In relation to manufacturers, partly manufactured goods that are not 'finished' goods are treated as trading stock and it is necessary to determine the difference between the opening and closing value of the trading stock for the income year. (*See Trading Stock.*)

- **TIP:** Taxpayers who provide professional services may consider, in consultation with their clients, rendering accounts after 30 June to defer the income.

### **Income from property**

Income from property is essentially all income that is not personal exertion income and includes interest, rent, dividends, royalties and trust distributions. The time of when such income is derived for non-business taxpayers is as follows:

<b>Category</b>	<b>Income is derived when</b>
Interest	In the year of receipt
Rental income	In the year of receipt
Dividends	In the year of receipt
Royalties	In the year of receipt
Trust distributions	In the year the distribution is declared

- **STOP:** Where the income has been applied or dealt with on behalf of a taxpayer, the taxpayer is taken to have received the income as soon as it is so applied or dealt with (principle of constructive receipt, albeit the taxpayer has not physically received the income): see 6-5(4) of ITAA 1997.

### **Sale of depreciating assets**

A taxpayer is required to calculate the balancing adjustment amount resulting from the disposal of a depreciating asset. The balancing adjustment amount is calculated by comparing the termination value against the adjustable value. If the termination value is greater than the adjustable value, the difference is included as assessable income of the taxpayer. If the termination value is less than the adjustable value, the difference is a deduction available to the taxpayer.

If the disposal of an asset will result in assessable income, a taxpayer may want to consider postponing the disposal to the following income year. However, if it is not possible to delay the disposal, consideration may be given to whether a balancing adjusting rollover relief is available. If the disposal of an asset will result in a deduction, it may be beneficial to bring the disposal forward to the current year.

### **Balancing adjustment rollover relief**

Balancing adjustment rollover relief effectively defers a balancing adjustment until the next balancing adjustment event occurs. Broadly, the rollover relief will apply automatically if the conditions listed in s 40-430(1) of ITAA 1997 are satisfied. If the automatic rollover relief applies, the transferor must give a notice containing sufficient information about the transferor's holding of the asset for the transferee to work out how Div 40 applies to the transferee's holding of the depreciating asset.

An optional rollover relief is available in a partnership scenario if the composition of the partnership changes or when assets are brought into or taken out of the partnership. To defer any balancing adjustments, the existing partners and the new partner can jointly elect for the rollover relief to apply.

- **TIP:** A small business entity can access the optional rollover relief.
- **STOP:** The optional rollover relief is not available unless the original holder retains an interest in the asset after the change.

## Pending legislation

The Government introduced Tax Laws Amendment (2009 Measures No 2) Bill 2009 into the House of Representatives on 19 March 2009. The Bill will amend ITAA 1997 to provide an exemption from tax for the Clean-up and Restoration Grants paid to small business and primary producers affected by the Victorian bushfires.

At the time of publication, this Bill has not received Royal Assent.

## Maximising Deductions

Deductions are divided into general deductions and specific deductions. General deductions are allowable under s 8-1 of ITAA 1997 whereas specific deductions are those provided for by sections of ITAA 1936 and ITAA 1997. Where an item of expenditure would be a deduction under more than one section, it is deductible under the provision that is most appropriate.

## Meaning of incurred

In Taxation Ruling TR 97/7, the Commissioner states his view on the meaning of 'incurred' for the purposes of s 8-1 of ITAA 1997. He states that an outgoing has been incurred when:

- (a) there is a presently existing liability to pay a pecuniary sum. The taxpayer need not actually have paid any money to have incurred an outgoing, provided the taxpayer is definitively committed in the year of income;
- (b) a taxpayer may have a presently existing liability notwithstanding that the liability may be defeasible by others;
- (c) a taxpayer may have a presently existing liability although the amount of the liability cannot be precisely ascertained, provided it is capable of reasonable estimation;
- (d) whether there is a presently existing liability is a legal question in each case, having regard to the circumstances under which the liability is claimed to arise; and
- (e) if a presently existing liability is absent, an outgoing is incurred when the money is paid.

The phrase 'presently existing liability' means that a taxpayer is definitively committed (or completely subjected) to the outgoing, ie the liability is more than impending, threatened or expected.

An outgoing is still incurred even if the amount cannot be quantified precisely, provided it is capable of approximate calculation based on probabilities.

If a taxpayer could have claimed a deduction for an outgoing that was incurred but not paid in the particular income year but failed to do so, the taxpayer cannot claim a deduction in the year in which the liability is discharged, as the outgoing has not occurred in that year. The taxpayer is required to seek an amendment of the assessment for the previous year, within the statutory limits.

- **TIP:** An outgoing may be incurred in one income year even if the liability is not discharged until a later year. Therefore, a taxpayer can claim a deduction for the outgoing.
- **STOP:** Small business entities which were simplified tax system (STS) taxpayers who are still using the mandatory cash accounting rules under the former STS can only deduct an outgoing under ss 8-1 (general deductions), 25-5 (tax-related expenses) and 25-10 (repairs) of ITAA 1997 when the outgoing is paid.

## Managed investment schemes

The deductibility of expenses incurred for a managed investment scheme (MIS) was the subject of a Full Federal Court case.

In a test case decision, the Full Federal Court has found that two taxpayers' investments in an almond MIS constituted the carrying on of a business and the outgoings incurred on the schemes were allowable deductions pursuant to s 8-1 of ITAA 1997: *Hance & Anor v FCT* [2008] FCAFC.

The Court also found that there would be no relevant trust interest acquired by the taxpayers in exchange for payment of the relevant deductions and therefore the income to be derived by the taxpayers should not be taxed as trust income.

The Commissioner has indicated that the Tax Office will not appeal against the decision of the Full Court. He said that investments in MIS arrangements which are broadly similar to the test case are deductible. He said the arrangements did not involve features like non-recourse or round-robin funding in mass-marketed schemes that were disallowed by the courts in cases such as *Howland-Rose & Ors v FCT* (2002) 49 ATR 206 and *Vincent v FCT* (2002) 51 ATR 18.

In light of the Court's decision, the Tax Office has withdrawn its Taxation Ruling TR 2007/8 and Draft GST Ruling GSTR 2008/D1 on managed investment schemes.

- **TIP:** Taxpayers seeking to claim a deduction for in MISs should ensure that the features of the schemes are similar to the features in the test case.

## Bad debts

A debt that is written off as a 'bad' in an income year is an allowable deduction under s 25-35 of ITAA 1997, provided:

- the amount owned was either previously brought to account as assessable income in the current or a former income year or lent in the ordinary course of a money-lending business of the taxpayer;
- there must be a debt in existence at the time of writing off;
- the debt must be bad; and
- the debt must be written off as bad during the income year in which the deduction is claimed.

Taxpayers should review their debtors prior to year-end and assess which debts may be written off as 'bad'.

In Taxation Ruling TR 92/18, the Tax Office sets out the list of circumstances in which a debt may be considered to have become bad. These circumstances include:

- a debtor has died leaving no, or insufficient, assets out of which the debt may be satisfied;
- a debtor is untraceable and the creditor has been able to ascertain the existence of, or whereabouts of, any assets against which action could be taken;
- a debt has become statute-barred and a debtor is relying on this defence for non-payment;
- where a debtor is a company, it is in liquidation or receivership and there are insufficient funds to pay the whole debt, or the part claimed as a bad debt;
- where on an objective view of all the facts or on the balance of probabilities existing at the time the debt (or part of the debt) is alleged to have become bad, there is little or no likelihood of the debt (or part of the debt), being recovered.

Before a debt can be written off as 'bad', a taxpayer must have taken the appropriate steps in an attempt to recover the debt. The Tax Office, in TR 92/18, lists the steps to be taken to establish that a debt is bad, which include:

- issuing reminder notices to a debtor and attempting to contact a debtor by telephone/mail;
- lapsing of a reasonable period of time since the original due date for payment of a debt;
- serving a formal demand notice for a debt;
- issuing and servicing a summon;
- proceedings to enforce judgment for a debt has been executed;

- calculating and charging of interest on a debt has ceased and a debtor's account is closed;
- valuing any security held against a debt; and
- selling of any sized or repossessed assets.

It is important to note that while the above factors are indicative of the circumstances in which a debt is considered bad, ultimately the question of whether the debt is bad is one of fact and will depend on all of the facts and circumstances surrounding the debt.

- **TIP:** Notwithstanding that a bad debt is not deductible under s 25-35, it may be deductible under s 8-1.
- **TIP:** A bad debt does not need to be written off in the account books of a taxpayer. In the case of a company, the requirements of s 25-35 will still be satisfied in the following circumstances:
  - a Board meeting authorises the writing off of a debt and there is a physical record of the written particulars of the debt and the Board's decision before year-end, but the writing off of the debt in the taxpayer's books of account occurs subsequent to year-end; and
  - a written recommendation by the financial controller to write off a debt which is agreed to in writing by the Managing Director prior to year-end followed by a physical writing off in the books of accounts subsequent to year-end.
- **TIP:** A bad debt deduction is also available for a partial write off of a debt, provided the requirements of s 25-35 are satisfied. One debt may, over a period, be subject to several partial write offs.

### **Additional requirements for companies**

A company must pass either the continuity of ownership test (the primary test to be applied) or the same business test in addition to satisfying the requirements of s 25-35.

Companies that have undergone a change in underlying ownership due to a sale of the business during the year will need to pass the 'same business test' to claim a deduction for bad debts.

In *Lilyvale Hotel Pty Ltd v FCT* [2009] FCAFC 21, the Full Federal Court said that the management of a taxpayer's business at different times in different ways had no bearing upon the characterisation of its business. Therefore, the Court found that the business carried on by the taxpayer was that of 'owning and operating a hotel to derive revenue from its guests and profits from its operation' at all relevant times. Accordingly, the Court held that the taxpayer satisfied the same business test.

- **STOP:** A company cannot claim a deduction for a debt incurred and written off as bad on the last day of an income year.
- **STOP:** Consideration must be given to the specific anti-avoidance provisions contained in Subdiv 175-C.
- **STOP:** A deduction is denied where a company was purchased through an asset sale because the requirements of s 25-35 have not been met, albeit the same business test has been satisfied: see *Easons Ltd v C of T (NSW)* (1932) 2 ATD 211.

### **Additional requirements for trusts**

Special rules apply to deny trusts a deduction for bad debts unless certain strict tests are passed. The applicable tests will depend on the nature of the trust. (*See Trust losses.*)

### **Carried forward losses**

The deductibility of tax losses carried forward from previous income years will depend on the type of entity claiming the losses.

## **Corporate tax entities**

The entitlement of corporate tax entities to deductions in respect of prior year losses is subject to certain restrictions. An entity needs to satisfy the continuity of ownership test before deducting the prior year losses. If the continuity of ownership test is failed, the entity may still deduct the loss if it satisfies the same business test.

- **TIP:** A corporate tax entity can choose the amount of prior years losses it wishes to deduct in an income year. That is, the entity can choose to 'ignore' the carried forward tax losses and pay tax for the income year to generate franking credits for its distributions.

## **Other taxpayers**

The method for deducting earlier tax losses incurred by other taxpayers is governed by s 36-15 of ITAA 1997. If a taxpayer derives net exempt income for an income year, the carried forward loss will need to be firstly offset against net exempt income before being available for deduction against assessable income.

- **TIP:** Carried forward losses do not need to be offset against non-assessable non-exempt income derived by a taxpayer. It is net exempt income that is offset against any carried forward tax losses and not exempt income. Net exempt income is defined in s 36-20 of ITAA 1997 and exempt income is defined in s 6-20 of ITAA 1997.
- **TIP:** Try to avoid deriving exempt income in an income year if there are carried forward losses.

## **Depreciation (Capital allowances)**

A deduction may be available on the disposal of a depreciating asset if a taxpayer stops using and expects never to use it again. Therefore, asset registers may need to be reviewed for any assets that fits this category.

The effective life of an asset can be recalculated at any time after the end of the first income year for which depreciation is claimed by a taxpayer, if it is no longer accurate because of changed circumstances relating to the nature of use of the asset. Therefore, consideration may be given to the use of an asset to determine whether its effective life can be recalculated, which may result in an increased or decreased rate of depreciation.

## **Immediate deduction**

### **Non-business taxpayers**

Non-business taxpayers are entitled to an immediate deduction for assets costing \$300 or less, provided:

- the asset is used predominantly to produce assessable income that is not income from carrying on a business;
  - the asset is not part of a set of assets that the taxpayer started to hold in the income year if the total cost of the set of assets exceeds \$300; and
  - the total cost of the asset and any other identical, or substantially identical, asset that the taxpayer starts to hold in that income year does not exceed \$300.
- **TIP:** If two or more taxpayers jointly own a depreciating asset, a taxpayer is still eligible to claim an outright deduction, provided his or her interest does not exceed \$300 (even if the asset costs more than \$300).

### **Small business entities**

A small business entity (*see* Small business entities) that chooses to apply the capital allowance rules contained in Div 328 of ITAA 1997 is eligible for an outright deduction for the taxable purpose proportion of the adjustable value of a depreciating asset in the income year it first starts to use the asset or installs it for a taxable purpose if:

- it starts to hold the asset when it is a small business entity, and
- the asset is a 'low cost asset', ie its cost is less than \$1,000.

The entity is also entitled to an immediate deduction for any addition to a low cost asset, provided the cost of the addition is less than \$1,000. Where an asset costs more than \$1,000, the entity is required to pool the asset into either a general pool or a long-life pool depending on the effective life of the asset.

## Business taxpayers

For business taxpayers that are not small business entities, all capital items must be written off over their effective life under Div 40 of ITAA 1997, regardless of the cost (including low-value items). However, the Tax Office has adopted an administrative practice allowing an outright deduction for low-cost capital assets in certain cases.

Broadly, an expenditure of \$100 or less (inclusive of GST) incurred by a taxpayer to acquire a capital asset in the ordinary course of carrying on a business will be assumed to be revenue in nature and therefore deductible in the year of the expenditure. It is important to note that because the threshold includes GST, for a business registered for GST, the threshold is effectively \$90.91.

This administrative practice does not apply to expenditure incurred by a taxpayer on:

- establishing a business or business venture;
- building up a significant store or stockpile of assets;
- assets held under a lease, hire purchase or similar arrangement;
- assets acquired for lease or hired to, or that will otherwise be used by another entity;
- assets included in an asset register maintained in a manner consistent with reporting requirements under generally accepted Australian accounting standards;
- any asset that forms part of a collection of assets that is dealt with commercially as a collection;
- trading stock or spare parts; and
- items that are part of another composite asset, ie items that are not functional on their own.

## Pooling

Certain depreciating assets can be pooled, with the result that the decline in value is calculated for the pool instead of the individual assets.

For a small business entity, two pools are available: a general pool for assets with an effective life of less than 25 years, and a long-life pool for assets with an effective life of more than 25 years. If the cost of the asset is less than \$1,000, the small business entity is entitled to an outright deduction.

For other taxpayers, there is the option of pooling 'low-cost' and 'low-value' assets to a low-value pool. A 'low-cost' asset is a depreciating asset that costs less than \$1,000. A 'low-value' asset is a depreciating asset that has been depreciated using the diminishing value method, has an opening adjusted value of less than \$1,000 in an income year, and is not a 'low-cost' asset. If a taxpayer sets up a low-value pool, all low-cost assets have to be allocated to the pool. However, low-value assets do not need to be allocated to the pool.

Category of taxpayer	Assets allocated to pool during year are depreciated at	Assets allocated to pool in a previous income year are depreciated at
Small business entity — General pool	15%	30%
Small business entity — Long-life pool	2.5%	5%
Other taxpayers — Low-value pool	18.75%	37.5%

- **TIP:** If two or more taxpayers jointly own a depreciating asset, a taxpayer can set up a low-value pool to take advantage of the accelerated rate of depreciating, provided his or her interest is less than \$1,000, even though the asset costs more than \$1,000.

## Donations

A taxpayer may make a written election to spread the deduction for a donation made over a period of five years if:

- the donation was a gift of money of \$2 or more;
- the donation was property valued by the Tax Office at more than \$5,000;
- the donation was made under the Cultural Gifts Program; or
- the donation was a heritage gift.

If a taxpayer is anticipated to have an increase in assessable income in the coming income years, consideration may be given to spread the deductibility of the donation over five years.

- **TIP:** As a general proposition, try to avoid making donations in a year of losses. This is because a deduction for a donation cannot add to or create a tax loss for a taxpayer.
- **TIP:** Charitable donations of \$2 or more are deductible, as long as receipts are retained.

### **Donations to the Victorian bushfires**

*Tax Laws Amendment (2008 Measures No 6) Act 2009* amended ITAA 1997 to specifically list the 2009 Victorian Bushfire Appeal Trust Account as a deductible gift recipient in Div 30 of ITAA 1997. A donation to the Trust Account will be a deduction if the donation is made after 7 February 2009 and before 6 February 2014.

On 27 March 2009, the Treasurer and Assistant Treasurer declared the recent Victorian bushfires a disaster for the purposes of establishing the Australian disaster relief funds, effective from 29 January 2009. The declaration is made pursuant to amendments to the ITAA 1997 by the *Tax Laws Amendment (2008 Measures No 6) Act 2009*. The Treasurer and Assistant Treasurer say the declaration ensures that qualifying existing and new funds established for the relief of people in communities affected by the bushfires can receive tax deductible donations. Donations to Australian disaster relief funds established to provide relief in the aftermath of the bushfires will be tax deductible for a period of 2 years from 29 January 2009.

At the time of publication, the Government has not released further details about the declaration.

### **Tax Office media release**

In Media Release 2009/10, the Tax Office stated that individuals who donated to the Victorian bushfires and Northern Queensland floods through 'bucket donations' can claim a tax deduction equal to their contribution of up to \$10 in their 2008/09 tax return without the usual need to keep a receipt. It also stated that where individuals have made a donation over \$10 using the Internet, the telephone or through third parties (eg banks and retail outlets), the internet receipt or the credit card statements will suffice in lieu of a receipt.

## Legal expenses

It is impossible to formulate an all-encompassing 'rule' as to the deductibility of legal expenses because each expense must be considered on its own merits.

In *FACT v Day* (2008) 70 ATR 14, the High Court held that legal expenses incurred by a public servant in relation to charges under the *Public Service Act 1922* (Cth) of having failed to fulfil his duty as an officer were deductible under s 8-1. The Court said that the consequences to the taxpayer of internal disciplinary proceedings, in relation the continuation or termination of his employment, formed part of what was productive of his assessable income as a public servant. Accordingly, the 'occasion' of the legal expenses was to be found in his position as a public servant and therefore the expenses were deductible.

## Non-commercial losses

An individual taxpayer should consider whether a loss from his or her business activity (whether carried on alone or in partnership) will be deferred under the non-commercial loss rules, which are contained in Div 35 of ITAA 1997. This is because the individual's overall tax position will be impacted when the loss is deferred.

In essence, an individual may only offset a loss arising from a business activity against other income derived in the same income year if the business activity satisfies at least one of the four commerciality tests – the assessable income, profits, real property, and other assets tests. If the individual does not satisfy at least one of the tests, the loss is carried forward and applied in a future income year against assessable income from the particular activity.

The Commissioner has the discretion to override the provisions of Div 35. Further, an exemption is available for individuals who carry on a primary production or professional arts business and whose assessable income for the year from other sources (eg salary and wages) does not exceed \$40,000.

➤ **TIP:** The \$40,000 threshold excludes net capital gains derived by a taxpayer.

## Prepayments

One of the simplest methods to accelerate deductions is the prepayment of deductible expenses.

### *Excluded expenditure*

The prepayment rules do not apply to 'excluded expenditure', ie a taxpayer is able to claim an outright deduction. Excluded expenditure is defined as:

- expenditure that is less than \$1,000;
  - expenditure that is required to be made under a court order or by law (for example, car registration fees and audit fees); and
  - expenditure that is for salary or wages.
- **TIP:** If a taxpayer is entitled to an input tax credit in respect of an expenditure, the \$1,000 is the GST-exclusive amount. If the taxpayer is not entitled to an input tax credit, the \$1,000 is the GST-inclusive amount.

### *Small business entities and non-business individuals*

Small business entities and non-business individuals are able to access the 12-month prepayment rule. If the prepaid expenditure is not excluded expenditure, it is deductible outright in the income year it is incurred, subject to two provisos: the eligible service period does not exceed 12 months, and ends in the expenditure year or the income year immediately following. If the prepayment has an eligible service period of greater than 12 months, the expenditure will be apportioned over the relevant period (on a daily basis) up to a maximum of ten years.

The eligible service period is the period over which the relevant services are to be provided.

### *Other taxpayers*

If the eligible service period covers only one income year, the expenditure will be deductible in that particular year. If the eligible service period covers more than one income year, the expenditure is apportioned (on a daily basis) over those years up to a maximum of 10 years in accordance with the formula:

$$\text{Expenditure} \quad \times \quad \frac{\text{No of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

## **Speculators and losses from shares**

Generally, speculators are denied a revenue deduction for any losses arising for the disposal of shares unless a speculator is carrying on a business in relation to the shares. By way of example, in *AATA Case 6297* (1990) 21 ATR 3747, the Tribunal concluded that a taxpayer's share activities did not amount to carrying on a business and that, as a result, the taxpayer was not entitled to a deduction for losses arising from the disposal of his shares.

Furthermore, in ATO ID 2002/951 the Commissioner ruled that a speculator was not entitled to a revenue deduction for losses under s 25-40 of ITAA 1997 on the sales of post-CGT shares. Interestingly, the Commissioner did not discuss the deductibility of the losses under s 8-1 of ITAA 1997, nor whether the losses were capital in nature.

## **Trading stock**

The tax treatment of trading stock, which is contained in Div 70 of ITAA 1997, impacts on year-end tax planning. This is because a taxpayer is required to either include in or deduct from its assessable income for an income year the difference between the opening and closing value of the trading stock.

### ***Valuation of trading stock***

A taxpayer can elect to use the cost, market selling value or replacement value to value each item of trading stock-on-hand. However, this does not apply to obsolete stock or certain taxpayers.

There is no requirement to adopt permanently any one of the three methods of value.

- **TIP:** There is no compulsion to use the same method to value all closing stock. A taxpayer can use different methods for different items of trading stock to maximise its deductions or minimise its assessable income.

### ***Small business entities***

If a small business entity elects to apply the trading stock concession under Div 328, it is permitted to ignore the difference between the opening and closing value of trading stock if the difference between the opening value of stock on hand and a reasonable estimate of stock on hand at the end of that year does not exceed \$5,000. The effect of electing this concession is that the value of the entity's stock on hand at the beginning of the income year is the same as the value taken into account at the end of the previous income year.

However, a taxpayer could choose to account for changes in the value of trading stock even if the reasonably estimated difference between opening and closing values was less than \$5,000.

- **TIP:** Accounting for the difference between the opening and closing stock is a good tax planning method for to avoid a large adjustment in the calculation of taxable income in a future year when the benefit of Div 328 is not available or to claim a deduction in the current year for a reduction in the value of trading stock.

### ***Other business taxpayers***

It is a requirement to value each item of trading stock at the end of an income year at its cost, market value or replacement value. There is no requirement to permanently adopt any one of the three methods of valuation. Further, there is no compulsion for a taxpayer to use the same method across all items of trading stock.

- **STOP:** Manufacturers who elect to value stock on hand at year-end at cost price, and wholesale and retail industries must use the absorption cost method to value their trading stock: see Rulings IT 2350 and TR 2006/86.

### ***Obsolete stock***

A deduction may be available for obsolete stock. Therefore, a taxpayer should review its closing stock to identify whether any obsolete stock exists. In Taxation Ruling TR 93/23 the Tax Office states that obsolete stock is either:

- going out of use, going out of date, becoming unfashionable or becoming outmoded (ie becoming obsolete); or
- out of use, out of date, unfashionable or outmoded (obsolete stock).

When valuing obsolete stock, a taxpayer does not need to use any of the prescribed methods (ie cost, market value or replacement value). Rather, provided adequate documentation is maintained, the Tax Office will accept any fair and reasonable value which is calculated taking into account the appropriate factors: see s 70-50 of ITAA 1997.

## **Repairs and maintenance**

A deduction is available for repairs to premises, part of premises or a depreciating asset (including plant) held or used by a taxpayer solely for the purpose of producing assessable income: see s 25-10(1) of ITAA 1997. If the relevant premises or assets are held or used only partly for income-producing purposes, expenditure on repairs is only deductible to the extent that it is reasonable in the circumstances: see s 25-10(2).

A common issue that arises is the distinction between restoration of an item to its former condition (deductible) and improvement of the item (capital and therefore not deductible). It is important to realise the mere fact that different materials from those replaced are used will not of itself cause the work to be classified as an improvement, particularly in circumstances where the previous materials are no longer in current use. If the change is merely incidental to the operation of the repair, the deduction, generally, will be allowed.

Initial repairs, the replacement of the entire item, and improvements are not deductible, but may qualify for a periodic write-off under the capital allowance provisions. In addition, the expenditure may form part of the cost base of an asset for capital gains tax purposes.

- **TIP:** The Tax Office has stated that if a taxpayer replaces something identifiable as a separate item of capital equipment, the taxpayer has not carried out a repair. Therefore, the taxpayer is required to depreciate the item over its effective life.
- **TIP:** Taxpayers should seek an itemised invoice to separate the costs of work where the work includes both repairs and improvements.

## **Superannuation contributions**

### ***Deductions for employer contributions***

Employers are entitled to a tax deduction for contributions made to a complying superannuation fund or a retirement savings account (RSA) for the purpose of providing superannuation benefits for an employee. Any contributions made are only deductible for the year in which the contributions are made: see s 290-60(3) of ITAA 1997. To maximise the deductions available, employers should ensure that the contributions are paid to their employees' superannuation funds or RSAs before 30 June.

- **TIP:** A mere accrual of a superannuation liability or a book entry is not sufficient to qualify for a deduction.
- **TIP:** For employees turning 75, the contribution must be made by an employer within 28 days after the end of the month in which an employee turns 75 to obtain a deduction.

### **Superannuation guarantee charge**

The superannuation guarantee charge (SGC) is imposed if an employer does not make sufficient quarterly superannuation contributions for each employee by the relevant quarter due date. The SGC is also imposed where the employer pays the contributions after the due date, albeit there is no shortfall for the quarter.

Employers who have made a contribution for an employee after the due date for a quarter and have an outstanding SGC for the employee for that quarter may elect (using the approved form) to use the late payment offset to reduce part of their SGC liability.

Since 24 June 2008, employers can elect to use the late payment offset to reduce their SGC liability for a year (rather than a quarter) which becomes payable after that date. The offset provisions were amended by *Tax Laws Amendment (2008 Measures No 6) Act 2009*.

From 26 March 2009, an employer will be eligible to use the offset to reduce its SGC liability where:

- the employer has made a contribution for a quarter into an employee's fund after the due date for the quarter;

- the contribution in respect of the employee is made before the employer's original assessment for the SGC for the quarter (original SG assessment date);
  - the employer has given election (in the approved form) to the Commissioner to use the offset in respect of the employee to reduce their SGC liability for the quarter; and
  - the election is made within four years after the original SG assessment date for the quarter.
- **TIP:** The SGC and late payment offset are not deductible to an employer. Therefore, the employer still has a strong incentive to continue making its superannuation guarantee quarterly payments on time.
- **TIP:** The SGC is the only tax that the Commissioner wants employers to avoid paying.

### ***Personal superannuation deductions***

The self-employed and other eligible persons are entitled to a deduction for personal superannuation contributions is available if less than 10% of a taxpayer's total assessable income and reportable fringe benefits for an income year is attributable to activities that result in the taxpayer being treated as an employee for superannuation guarantee purposes.

The contribution is only deductible for the year in which it is made. Further, the contribution is deductible in full, subject to the restriction that the maximum amount that is deductible is the amount stated in the notice of intention to claim a deduction, which is given to the trustee of a superannuation fund. However, excess contributions tax may apply for contributions above the contributions cap (*see* Tax Rates and Figures).

- **TIP:** A deduction for personal superannuation should only be made towards the end of the income year when it is certain a taxpayer will satisfy the 10% rule (and other eligibility conditions) and not breach the taxpayer's concessional contributions limit of \$50,000 (or \$100,000 for those aged between 50 and 74).
- **TIP:** A taxpayer who realised a significant capital gain during the year should evaluate his or her eligible to claim a deduction for personal superannuation contributions. If the taxpayer is eligible, he or she should consider contributing an amount of the capital gain to superannuation which may reduce the tax payable on the capital gain derived.

## **Pending developments**

### ***Small business and general business tax break***

On 19 March 2009, the Government introduced the Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009 into the House of Representatives, which seeks to provide a once-off bonus deduction for new investment in tangible depreciating assets undertaken between 13 December 2008 and 31 December 2009 (inclusive). Key details of the bonus deduction follow.

- The deduction is limited to new tangible, depreciating assets for which a deduction is available under Subdiv 40-B of ITAA 1997 and new investment in existing assets. An asset is new if it has never been used or installed ready for use by anyone, anywhere.
- Second-hand assets are not eligible for the deduction.
- New investment in relation to an asset (usually the asset's GST-exclusive cost) needs to exceed a certain threshold before it can qualify for the deduction. The new investment threshold is \$1,000 for small business entities and \$10,000 for all other taxpayers.
- The asset must be used principally in Australia for the principal purpose of carrying on a business.
- Generally, the new investment threshold needs to be met for each individual asset. However, multiple investments — or recognised new investment amounts — in an individual asset may be amalgamated in meeting the new investment threshold.
- The deduction is worked out using a rate of either 30% or 10%, depending on when the taxpayer committed to investing in the asset. The deduction can be claimed in the income year that the asset is first used or installed ready-for-use.
- The deduction will not be apportioned for any non-taxable use of the asset.
- A taxpayer must make a decision to invest either in a new asset or an existing asset between 13 December 2008 and 31 December 2009.

- Assets that a taxpayer held or entered into a contract to hold on or before 12 December 2008 will not qualify. However, additional investment in such assets undertaken from 13 December 2008 may be eligible for the deduction.
- To qualify for the 30% deduction, a taxpayer must:
  - commit to investing in the asset between 13 December 2008 and 30 June 2009; and
  - first start to use the asset or have it installed ready for use, or (in the case of new investment in an existing asset) bring the asset to its modified or improved state on or before 30 June 2010.
- To qualify for the 10% deduction, a taxpayer must:
  - commit to investing in the asset by 31 December 2009; and
  - first start to use the asset or have it installed ready for use, or bring the asset to its modified or improved state on or before 31 December 2010.

There are a number of important changes from the Exposure Draft Bill that was released on 25 February 2009. These changes include:

- ***Option to acquire a new asset*** — Where a taxpayer enters into a contract prior to 13 December 2008 which includes an option to acquire an eligible asset at a later point in time and the option is exercised on or prior to 31 December 2009, the taxpayer may still be eligible to claim the tax deduction. The investment commitment time is deemed to have occurred when an option is exercised rather than on the date of an original contract.
- ***Jointly held assets*** — If an asset is jointly held, a taxpayer will be able to recognise all other business interests in the asset for the purpose of meeting the threshold that applies to it individually but will only be claim the tax deduction on its interest in the asset.
- ***Self-constructed assets*** — A taxpayer who self-constructs an eligible asset may still qualify for the tax deduction. In determining whether the taxpayer qualifies for the deduction, the taxpayer must demonstrate a clear intention or commitment to proceed with the construction, which is analogous to a case where a taxpayer enters into a binding contract.
- ***Investment threshold for batches and sets assets*** — A taxpayer is permitted to aggregate its investment in assets that are identical, or substantially identical, and in assets that form a set for the purposes of meeting the investment threshold. The taxpayer still needs to consider each asset individually. The assets forming a batch or a set will need to satisfy the basic requirements to qualify for the tax deduction. A batch or set of assets does not need to be acquired in the same transaction or in the same income year.
- ***Carried over for threshold purposes*** — Notwithstanding that a taxpayer has claimed an amount relating to the tax deduction for a new qualifying asset or new expenditure on a qualifying asset, the amount can still be used towards meeting the investment threshold for subsequent years. That is, the amount can be carried over for the purposes of meeting the investment threshold but it cannot be claimed again.

The amendments will apply to assessments for the 2008/09, 2009/10, 2010/11 and 2011/12 income years.

- **TIP:** If a taxpayer is in a tax loss position, the bonus deduction will form part of that loss and carry-forward to the following income year.
- **TIP:** Where an eligible asset is used for private and business purposes, a taxpayer does not need to apportion the cost of the asset between the different usages, provided the asset was required principally for a business use. Further, the bonus depreciation will not be clawed back in future years even if its usage changes.
- **STOP:** Where an eligible asset is held by a partnership, it is the partnership rather than the partners that is eligible to claim the bonus deduction.
- **STOP:** At the time of publication, the Bill has not received Royal Assent.

## Common deductions

The table below lists the common deductions. Note that the table is not exhaustive.

Item	Item
Bad debts	Tax losses
Balancing adjustment – depreciating asset	Payroll tax
Business related expenses ('blackhole' expenses)	Protective clothing
Borrowing expenses	Professional library
Building – write-off	Tools of trade
Capital allowances	Work-related travel
Capital work	Membership fees
Car expenses	Union dues
Compulsory uniform – cleaning and repairs	Repairs and maintenance
Computer hardware and software	Self-education expenses
Conferences and seminars	Gifts and donations
Donations	Home office
Fringe benefits tax	Interest
General interest charge	

## Capital Gains Tax

A taxpayer may consider crystallising any unrealised capital gains and losses in order to improve his or her overall tax position for an income year. For example, if the taxpayer is anticipating a significant capital gain in an income year, consideration may be given to reducing the gain by crystallising a capital loss in the same income year. However, consideration must be given to the Commissioner's view on wash sales contained in Taxation Ruling TR 2008/1, particularly if a taxpayer reacquires the assets being disposed or identical assets, or somehow retains dominion or control over the original assets.

### Small business CGT concessions

Broadly, the small business CGT provisions contained in Div 152 of ITAA 1997 provide a range of concessions for a capital gain made on a CGT asset that has been used in a business if certain conditions are met. These concessions are:

1. the 15-year asset exemption: a capital gain may be disregarded if the relevant CGT asset has been continuously owned by the taxpayer for at least 15 years. If the taxpayer is an individual, he or she must be at least 55 years of age and the CGT event must happen in connection with the taxpayer's retirement, or he or she is permanently incapacitated at that time. If the taxpayer is a company or trust, a person who was a significant individual just before the CGT event must satisfy the requirements;
2. the 50% reduction: a capital gain resulting from a CGT event happening to an 'active asset' of a small business may be reduced by 50%;
3. the retirement exemption: a taxpayer can choose to disregard all or part of a capital gain up to a lifetime maximum of \$500,000; and
4. the asset roll-over: a taxpayer can disregard all or part of a capital gain if a replacement asset, which is an active asset, is acquired.

➤ **TIP:** The concessions do not apply to deny capital losses that a taxpayer has for an income year. That is, the taxpayer is still able to utilise any capital losses against any other capital gains for the income year.

- **TIP:** A taxpayer can choose not to claim the 50% reduction on a gain. If the taxpayer is a company or trust which cannot pass on the full benefits of the 50% reduction to shareholders or unit holders, by not choosing this option, the taxpayer will be able to pass on the full benefits of the retirement exemption.
- **TIP:** Partial use of an asset in the course of carrying on a business will suffice for the active asset test.
- **TIP:** A small business entity wanting to access the small business CGT concessions is exempted from the maximum net asset value test.
- **STOP:** Unless specifically excluded, all assets, including depreciating assets, are taken into account in the maximum net asset value test.
- **STOP:** Consideration should be given to the integrity measures contained in the CGT regime: see ss 115-40 and 115-45, Div 149 and CGT event K6.
- **STOP:** The Government has introduced a Bill to amend the small business CGT concessions (see below). Generally, the amendments are proposed to commence from the 2007/08 income year.

### ***Pending changes to the small business CGT concessions***

The Government has introduced Tax Laws Amendment (2009 Measures No 2) Bill 2009 in which it will amend ITAA 1997 the law to increase access to the small business CGT concessions. These amendments include:

<b>Proposed amendment</b>	<b>Date of effect</b>
Allowing a taxpayer who owns a CGT asset that is used in a business by an affiliate, or entity connected with the taxpayer, to access the small business concessions via the \$2 million turnover test, subject to certain conditions	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Allowing partners who own a CGT asset that is used in a partnership business to access the small business CGT concessions via the \$2 million turnover test where CGT asset is not an 'asset of the partnership', provided the asset is made available for use in the partnership and satisfying certain conditions	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Allowing a CGT asset owned by a taxpayer to also be treated as an active asset where the taxpayer's spouse owns an entity that uses the CGT asset in its business. Specifically, the amendments will treat an individual's spouse or child (under 18 years of age) as an affiliate of the individual for the purposes of determining whether the individual, or an entity in which the individual has an interest, is eligible for the small business concessions where one entity owns a CGT asset and (a) that asset is used, or held ready for use, in the course of carrying on a business by another entity; or (b) is inherently connected with a business carried on by another entity	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Inserting rules for calculating aggregated turnover for passively held assets that apply in addition to the standard aggregated turnover rules in Subdiv 328-C of ITAA 1997. For these purposes, a special rule treats an entity (the deemed entity) that is an affiliate of, or is connected with, the owner of a passively held CGT asset as an affiliate of, or connected with, the entity that uses the passively held asset in its business (the test entity) if the deemed entity is not already an affiliate of, or connected with, the test entity	These amendments will apply to CGT events happening in the 2007/08 income year and later income years

Proposed amendment	Date of effect
Inserting another special rule to deal with situations where a taxpayer makes their CGT asset available for use in the business of more than one partnership of which they are a partner. The new rule for taxpayers in these circumstances treats each partnership that is not already connected with the test entity as being connected with the test entity	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Catering for the situation where an entity is an affiliate of the test entity and connected with the test entity at different times, a new rule in s 152-48(2) will mean that the same entity can only be an affiliate of the test entity and be connected with the test entity at different times during the income year	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Providing comparable access to the small business concessions for owners of passively held assets by inserting a new rule that permits the CGT event to occur in an income year after a business has ceased operating but while it is being wound up. The new rule applies to an entity that previously carried on a business which is being wound up in the CGT event year but only if the asset had been used, held ready for use, or was inherently connected with the business in the income year it ceased to operate	These amendments will apply to CGT events happening in the 2007/08 income year and later income years
Amending s 152-20(2)(a) to provide that liabilities relating to disregarded interests in entities connected with the taxpayer or the taxpayer's affiliates are taken into account in calculating the net asset value	This amendment will apply to CGT events that happen on or after the day on which the amending legislation receives Royal Assent
Amending the active asset test in s 152-40 of ITAA 1997 to ensure that all the uses of an asset (apart from personal use of an asset by the taxpayer or an individual who is the taxpayer's affiliate) are considered in determining whether it is an active asset for the purpose of the small business CGT concessions	This amendment will apply to CGT events that happen on or after the day on which the amending legislation receives Royal Assent
Extending the access to the small business CGT concessions under s 152-80 of ITAA 1997 to capital gains relating to assets acquired on the death of a joint tenant and to assets that devolve to the trustee of a trust that is established by the will of an individual where the deceased would have been able to access the concessions	The amendments apply to CGT events that happen in the 2006/07 income year and later income years
Removing the duplicate provision for receipt of capital proceeds in instalments by companies and trusts in s 152-310(3) of ITAA 1997	The amendment to reinsert the rule for capital proceeds received by individuals in instalments applies for capital proceeds received in instalments in the 2007/08 and later income years
Ensuring gains made under CGT events J5 and J6 (failure to acquire, or incur adequate expenditure on, replacement asset under the small business rollover) can also qualify for the retirement exemption. In particular, the amendments will make it unnecessary for gains arising under these CGT events to satisfy the basic conditions for the small business retirement exemption	The amendment applies to CGT events that happen in the 2006/07 income year and later income years

<b>Proposed amendment</b>	<b>Date of effect</b>
Allowing a company or trust to make a retirement exemption payment indirectly through one or more interposed entities to a CGT concession stakeholder for the purpose of satisfying the requirements of the retirement exemption.	This amendment will apply to payments that are made on or after the day on which the amending Bill receives Royal Assent.
Amending the meaning of small business entity contained in s 328-110 of ITAA 1997 to provide that a partner in a partnership cannot be a small business entity in their capacity as a partner. (Note: this amendment applies for the small business concessions generally and not just for the small business CGT concessions.)	The amendment applies to assessments for the 2007/08 income year and later income years.

At the time of publication, the Bill has not received Royal Assent.

## **Rollover relief**

Rollover relief is available to provide taxpayers with the option to defer the consequences of a CGT event. Apart from disregarding any capital gains or capital losses that would otherwise arise from a CGT event, a rollover usually places the transferee under the rearrangement in the same CGT position as the transferor was before the event occurred. Some of the rollover reliefs will apply automatically while some will require taxpayers to elect the use of the reliefs, which is indicated by the way their tax returns are prepared.

Two types of rollovers are available: the replacement asset rollover and the same asset rollover. A replacement asset rollover allows the deferral of a capital gain or loss until a later CGT event happens to the replacement asset. A same asset rollover allows the deferral of a capital gain or loss arising from the disposal of the asset until the later disposal of the asset by the successor entity.

The table below sets out the common rollover reliefs that may be considered for tax planning purposes:

<b>Type of rollover</b>	<b>Brief description</b>	<b>Election required</b>
Rollover from individual to company	Individual disposes assets to a resident company	Yes
Rollover from trust to company	Trustee of a trust disposes assets to a resident company	Yes
Rollover from partnership to company	Partnership disposes assets to a wholly owned resident company	Yes
Assets compulsorily acquired, lost or destroyed	Disposal of an asset from being compulsorily acquired, lost or destroyed	Yes
Fixed trust to company	Fixed trust disposes all of its assets to a resident company	Yes
Marriage breakdown	Taxpayer disposes assets to his or her spouse pursuant to an order of a court under the <i>Family Law Act 1975</i>	No
Small business replacement asset rollover	Taxpayer who is eligible for the small business CGT concessions acquires a replacement asset or improves an existing asset	Yes

## Quick reference tables

### Availability of CGT discount and indexation

Entity	CGT event after 21/9/1999 and asset acquired after that time	CGT event after 21/9/1999 and asset acquired before that time
Individual	<ul style="list-style-type: none"> <li>▪ CGT discount only</li> <li>▪ No indexation</li> </ul>	<ul style="list-style-type: none"> <li>▪ CGT discount or indexation<sup>1</sup> (frozen at 30/9/1999)</li> </ul>
Trustee	<ul style="list-style-type: none"> <li>▪ CGT discount only<sup>2</sup></li> <li>▪ No indexation</li> </ul>	<ul style="list-style-type: none"> <li>▪ CGT discount or indexation (frozen at 30/9/1999)</li> </ul>
Trustee of superannuation fund	<ul style="list-style-type: none"> <li>▪ CGT discount only</li> <li>▪ No indexation</li> </ul>	<ul style="list-style-type: none"> <li>▪ CGT discount or indexation (frozen at 30/9/1999)</li> </ul>
Company	<ul style="list-style-type: none"> <li>▪ No CGT discount</li> <li>▪ No indexation</li> </ul>	<ul style="list-style-type: none"> <li>▪ No CGT discount</li> <li>▪ Indexation frozen at 30/9/1999</li> </ul>

1. CGT discount and indexation method requires asset to be held for at least 12 months.
2. CGT discount not available when the trustee is assessed under either s 98(3) or 99A of ITAA 1936.

### CGT discount

Entity	CGT discount (%)
Individual	50
Trustee (if entitled to the CGT discount)	50
Trustee of superannuation fund	33.3
Company	0

## Companies

The tax treatment of companies will depend on their classification, that is, a private company or a public company. For example, only a private company is subject to the operation of Div 7A of ITAA 1936. Companies are subject to a flat rate of tax (currently 30%) on the entirety of their taxable income. This rate applies whether the company is public, private, resident or non-resident.

### Franking account

It is a requirement that every entity that is (or has ever been) a corporate tax entity has a franking account. The franking account is recorded on a 'tax paid' basis and operates on a rolling balance basis.

### Franking of distributions

All distributions are frankable unless specifically deemed unfrankable. Unfrankable distributions include:

- deemed dividends under Div 7A; and
- deemed dividends in relation to excessive payments made by a private company to its shareholders, directors and associates.

### **Benchmark rule**

The benchmark rule requires all frankable distributions made by an entity during its franking period to be franked to the same extent (the 'benchmark franking percentage').

It should be noted that a corporate tax entity would incur an over-franking tax if the franking percentage for a distribution exceeds the benchmark percentage, or a franking debit (for under-franking) if the franking percentage is less than the benchmark rate. (Certain concessions to this rule may apply to public companies.)

If the benchmark percentage varies by more than 20% from the last frankable distribution in the last franking period, an entity must notify the Commissioner in writing.

### **Franking period**

The franking period of a corporate tax entity will depend on whether it is a public company or a private company. The franking period of a private company is the same as its income year. Generally, a public company has a six-month franking period.

### **Distribution statements**

Entities that make frankable distributions must provide their shareholders with a distribution statement. (Note that the information that must be disclosed on the statement is prescribed in s 202-80 of ITAA 1997.) For entities that are private companies, the distribution statement must be given to their shareholders within four months after the end of the income year in which the distribution was made, or such further time as the Commissioner allows. If this statement is not received, the shareholder will not be able to claim a franking credit tax offset.

- **TIP:** As a private company has four months after the end of an income year to provide its shareholders the distribution statements, in effect, the company can retrospectively frank a distribution.
- **TIP:** It is an offence under the *Taxation Administration Act 1953* if a corporate tax entity fails to give a distribution statement or makes a misleading statement in connection with a distribution.

### **Franking account balance**

A company's franking account should be reviewed to ensure that the company is not liable for franking deficit tax. If the company is liable for franking deficit tax, it must be paid within a month of the end of the franking period. Franking deficit tax is not a penalty but an early payment of income tax that is offset against future tax obligations.

### **Concession for private companies**

A private company generating profit in its first income year is prevented from making a franked distribution to its shareholders because of insufficient franking credits. However, a concession, which allows the company to make a franked distribution to its shareholders, exists if the following conditions are satisfied:

1. it is liable to pay income tax for the income year that is sufficient to generate franking credits equal to at least 90% of the deficit in its franking account at the end of that income year; and
2. it is the company's first income year.

### **Private company and Div 7A**

The broad thrust of Div 7A of ITAA 1936 is to deem certain loans, payments and debt forgivenesses by private companies to their shareholders and associates to be assessable unfranked dividends to the extent that there are realised or unrealised profits of the company.

## Managing your Div 7A risk

To minimise any adverse Div 7A consequences, taxpayers must consider the following:

- repay private company loans by the earlier of the actual lodgment date or the due date for lodgment of the company's return for that year;
- ensure a loan agreement is in place by the earlier of the actual lodgment date or the due date for lodgment of the company's return for that year;
- ensure minimum repayments are made on loans from prior years;
- a deemed dividend can only arise to the extent of a company's distributable surplus, so this issue needs to be considered along with planning opportunities;
- payments under a guarantee can trigger a deemed dividend and must be considered carefully;
- the payment of an actual franked dividend by a company to offset a loan which has been deemed to be a dividend can have adverse implications and should be carefully considered;
- the exemptions available should be considered and used if possible; and
- a deemed dividend can also apply if property is provided, so companies should consider requiring shareholders to pay market value.

## Trusts and Div 7A

If a private company beneficiary of a trust has an unpaid present entitlement to an amount of the net income of the trust, and the trustee subsequently makes a loan, payment or debt forgiveness to a (non-corporate) shareholder or associate of the private company, it is important to consider the application of Div 7A.

Had the actual transaction (a loan, payment or forgiveness) been done by the private company and the shareholder or associate, a deemed dividend would arise here. Whether the company's unpaid present entitlement arises before or after the transaction is immaterial.

The amount of the deemed dividend is the lesser of:

- a) the amount involved in the actual transaction; and
  - b) the unpaid present entitlement less any amounts previously treated as deemed dividends.
- **TIP:** If the present entitlement is paid to the private company beneficiary by the earlier of the actual lodgment date or the due date for lodgment of the trust's return of an income year, a deemed dividend will not arise.

## Primary Producers

Although primary producers are subject to the general rules relating to assessable income and allowable deductions, they receive special concessions under ITAA 1997. These concessions include:

- **income averaging** — Div 392 allows primary producers to average their income from primary production and certain other limited amounts of income over a period not exceeding five years. This results in an averaging adjustment of either a tax offset or extra income tax, depending on whether the taxable income for an income year is above or below the average income.
- **double wool clips** — Subdiv 385-G allows a taxpayer who carries on a primary production business in Australia to defer the profit on a second wool clip in an income year if the taxpayer satisfies the conditions prescribed in that Subdiv.
- **insurance recoveries** — Subdiv 385-F applies to insurance recoveries for a loss of livestock or a loss by fire of trees owned by a taxpayer carrying on a primary production business in Australia. A taxpayer may elect to include 20% of the insurance recovery in assessable income for the first income year and 20% of the insurance recovery in assessable income for each of the next four income years: see s 385-130.

## Livestock accounting

The value of all livestock on-hand at the beginning of an income year and at the end of the year is taken into account in ascertaining whether or not a taxpayer has a taxable income. Therefore, a deduction is obtained for all losses by death, etc, in the income year. Conversely, the taxpayer's assessable income is increased by the value of all natural increases on hand at the end of that year.

A taxpayer can choose to value livestock at the end of an income year using the livestock's cost, market selling value or replacement value. (Note that there are additional options for valuing horse breeding stock.)

If livestock acquired by natural increase is valued at cost, a taxpayer may choose either the actual cost of the animal or the cost prescribed by the regulations for each animal in the applicable class of livestock. The actual cost means the full absorption cost of bringing the animal into its current state and location. The prescribed costs are set out as follow:

Class of livestock	Prescribed minimum value (\$)
Cattle	20.00
Deer	20.00
Horses	20.00
Pigs	12.00
Emus	8.00
Goats	4.00
Sheep	4.00
Poultry	0.35

### Disposal of livestock

In certain situations where a primary producer makes a profit on the forced disposal or death of livestock (eg the livestock was disposed because pasture or fodder is destroyed by fire, drought or flood), Subdiv 385-E allows the primary producer to elect either to spread the tax profit over five years or, where the profit is mainly used for replacement stock, to defer including the tax profit in assessable income.

Where livestock disposed of is replaced by stock of the same species (eg sheep by sheep), in calculating the cost of the replacement animals for income tax purposes the amount applicable to each replacement animal is the amount paid or payable for the purchase of that animal less the reduction amount: see s 385-120(1). The reduction amount is the amount of the tax profit on disposal or death attributed to livestock of the species being replaced, divided by the number of animals of that species that were disposed of or died: see s 385-120(2). Section 385-120(4) limits the reduction amount to the unused tax profit so that a particular purchase cannot reduce it to less than nil. The excess amount is carried forward in the unused tax profit. The right to reduce the cost, and thus absorb the assessable income derived from the original disposal or death until such time as the newly acquired animals are disposed of, extends for a period of five years from the date of the disposal.

Where livestock disposed of is replaced by stock of a different species (eg sheep by cattle), s 385-120(3) provides that the reduction amount for the animal is any reasonable amount at least equal to the amount calculated under s 385-120(2). Where the replacement stock is acquired at a price substantially in excess of the replacement cost of the species disposed of, the proportion of the profit on disposal required to reduce for taxation purposes the cost of the new animal is any reasonable amount at least equal to the amount worked out under s 385-120(2), provided that it does not exceed the cost of the new animal. Where the cost of the replacement animal is not substantially in excess of the replacement cost of stock of a similar species to that disposed of, the reduction amount is the amount worked out under s 385-120(2) or the cost of the animal.

Where a primary producer makes an election under s 385-110 and replaces the stock disposed of by breeding, the primary producer may elect to include an amount in its assessable income of the income year in which the livestock are replaced: s 385-115. No formula is provided for determining the amount to be included and it is any amount chosen by the taxpayer.

## Trusts

The provisions governing trust, which include in whose hands trust income is assessed and the amount assessed, can be complex. A good starting point is always the trust deed. This is because the deed governs the operation of the trust.

### Trust losses

The trust-loss recoupment rules restrict the circumstances in which prior year and current year losses of a trust can be claimed as a deduction when calculating the net income of the trust. The applicable tests that must be satisfied will depend on the type of trust. These tests must also be satisfied when the trust is seeking to claim a bad debt deduction.

Type of trust	Category	Ownership/control tests			Income injection test
		50% stake test	Pattern of distribution test	Continuity of ownership test	
Fixed	Ordinary fixed trust	✓	N/A	N/A	✓
Non-fixed		✓ <sup>1</sup>	✓	✓ <sup>2</sup>	✓
Excepted	Family trust	N/A	N/A	N/A	✓

1. Only when certain fixed entitlements exist.
2. Not relevant for current-year losses.

### Trust distribution minutes

The drafting of the distribution minutes needs to take into account the following tax issues:

- if there is a corporate beneficiary, will the distribution to the corporate beneficiary create an 'unpaid entitlement' and thus potential Div 7A issues?
  - if a family trust election has been made, is the income being distributed to a person outside the family group?
  - if the trust does not have any net income for the year, does it need to nominate a controlling individual to ensure the relevant trust-loss recoupment rules are satisfied?
  - if applicable, does the distribution of dividend income to the beneficiaries require a family trust election to be made to satisfy the 'holding period rule'?
  - if applicable, have the relevant trust-loss recoupment rules been taken into account when drafting the minutes to ensure access to the small business CGT concessions for the beneficiaries?
- **TIP:** A minor (ie under age 18 at the end of an income year) can receive up to \$2,667 in non-taxable distributions for the 2008/09 income year.
- **TIP:** If possible, all income should be distributed to the beneficiaries. This is because income retained in the trust will be subject to tax under s 99 or s 99A of ITAA 1936 at potentially the highest margin rate.
- **TIP:** If the trust deed permits, a trustee may want to consider streaming income to beneficiaries that are able to benefit the most from the distribution. However, consideration should also be given to the operation of the general anti-avoidance provision and any specific anti-avoidance provisions.
- **STOP:** The trustee's minutes distributes 'trust income' not 'taxable income'.
- **STOP:** If a trustee has distributed income to a minor up to the minor's non-taxable limit and the trust's net income is subsequently amended, the minor would need to receive an additional amount in proportion to the original distribution. The additional amount will normally be taxed at the top marginal rate (ie 45%).

## Trusts and unpaid entitlements to private companies

A 'loan' from a private company to a trust can generally trigger a Div 7A deemed dividend under s 109D of ITAA 1936 where:

- the company's shareholders can directly or indirectly benefit from the trust;
- the company has sufficient distributable surplus; and
- the loan is not repaid, or a loan agreement that complies with s 109N is not executed before the earlier of the lodgment date or due date for lodgment of the company's tax return.

An unpaid present entitlement may result in a s 109D loan where either:

- the trustee and the private company beneficiaries have entered into a written loan agreement; or
- the parties have entered into a consensual agreement for the provision of credit or other form of financial accommodation.

### *Tax Office view*

In a recent address at a Taxation Institute of Australia seminar, the Deputy Commissioner of Taxation indicated that s 109D and s 100A of ITAA 1936 may apply to unpaid present entitlements of a private company beneficiary to trust income. The Deputy Commissioner said his comments regarding the application of s 109D reflected the approach being taken by the Tax Office in one of its audit cases.

The Deputy Commissioner confirmed that a consensual agreement may arise if a private company's unpaid present entitlements to trust income are credited to a loan account on the trust's balance sheet, and the company acquiesces to or adopts the same accounting treatment. The Deputy Commissioner also confirmed that, if the evidence indicates that an unpaid present entitlement is not a s 109D loan, consideration should still be given to the potential application of s 100A.

Section 100A was originally enacted to prevent trust-stripping but has wider scope due to its broad wording. It generally operates to disregard a trust distribution that is diverted away from a presently entitled beneficiary under a reimbursement agreement, and to instead tax the trustee under s 99A.

- **STOP:** The term 'agreement' for s 100A purposes is broadly defined. The term can include informal, implied and unenforceable arrangements or understandings. However, the definition is subject to an exclusion for agreements entered into in the course of 'ordinary commercial or family dealings'.

## Capital gains distribution

There are two methods that a trustee can use to distribute the income of the trust: the quantum approach and the proportionate approach. The preferred method is the proportionate approach, based on the volume of case law regarding trust distribution, which distributes the income based on the proportions of the trust income to the beneficiaries. For example, if a beneficiary is presently entitled to 10% of the trust income, he or she will be taken to be presently entitled to 10% of the net income for tax purposes.

However, a strict application of the proportionate approach will result in an anomaly if capital gains are derived by the trust, and there are separate and distinct income beneficiaries and capital beneficiaries. This is because under s 97 of ITAA 1936, a beneficiary who is entitled to the 'income' would be taxed on all of the 'taxable income' (including the capital gains, even though the beneficiary has not received any of the capital distribution). To overcome this anomaly, in Practice Statement PS LA 2005/1 (GA), the Commissioner has stated that he will permit the use of the capital beneficiary approach or the trustee approach. However, for a trust to be able to use either one of these approaches, documentation as discussed must be entered into within two months of year-end.

### ***Capital beneficiary approach***

The capital gain may be assessed to a beneficiary (or a trustee on his or her behalf) if:

- the beneficiary has a vested and indefeasible interest in the trust capital representing the trust's capital gain;
- the beneficiary would have had an interest if the trust's capital gain had been a 'deemed' amount for tax purposes or the gain had been represented by actual trust capital; or
- the beneficiary has been allocated the trust's capital gain as a present entitlement no later than two months after the end of the income year.

A capital beneficiary must agree in writing on the approach to be used, and he or she must prepare his or her tax return in a way that corresponds to the agreement. The agreement must be made within two months after the end of the income year, or such further time as the Deputy Commissioner allows. The trustee resolution allocating the capital gain must also be made by the time the agreement is made.

### ***Trustee approach***

If there is a capital gain that is not to be included in the share of the net income of a beneficiary, the trustee will be assessed under ss 99 or 99A of ITAA 1936.

This approach can only be used if the beneficiaries and trustee have agreed in writing to use it. Any agreement must be made within two months after the end of the relevant income year.

If a party does not prepare his or her income tax return in accordance with an agreement, the Tax Office will ignore the agreement in assessing the capital gain.

### **Pending developments**

In a media release dated 31 October 2008, Federal Assistant Treasurer, Mr Chris Bowen, announced that the Government will remove one of the CGT exceptions to CGT events E1 and E2. According to the media release, the Government will abolish the 'trust cloning' exception. This exception provides a CGT exemption for capital gains arising from a change in ownership of an asset that typically occurs on the creation of a trust over a CGT asset (CGT event E1) and on transferring a CGT asset to an existing trust (CGT event E2).

However, the other exception to CGT events E1 and E2, that is, where an individual is the sole beneficiary of a trust and absolutely entitled to the assets of the trust, and the trust is not a unit trust, will be retained.

The media release stated that the amendments will resolve uncertainty surrounding the application of the exception. It also stated that the amendments will remove the possibility of using the trust cloning exception to eliminate tax liabilities on accrued capital gains.

At the time of publication, the Government has not released any draft legislation or Bill to implement the proposed changes.

### ***Tax Office administrative treatment***

The Tax Office has said that it would continue to apply the existing law until enactment of the proposed changes. It also said that, if the legislation receives Royal Assent prior to 1 July 2009, taxpayers should ensure the enacted changes are taken into account when completing their income tax returns for the income year ending 30 June 2009.

## **Small Business Entities**

The small business entity regime replaced the Simplified Tax System (STS) with effect from 1 July 2007. Under the small business entity regime, a taxpayer does not need to elect to enter into the regime. Instead, it will be apparent from a small business entity's tax return whether it has used the tax concessions. These concessions include:

- the simpler depreciation rules;
- the simpler trading stock rules;

- the entrepreneurs' tax offset;
- the prepaid expenses rules; and
- the two-year period of review.

In addition, a small business entity will be able to access other various concessions (subject to any additional criteria set out in the particular concessions themselves). These are:

- the CGT 15-year exemption, CGT 50% active asset reduction, CGT retirement exemption and CGT roll-over;
- the use of the GDP-adjusted notional tax method to work out PAYG instalments;
- the FBT car parking exemption; and
- the choice to account for GST on a cash basis, apportion GST input tax credits annually and pay GST by instalments.

### **Definition of a small business entity**

An entity will be classified as a small business entity for an income year if:

- it is carrying on a business in the current year; and
- it had an aggregated turnover for the previous year of less than \$2 million or an aggregated turnover for the current year likely to be less than \$2 million.

The aggregated turnover is the annual turnover of the entity's business plus the annual turnover of any businesses that the entity is connected to or affiliated with. The aggregated rules are similar to the former STS grouping rules.

An entity satisfies the aggregated turnover test if:

- its aggregated turnover for the previous income year was less than \$2 million;
- its aggregated turnover for the current income year, worked out as at the first day of the income tax year, is likely to be less than \$2 million; or
- its aggregated turnover for the current income year, worked out as at the end of the current income year, is actually less than \$2 million.

➤ **STOP:** Tax Laws Amendment (2009 Measures No 2) Bill 2009 contains various amendments which will potentially impact on the definition of a small business entity. (See Capital Gains Tax.)

### **Personal Services Income**

Broadly, the personal services income (PSI) rules attribute income derived by an interposed entity to the individual providing services to the entity. This is achieved by 'forcing' individuals to include the income generated by their personal skill or efforts in their personal tax returns. The deductions of a taxpayer who receives PSI are generally limited to the amount that he or she would be entitled to deduct if they had received the income as an employee.

However, the PSI rules do not apply to individuals or interposed entities if one of the required personal services business (PSB) tests (results test, unrelated clients test, employment test and business premises test) is satisfied. The primary test to be applied is the results test. If this test is met, there is no further requirement to self-assess against the other tests and the PSI rules do not apply.

In addition, the Commissioner has the power to grant a determination, which has the effect of exempting a PSB from the PSI regime. Generally, a determination will be granted if unusual circumstances existed that prevented the business from satisfying the tests or the business would have had, but for the unusual circumstances, two or more unrelated clients in the current income year.

➤ **STOP:** If a taxpayer fails the result test **and** the 80% rule in an income year, the taxpayer is not permitted to self-assess itself against the remaining tests. The PSI rules will apply unless a PSB determination is obtained from the Tax Office.

## General anti-avoidance and PSB

It is a common misconception that income earned by a PSB is income from a business structure. The income derived by a PSB is still categorised as PSI for income tax purposes if it is income that is mainly a reward for an individual's personal efforts or skills. Therefore, the income (as distinct from income from a business structure) that is derived by the PSB may be subject to the application of Pt IVA, if:

- the income is split with an associate; or
- the income is split with another entity associated with the individual; or
- the income is retained in a company and taxed at the lower company tax rate.

However, remuneration paid to an associate (or service trust) for bona fide services related to the earning of PSI will not attract the application of Pt IVA if the amount is reasonable.

The Tax Office has stated that Pt IVA will not apply in the following situations:

The PSB is conducted through:	Situation
a company	There is no income splitting and no retention of profits in the company.
	If there is a bona fide attempt to break even, a relatively small amount of taxable income may be returned by the company provided that income is distributed to the individual by way of a franked dividend in the following year.
a trust	If the trustee is a corporate trustee, the situations are the same as for a company.
a partnership	If a partnership income results from the services of employees or the use of income-producing assets.

➤ **TIP:** A partnership with a spouse will not attract the operation of Pt IVA if it is a genuine partnership.

## Superannuation

Superannuation should not necessarily be viewed as a year-end planning matter but rather as a long-term retirement savings approach. However, it is worth reflecting on the various concessions and deductions available under the superannuation system which may impact on the tax position of a taxpayer.

### Benefit withdrawal and re-contribution strategy

A re-contribution strategy may still produce tax benefits for those seeking to access superannuation benefits before age 60 or for estate-planning purposes. In particular, the taxable component of a superannuation interest remaining after the death of a member is still subject to 16.5% tax when ultimately paid in a lump sum to a beneficiary who is not a 'death-benefits dependant'.

Broadly, the aim of a re-contribution strategy is to convert part of a superannuation interest from a taxable component to a tax-free component. This strategy is relevant where benefits are paid to a person under age 60 (eg a transition to retirement pension) as the pension is deemed to comprise a portion of the total value of the superannuation interest reflecting the tax-free and taxable components. The underlying components also become relevant again upon the death of a member if the remaining benefits are paid to a non-dependant.

Re-contribution personal superannuation contributions are classified as non-concessional contributions and are therefore restricted by the annual non-concessional contributions cap. A person aged 65 to 74 must also satisfy the work test (ie gainful employment for at least 40 hours in a period of not more than 30 consecutive days in the financial year in which the contribution is made), in order for a fund to accept the personal contributions. As a result, any re-contribution strategy needs to be carefully considered in the light of the taxpayer's particular situation.

## Government co-contribution

Eligible low-income earners (including self-employed individuals) may qualify for a government superannuation co-contribution payment. The amount of co-contribution is equal to 150% of the sum of eligible personal superannuation contributions up to a maximum of \$1,500 per annum for a \$1,000 personal contribution. The maximum amount is available to all qualifying persons whose total income for an income year does not exceed the lower threshold. For qualifying persons whose total income exceeds the lower threshold but is below the upper threshold, the co-contribution tapers out at a rate of \$0.05 for each whole dollar of income. (*see* Tax Rates and Figures.)

For a self-employed individual, the total income will be reduced by amounts for which the individual is entitled to a deduction as a result of carrying on a business.

To qualify for a government co-contribution, a person must:

- have made one or more eligible personal superannuation contributions during the income year for which no deduction has been allowed to a complying superannuation fund or retirement savings account. The contribution must be made to obtain superannuation benefits for the person making the contribution or, in the event of the person's death, her or his dependants;
  - have at least 10% of his or her assessable income and reportable fringe benefits for the income year from carrying on a business (ie self-employed) or attributable to activities that result in the person being treated as an 'employee' for superannuation guarantee purposes, or a combination of both;
  - have a total income for the year that does not exceed \$60,342 for 2008/09. Total income is the sum of assessable income and reportable fringe benefits;
  - be aged under 71 on 30 June of the year in which the contributions are made. For persons aged 65 to 70, the additional work test rules must also be satisfied for a complying superannuation fund or retirement savings account to accept contributions from a person;
  - lodge an income tax return for the year; and
  - not have held an eligible temporary resident visa during the income year.
- **STOP:** From the 2009/10 income year, total income will also include any 'reportable employer superannuation contributions': see Tax Laws Amendment (Budget Measures No 1) Bill 2009, which received Royal Assent on 26 March 2009.

## Superannuation splitting

A member of an accumulation fund (or a member whose benefits include an accumulation interest in a defined benefit fund) is able to split with her or his spouse superannuation contributions made from 1 January 2006. The spouse contributions-splitting regime has also been extended to cover employer contributions to untaxed superannuation schemes and exempt public-sector superannuation schemes.

While the relevance of spouse contribution-splitting has been reduced following the abolition of reasonable benefit limits and end benefits tax for those aged 60 and over, splitting contributions between spouses can still be a useful strategy to effectively transfer concessional contributions to the older spouse who will reach age 60 (and tax-free benefit status) first. In addition, contribution splitting may be relevant to access two low-rate cap thresholds for superannuation benefits taken before age 60. However, it is not possible to split 'untaxed splittable contributions' (eg non-concessional contributions made after 5 April 2007).

In broad terms, the low-rate cap amount operates as a lifetime limit on the level of concessional tax treatment applicable to the taxable component of a superannuation lump sum (including an element untaxed in the fund) received by a person who has reached his or her preservation age but is under age 60. The cap amount is \$145,000 for the 2008/09 income year.

It is important to note that a superannuation fund does not need to offer a contributions-splitting service for its members. However, a trustee that accepts a valid application must roll over, transfer or allot the amount of benefits in favour of the receiving spouse within 90 days after receiving the application.

### **Tax treatment**

A member's contribution that is split and paid to another fund is considered a 'contributions-splitting superannuation benefit' and treated as a roll-over superannuation benefit for the receiving spouse. Therefore, the contributions-splitting amount rolled over or transferred for the benefit of the member's spouse is not subject to the 15% contributions tax in the hands of the fund.

Where a contributions-splitting superannuation benefit is transferred to an account within the same fund and paid to a taxpayer because her or his spouse is a member of the superannuation fund, the receiving spouse is deemed by s 307-5(6) to be the member of the fund for tax treatment of the superannuation benefit.

At the benefit payment stage, a contributions-splitting superannuation benefit is deemed to consist entirely of a taxable component of a superannuation benefit.

A person entitled to a tax deduction for a personal superannuation contribution who wants to split personal contributions and claim a deduction must provide a notice under s 290-170 of ITAA 1997 to her or his superannuation fund before requesting the fund to split the contributions. Once a contribution has been split, a self-employed person is not able to make a new s 290-170 election to claim a deduction or amend an existing election in respect of the split amount.

### **Spouse contributions tax offset**

A tax offset is available up to \$540 under s 290-230 of ITAA 1997 for a resident taxpayer in respect of eligible contributions made by the taxpayer to a complying superannuation fund or a retirement savings account for the purpose of providing superannuation benefits for the taxpayer's low-income or non-working resident spouse (including a de facto spouse): *see* Tax Rates and Figures.

A taxpayer is entitled to the spouse-contributions tax offset only if:

- the contribution is made on behalf of a person who was the taxpayer's spouse when the contribution was made;
- both the taxpayer and the spouse were Australian residents and were not living separately and apart on a permanent basis when the contribution was made;
- the total of the spouse's assessable income and any reportable fringe benefits for the income year is less than \$13,800;
- the taxpayer cannot and has not deducted an amount for the spouse contribution as an employer contribution under s 290-60 of ITAA 1997; and
- if the contribution is made to a superannuation fund, it must be a complying superannuation fund for the income year in which the contribution is made.

If the spouse in respect of whom the contribution is made is age 65 or over, the contribution cannot be accepted by the fund unless the spouse satisfies the requisite work test. Likewise, a regulated superannuation funds is not able to accept contributions on behalf of a spouse aged 70 to 74.

- **TIP:** The definition of a 'spouse' includes a person who, although not legally married to a person, lives with the person on a genuine domestic basis as the person's husband or wife.
- **STOP:** From the 2009/10 income year, the offset will not be available if the total of the taxpayer's spouse's assessable income, reportable fringe benefits and 'reportable employer superannuation contributions' exceeds \$13,800: *see Tax Laws Amendment (Budget Measures No 1) Act 2009*.

### **Spouse's income test and limit on amount of tax offset**

The assessable income and any reportable fringe benefits of the spouse must be less than \$10,801 in total to obtain the maximum tax offset of \$540, and less than \$13,800 to obtain a partial tax offset.

The taxpayer's own assessable or taxable income, and whether he or she qualifies for a deduction or tax offset for any superannuation contributions made on behalf of herself or himself, is irrelevant to entitlement to the rebate. Similarly, whether the spouse has any other superannuation is also irrelevant.

There is no limit on the amount of the actual contributions that can be made on behalf of the spouse, merely a \$3,000 limit on the contributions for which a tax offset can be obtained. Where less than \$3,000 is contributed, the tax offset is 18% of the actual amount of the contributions. Where the sum of assessable

income and reportable fringe benefits (if any) of the spouse is greater than \$10,800, the \$3,000 maximum contributions subject to the tax offset is reduced by \$1 for each dollar of assessable income and reportable fringe benefits in excess of \$10,800 and an 18% tax offset applies on actual contributions up to this maximum.

### **Transition to retirement pensions**

Broadly, a transition to retirement pension (TRP) allows a taxpayer who has reached preservation age to access his or her superannuation benefits by commencing a non-commutable pension or annuity without having to retire permanently from the workforce. At the same time, an individual can salary sacrifice employment income back into retirement savings. However, the pension cannot be cashed or commuted to a lump sum while the taxpayer is still working, unless a condition of release with a 'nil' cashing restriction has been satisfied (eg attaining age 65). All superannuation funds, including self-managed superannuation funds, are able to offer such a product to their members, provided the fund's deed allows it.

A TRP can take the form of a non-commutable allocated pension but has a maximum annual payment limit of 10%. Both the minimum and maximum annual payment amounts are calculated according to the 'account balance' under Sch 7 of the SIS Regs. Further, the minimum annual payment amount is determined by the age of the taxpayer at the start of each financial year.

Therefore, it is necessary to decide how much superannuation capital needs to be set aside to guarantee a TRP within the minimum/maximum annual payment limits. Due consideration must also be given to the make-up of the capital, which consists of taxable components and/or non-taxable components, because the composition will impact upon the tax treatment of a pension received by a taxpayer under age 60.

#### ***Tax treatment***

A TRP paid from a taxed source to an individual aged 60 or over is non-assessable non-exempt income, ie tax free. As such, it is not counted in working out the tax payable on any other assessable income of the individual.

Conversely, if an individual is under age 60, the 'taxable component' of a TRP paid from a taxable source is included in the individual's assessable income. Where the individual is above his or her preservation age (but below age 60) a 15% tax offset in respect of the tax component of the pension is available.

The tax-free component of a TRP paid from a taxed source is tax free, regardless of an individual's age.

#### ***Salary sacrifice and TRP***

An advantage of a TRP is that instead of employment income being taxed at an individual's marginal rate, the salary-sacrifice superannuation contributions are only taxed at the rate of 15% on entry into the superannuation fund. This, generally, results in less overall tax being paid on the pension income (as compared to employment income). However, it is important to note that the amount available for salary sacrificing is effectively restricted by the annual concessional contributions cap, which is determined by reference to an individual's age. (*See Tax Rates and Figures.*)

Another advantage is the income-tax exemption available to superannuation funds in respect of income derived from assets that are segregated to support a fund's current pension liabilities.

### **Self-managed superannuation funds**

The establishing of a self-managed superannuation fund (SMSF) can be part of a taxpayer's tax-planning options. However, it is important to be aware that the SISA and the SIS Regs impose various restrictions on the fund. In addition, the Act and the Regs impose various duties upon a trustee of an SMSF. Failure to comply with those restrictions and duties may result in the trustee facing civil and/or criminal penalties, and the SMSF losing its complying fund status.

The restrictions imposed on an SMSF include the sole purpose test, borrowings and acquisition of assets from related parties (eg for residential rental properties).

## Pension drawdown relief

The Government has introduced regulations which temporarily suspend the minimum drawdown requirements for account-based annuities and pensions for the second half of the 2008/09 income year (ie 1 January 2009 to 30 June 2009).

The temporary suspension occurs through a 50% reduction in the minimum payment amount for 2008/09. For those people who have already taken half of the current minimum payment for 2008/09, the annual nature of the minimum payment rules means that a further payment will not be required until the end of the 2009/10 income year. The temporary suspension of the minimum payment requirement will apply to:

- account-based annuities and pensions;
- allocated annuities and pensions;
- account-based and allocated pensions payable from retirement saving accounts; and
- market-linked (term allocated) annuities and pensions.

The relief is also available to individuals who are receiving a transition to retirement pensions, provided the pensions are paid through one of the pension products stated above.

## Tax Offsets and Rebates

A variety of tax offsets and rebates are available to resident individual taxpayers. Unlike deductions, tax offsets and rebates are not taken into account in determining taxable income. Instead, they are subtracted from the tax payable on the taxable income of a taxpayer. The amount of any tax offset or rebate to which a taxpayer is entitled to will depend on several factors, including the level of the taxpayer's taxable income and the separate net income of the taxpayer's dependants.

It is important to be familiar with the individual requirements of each tax offset or rebate because of the impact the tax offset/rebate may have on a client's tax position.

Where a tax offset or rebate is of a kind specified in s 67-75 of ITAA 1997, a refund of the tax offset/rebate is allowed if it exceeds the taxpayer's income tax liability for an income year. For these purposes, the taxpayer's tax liability is effectively determined by disregarding any refundable tax offsets/rebates and any franking tax offset, but taking into account any non-refundable tax offsets/rebates. The refundable amount is the excess.

The specified refundable tax offsets/rebates are:

- the private health insurance tax offset;
- the first-child tax offset;
- the research and development tax offset;
- the various film tax offsets;
- the national rental-affordability scheme offset;
- the education tax offset (*see* Developments since 1 July 2008);
- the franking tax offsets and venture capital franking tax offsets;
- the tax offset available under s 713-545 of ITAA 1997 where a life insurance company's subsidiary joins a consolidated group; and
- the no-TFN contributions income tax offset.

➤ **TIP:** A refundable tax offset/rebate can be set off against the Medicare levy payable and any other tax liability (under the rules in ss 8AAZLA to 8AAZLE of the *Taxation Administration Act 1953*) of a taxpayer.

➤ **TIP:** Where a trustee is assessed under s 98 of ITAA 1936 on behalf of a beneficiary who is a resident (other than a company beneficiary), the trustee may be entitled to a personal tax offset/rebate in that assessment.

## Developments since 1 July 2008

It is important to note the changes to the tax legislation which are effective for the 2008/09 income year and later income years. Some of the changes are discussed below.

### Education Tax Refund

From 1 July 2008, eligible families can claim a 50% Education Tax Refund for qualifying education expenses incurred on their children's education every year up to:

- \$750 for each child undertaking primary studies (ie a maximum of \$375 refund); and
- \$1,500 for each child undertaking secondary studies (ie a maximum of \$750 refund).

Families who receive Family Tax Benefit (FTB) Part A with one or more children undertaking primary or secondary studies and who satisfy the schooling requirement are eligible for the refund. Families who would be eligible for FTB Part A in respect of a child but for the fact that they or the child receive payments under:

- a prescribed educational scheme (eg Abstudy, the Veterans' Children Education Scheme, the Student Financial Supplement Scheme);
- the scheme under s 258 of the *Military Rehabilitation and Compensation Act 2004*;
- a social security pension (eg carer payment, sole parent pension, widow B pension or disability wage supplement);
- a social security benefit (eg youth allowance, Austudy payment, Newstart allowance or sickness allowance); or
- a payment under a Labour Market Program,

are also eligible for the refund.

Independent students (aged under 25) undertaking secondary studies at an educational institution such as TAFE may also be eligible. However, students attending general TAFE courses and/or university are not eligible.

A child satisfies the schooling requirement contained in s 61-630 of ITAA 1997 if the child undertakes primary or secondary studies (which can include home schooling) on at least one day in a six-month period beginning on 1 July or 1 January.

The list of eligible education expenses is contained in s 61-640 of ITAA 1997 and includes the following:

- computers;
- computer-related equipment;
- computer software;
- home internet connection;
- school textbooks and stationery; and
- prescribed tools of trade.

The acquisition cost of an item can be by way of purchase, lease or hire-purchase. Where applicable, the cost of an item can include associated costs such as repair and maintenance, and establishment costs.

An expense is not eligible for the refund to the extent that the expense is deductible under another provision of ITAA 1997 or ITAA 1936, is subject to another tax offset, or a claimant received or is entitled to receive payment or property for the expenses: see s 61-640.

The Tax Office's FAQs state that if an item is used for different purposes (eg education and business) only the amount that relates to the education of the child is eligible for the refund. The Tax Office has also stated various items which it considers not eligible for the refund. These include: computer games and consoles, school fees, sporting equipment, musical instruments, tuck shop expenses and transport.

The Education Tax Refund is claimed through the tax system on lodgment of an income tax return. Those not required to lodge an income tax return can claim the refund through the Tax Office by lodging a separate form at the end of the income year.

- **TIP:** Where a child transits from primary to secondary school in the same financial year, the secondary-school limit of \$750 will apply.
- **TIP:** Where a child ceases full-time study, a partial refund is available for that part of the financial year that the child meets the schooling requirement.
- **STOP:** A Frequently Asked Questions document released by the Tax Office states that parents can only claim for items that they have paid for themselves.

## Medicare levy surcharge threshold

The Medicare levy surcharge thresholds for the 2008/09 income year were amended by *Tax Laws Amendment (Medicare Levy Surcharge Thresholds) Act (No 2) 2008*.

The Medicare levy surcharge thresholds for the 2008/09 income year are set out in *Tax Rates and Figures*.

Transitional arrangements apply so that individuals who have insurance policies that provide private patient hospital cover before 1 January 2009 will avoid the levy surcharge for the period 1 July 2008 to 31 December 2008.

## Fuel tax credits scheme

From 1 July 2008, the fuel tax credits scheme has expanded to include all taxable fuels that an entity uses in machinery, and plant and equipment for its business activities, provided that the fuel is not used in a vehicle with a gross vehicle mass (GVM) of 4.5 tonnes or less travelling on a public road. Examples of taxable fuels are diesel, petrol, kerosene, heating oil, toluene and fuel oil. However, aviation fuels and alternative fuels such as liquefied petroleum gas, compressed natural gas, liquefied natural gas, ethanol and biodiesel are not eligible fuels for the purpose of the scheme.

The expansion means that most taxpayers, including businesses in construction, manufacturing, wholesale/retail, property management and landscaping activities, are now able to claim fuel tax credits. The Tax Office has provided the following examples of business equipment that a business can claim the credits for:

- all-terrain bikes (off-road use)
- asphalt pavers
- augers
- backhoes
- blower vacuums
- bobcats
- bulldozers
- cement mixers
- chainsaws
- compactors
- compressors
- cranes
- crushers
- winches
- dredges
- drills
- excavators
- front-end loaders
- graders
- hoists
- lawn mowers
- motorcycles (off-road use)
- outboard motors
- pumps
- rollers
- wacker-packers
- whipper-snippers

An entity can claim \$0.190715 per litre for fuels it acquires for use in machinery, and plant and equipment that it uses for its business activities. If the entity is claiming a credit for vehicles with a GVM greater than 4.5 tonnes or operating in a specified activity such as fishing or mining, separate rates will apply.

- **STOP:** Fuel tax credits received by a taxpayer are included in the taxpayer's assessable income and the calculation of its PAYG instalment income.

## **Tax Office Focus**

Consideration should be given to the Commissioner's approach to administering the tax law, which includes pronouncements on aggressive tax planning, Taxpayer Alerts as to arrangements that have come to his attention, and the annual Compliance Program of the Tax Office.

### **Compliance Program 2008/09**

#### ***Individuals***

##### **Investors**

The Tax Office has stated that it will carry out data-matching programs to ensure individuals are reporting their capital gains tax obligations correctly. It also states that it will focus on whether capital gains distributed to investors in managed funds have been correctly classified.

The Tax Office will check that managed investment schemes are implemented as described in their product rulings and identify schemes that have proceeded without product rulings. The Tax Office will increase its monitoring of aggressive new financial products and arrangements to ensure financial products (including tax exploitation schemes) comply with the tax and superannuation laws.

##### **Rental properties**

The Tax Office has said that it will focus on the following areas for rental property owners:

- claims for body corporate fees;
- claims for capital works;
- incorrect claims for stamp duty deductions on the purchase of a property title;
- incorrect classification of expenditure as repairs and maintenance;
- incorrect completion of rental schedules; and
- incorrect deductions for interest expenditure.

##### **Senior executives and directors**

The Tax Office will expand its review of compliance of senior executives and directors of public companies to private companies and resident executives and directors of foreign-owned companies. It will focus on remuneration packages and any failure to report equity benefit and cash or share bonuses. The Tax Office has stated that, where compliance action with senior executives identifies significant issues that are relevant to other employees, it will extend its compliance work to the larger population.

##### **Work-related expenses claims**

The Tax Office will review and audit activities, particularly in relation to nurses, medical practitioners and chefs. The Tax Office said it will also focus on 'out of pattern' claims for self-education, car and travel expenses.

#### ***Micro enterprises***

Micro enterprises refer to taxpayers with an annual turnover of less than \$2 million and to self-managed superannuation funds. The key priorities that the Tax Office are focusing on include:

- tax obligations of small businesses;
- employer obligations (including superannuation guarantee);
- cash economy;
- offshore income including dividends and interest, royalties and rental income;
- capital gains on sales of assets and investments;
- tax debt management;
- refund fraud, in particular unusual and high value GST and income tax refund claims;

- obligations of trustees and auditors of superannuation funds;
- partnership and trust distributions;
- GST and property transaction; and
- claims for fuel tax credits.

### ***Small to medium enterprises***

Small to medium enterprise businesses refer to taxpayers with an annual turnover of between \$2 million and \$250 million, including highly wealthy individuals who, with their associates, effectively control \$30 million or more in net wealth. The key priorities that the Tax Office are focusing on include:

- private companies and Div 7A issues;
- highly wealthy individuals;
- tax planning around business exits;
- transactions between related Australian and offshore entities that shift profits from Australia to other countries and capital gains from overseas assets;
- trusts issues such as the effectiveness of clauses in trust deeds that seek to equate trust income with trust taxable income and trust cloning involving the permanent deferral of tax; and
- claims fuel tax credits.

### ***Superannuation***

The Commissioner has highlighted several superannuation-related compliance priorities for 2008/09. Key priorities include:

- ensuring employees' superannuation guarantee contributions are correctly paid;
- over-claiming deductions for superannuation contributions and excess contributions;
- early access to superannuation by individuals; and
- regulatory issues associated with self-managed superannuation funds.

Note that this year the Tax Office will also focus on supporting the implementation of the introduction of the new First Home Saver Accounts (FHSAs) from 1 October 2008 and ensuring that people understand the product.

### **Taxpayer Alerts**

Taxpayer Alerts are only intended to be an 'early warning' of tax-planning arrangements that the Tax Office have under risk assessment. However, it is expected that the Tax Office will follow-up on the release of an Alert with either a public ruling or determination.

#### ***TA 2009/1 – Early access to superannuation***

In Taxpayer Alert TA 2009/1, the Tax Office describes arrangements that incorrectly offer people early release of their preserved superannuation benefits prior to retirement without meeting statutory conditions for such release. The Alert also reiterates the Tax Office's concerns about similar arrangements to those described in Taxpayer Alert TA 2002/3.

The Tax Office says the arrangements are ineffective and may involve misleading or deceptive conduct and breaches of the sole purpose test.

# Tax Rates and Figures

## Individuals

### General rates for residents — 2008/09

Taxable income (\$)	Tax payable (\$)¹
0 – 6,000	Nil
6,001 – 34,000	Nil + 15% of excess over 6,000
34,001 – 80,000	4,200 + 30% of excess over 34,000
80,001 – 180,000	18,000 + 40% of excess over 80,000
180,001 +	58,000 + 45% of excess over 180,000

1. Medicare levy is payable at the flat rate of 1.5% of taxable income, subject to concessions for low income earners and various exemptions
- **TIP:** The tax-free threshold for 2008/09 for qualifying pensioners/self-funded retirees may effectively be increased up to \$28,867 via the senior Australians tax offset and low-income tax offset.

### Division 6AA income — resident minors

Div 6AA income (\$)	Tax payable (\$)
0 – 416	Nil
417 – 1,307	66% of excess over 416
1,308+	45% of entire amount

- **TIP:** A minor is also eligible for the low-income tax offset, which will effectively increase the Div 6AA tax-free threshold from \$416 to \$1,667.

### Medicare levy surcharge threshold

No of dependent children or students	Surcharge threshold (\$)
0 (Single)	70,000
1	140,000
2	141,500
3	143,000
4	144,500
Each extra child	+ 1,500

## Tax offsets and rebates

### Low-income tax offset — 2008/09

Taxable income (TI) (\$)	Offset (\$)
0 – 30,000	1,200
30,001 – 59,999	1,200 – ([TI – 30,000] x 4%)
60,000+	Nil

### **Spouse contributions tax offset**

<b>Spouse's assessable income (SAI)</b> ( <b>\$</b> )	<b>Maximum rebateable contributions (MRC)</b> ( <b>\$</b> )	<b>Maximum tax offset</b> ( <b>\$</b> )
0 – 10,800	3,000	540 <sup>1</sup>
10,801 – 13,799	3,000 – [SAI – 10,800]	MRC x 18% <sup>1</sup>
13,800+	Nil	Nil

1. The actual amount of the contributions x 18% will be the maximum tax offset where it is less than this figure.

### **Companies**

Company tax rate	30%
Division 7A benchmark interest rate for 2008/09	9.45%

### **Superannuation**

#### **Tax rates for complying superannuation funds**

Investment income and other income (other than non-arm's length income)	15%
Capital gains (after 1/3 discount if eligible)	15%
Non-arm's length income	45%
Concessional contributions (below contributions cap <sup>1</sup> )	15%
Concessional contributions (above contributions cap) <sup>2</sup>	15% <sup>2</sup>
Non-concessional contributions (below contributions cap <sup>3</sup> )	Nil
Non-concessional contributions (above contributions cap) <sup>4</sup>	Nil <sup>4</sup>
No-TFN contributions	46.5%
SMSF supervisory levy for 2008/09	\$150

1. The concessional contributions cap is \$50,000 for those under 50 (or \$100,000 until 30 June 2012 for those aged 50 or over).
2. If the contributions are above the concessional cap, the fund continues to pay tax on those contributions at 15% but extra tax is levied on the excess contributions on the individual contributor at 31.5%.
3. The non-concessional contributions cap is \$150,000 per person per year (or \$450,000 every three years for people under age 65).
4. If the contributions are above the non-concessional cap, the individual, rather than the fund, is taxed on the excess at 46.5%.

#### **Concessional contributions cap**

<b>Age as at 30 June 2009</b>	<b>Cap</b>
Under 50	\$50,000
50 – 64	\$100,000
65 – 74	\$100,000
75+	Only mandated employer contributions

**Government co-contribution**

Assessable income plus reportable fringe benefits (AI)	Maximum government co-contribution payment
\$0 – \$30,342	\$1,500
\$30,343 – \$60,342	\$1,500 – ((AI – \$30,342) x 0.05)
\$60,343	Nil

**Preservation age**

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 to 30 June 1961	56
1 July 1961 to 30 June 1962	57
1 July 1962 to 30 June 1963	58
1 July 1963 to 30 June 1964	59
30 June 1963+	60

**Quarterly date dues for superannuation guarantee**

Superannuation guarantee due dates	
Quarter ending	Due date
30 September	28 October
31 December	28 January
31 March	28 April
30 June	28 July

**Miscellaneous rates****Cents per kilometre rates for car expenses — 2008/09**

Description	Engine capacity non-rotary engine (cc)	Engine capacity rotary engine (cc)	Rate per kilometre (cents)
Small car	0 – 1,600	0 – 800	63.0
Medium car	1,601 – 2,600	801 – 1,300	74.0
Large car	2,601 +	1,301 +	75.0

**Luxury car limit/ car depreciation cost limit**

Income year	Limit (\$)
2008/09	57,180
2007/08	57,123

**Overtime meal allowances (per meal) — reasonable expenses**

Income year	Amount (\$)
2008/09	23.60
2007/08	22.60

**Value of goods taken from stock for private use**

Type of business	Adult/Child over 16 years <sup>1,2</sup> (\$)	Child 4 – 16 years <sup>1,2</sup> (\$)
Bakery	1,070	535
Butcher	720	360
Restaurant / café (licensed)	3,680	1,470
Restaurant / café (unlicensed)	2,940	1,470
Caterer	3,190	1,595
Delicatessen	2,940	1,470
Fruiterer / greengrocer	770	385
Takeaway food shop	2,780	1,390
Mixed business (includes milk bar, general store and convenience store)	3,520	1,760

1. The amounts are per adult or per child.

2. The amounts exclude GST.

**HELP repayment thresholds and rates — 2008/09**

HELP repayment income (\$) <sup>1,2</sup>	Repayment rate (%)
0 – 41,594	Nil
41,595 – 46,333	4.0
46,334 – 51,070	4.5
51,071 – 53,754	5.0
53,755 – 57,782	5.5
57,783 – 62,579	6.0
62,580 – 65,873	6.5
65,874 – 72,492	7.0
72,493 – 77,247	7.5
77,248+	8.0

1. 'HELP repayment income' is the sum of taxable income, reportable fringe benefits total, net exempt foreign employment income and net rental losses.

2. From the 2008/09 income year, a taxpayer's repayment amount may be reduced by the HECS-HELP benefit if the taxpayer:

- graduated from an undergraduate mathematics, statistics or science course of study from the second semester of 2008 onwards and is employed in a related occupation, including teaching those subjects in a secondary school; or
- is an early-childhood teacher employed in a childcare centre, kindergarten or pre-school in a regional or remote area, Indigenous community or an area of high socio-economic disadvantage.