PARMELIA PARTNERS

Client Newsletter

June 2017

End-of-year tax planning tips for business

The general rule is that you can claim deductions for expenses your business incurs in its task of generating assessable income. Many of these deductions are obvious – rent, materials, supplies and so on — but there are also some less obvious options left available just before the end of the income year, should your circumstances suit, to further reduce your enterprise's tax burden for the year.

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If your business has taken out a loan, any interest accrued but not physically paid by June 30 is potentially deductible (the crucial factor of course being that the loan was used to produce assessable income, which most business loans are) — assuming that the business accounts for tax on an accruals basis. In a similar vein, see if you can negotiate with your finance provider to make upfront interest repayments — that is, they may not be "due" until after July 1, but the finance provider will accept them before then.

End-of-year tax planning tips for business *cont*

In a related tip, it is a fact of life that many sole traders fund some business activities through their personal credit card or a personal loan. Because the interest costs are not being incurred under the business name, but in the name of the business owner, many operators have unfortunately assumed that a deduction cannot be claimed.

But remember — a sole trader's business and non-business activities are all dealt with under the taxpayer's personal income for tax purposes. So qualifying business expenses will be deductible even if you used your personal credit card instead of your business one.

Capital gain shuffle

Capital losses can be offset against, and therefore reduce, taxable capital gains that you may make on selling other assets. So if your business is due to sell some assets that will realise a capital loss, try to crystallise these losses before June 30.

If however the sale will produce a capital gain, delay crystallising this gain until the 2017-18 income year so that you will have a full fiscal year to get in place options to offset that gain with capital losses or revenue expenses. It may even be worthwhile for you to sell an underperforming asset, and realise a loss, if this suits your CGT circumstances.

And remember, as a general rule the "CGT event" for a disposal occurs at contract date — this could help in your planning if you sell an asset where settlement and/or payment takes place in 2017-18 but the contract is executed in 2016-17.

Appreciate depreciation

Getting a tax deduction for the wear and tear and loss of value on business assets that are used to derive assessable income is a stalwart of the business tax regime, so a review of your enterprise's depreciation schedule is always prudent. Any number of opportunities can be discovered, including the ability to scrap and write-off amounts of redundant assets, reassess remaining effective lives, or allocate assets to a low value pool.

This is important for this and next tax year as the $20,000 instant asset write-off has been extended until June 30, 2018 (subject to legislation passing). It will thereafter revert to $1,000 (notwithstanding possible further changes in next year's Federal Budget).

Trading stock isn't always standard

Taking into account the changed value of your trading stock over an income year can affect the resulting taxable income. But as you can have a choice of how that valuation is arrived at — that is, cost, market selling, or replacement value (or even a lower value due to obsolescence) — the end result may allow you to either bring forward deductions or alternatively increase taxable income if you have sufficient deductions to use up for the 2016-17 year.

And remember, each item of trading stock can be valued differently for tax purposes. Ask for our help should you need guidance.

Silk purse from a sow's ear

Another unfortunately not uncommon fact of business life is that some amounts owed to you sitting on the balance sheet are not likely to ever be paid. Now is the best time of year to re-consider these amounts, and decide if any are legitimate bad debts, and therefore able to be written off and be transformed into a tax deduction.

To this end, it could pay to go back through your outstanding invoices to find potential bad debt candidates and write them off before June 30. However the ATO has rules regarding bad debt deductions — call our office for more details.

A bonus from staff bonuses

Businesses that account for tax on an accruals basis are entitled to claim a tax deduction for an expense in the year in which the business has committed to the liability. If you have committed to pay employees end-of-year bonuses, the accrued expense can be claimed as a tax deduction even though it is physically paid next financial year.

A company can also claim director bonuses in the year the expense is accrued in the same way (directors are classified as employees). For a company to claim a deduction for a director or employee bonus without physically paying the money, the company must, before the end of the financial year, commit to the payment of a specific amount. The amount need not be quantified but the calculation methodology must be fixed (for example, a formula based on profits or revenue amounts yet to be finalised). The commitment should be documented (such as minutes of a directors' meeting).

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End-of-year tax planning tips for business *cont*

Remember the concessions

Parliament has finally passed most of the business tax relief package announced in the last Federal Budget, but with some amendments. The legislation brings into effect the following changes for SME businesses:

- Progressive cuts to the company tax rate:
  - The tax rate will be progressively reduced to 27.5% from 2016-17 to 2018-19 for companies that are carrying on a business and have an aggregated turnover of less than $50 million.
  - The 27.5% rate for those entities will be progressively cut to 25% by 2026-27.
- An increase to the small business entity threshold from 2016-17:
  - The aggregated turnover threshold for access to most small business tax concessions will be $10 million, with the exception of the below concessions.
    - The threshold for the small business income tax offset will be $5 million.
    - The threshold for the small business CGT concessions will remain at $2 million.

And a reminder that the small business income tax offset rate for unincorporated enterprises for 2016-17 has gone up to 8%, and will stay at that rate until 2023-24. It will then double to 16% by 2026-27 (the offset will remain capped at $1,000 a year however).

A summary of concessions available for small business and eligible thresholds (from July 1, 2016) is laid out in the table below.

Soak up those losses

There may be a case to offset prior year losses against current year income, however for companies and trusts the ability to do so can be subject to certain conditions (the carry forward loss rules). These include the continuity of ownership test and the same business test for a company.

See the accompanying article on the next page of this newsletter "What is a tax loss, and how can it be turned to good use?" And of course ask us to consult with you should this seem applicable.■

Summary of concessions available for small business and eligible thresholds (from 1 July 2016)

Aggregated annual turnover	$20,000 instant asset write-off	Small business CGT concessions	Small business restructure roll-over	Company tax cuts	Small business income tax offset	Small business pool	Immediate deduction for certain start-up costs
< $2m	Yes	Yes	Yes	Yes	Yes	Yes	Yes
< $5m	Yes	No	Yes	Yes	Yes	Yes	Yes
< $10m	Yes	No	Yes	Yes	No	Yes	Yes

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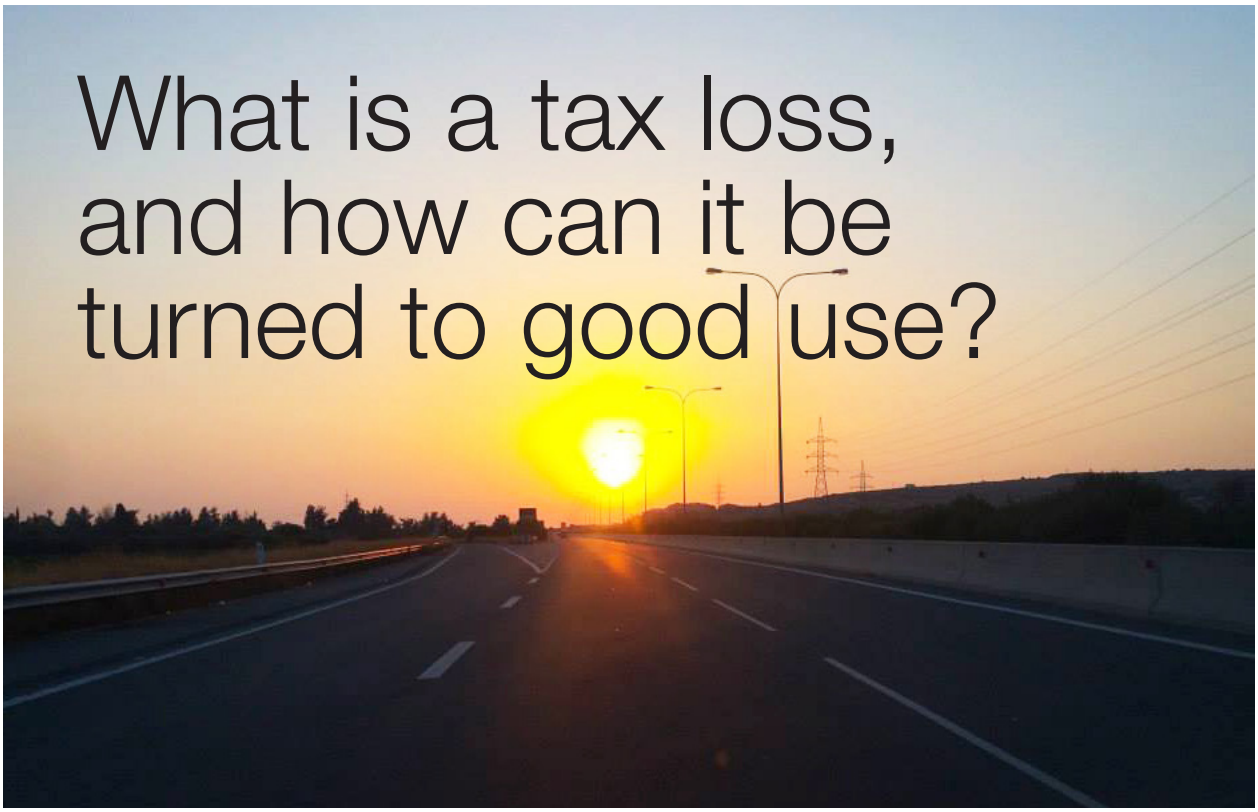

What is a tax loss, and how can it be turned to good use?

You generally make a tax loss when the total deductions that can be claimed for a financial year exceed the total of assessable and net exempt income for the year.

If you operate a business that makes a loss you can generally carry forward that loss and claim a deduction for it in a future year. If you're a sole trader or in a partnership, you may be able to claim business losses by offsetting them against your other personal income (such as investment income) in the same income year.

Only sole traders or individual partners in a partnership who meet one of the non-commercial losses requirements (see next page) can offset business losses against other income (such as salary or investment income) in the same income year.

If you do not meet any of these requirements, or if you operate through a company or a trust, you can still carry it forward to future years. If your business makes a profit in a following year, you can offset the deferred loss against that profit.

Note that a tax loss is different from a capital loss. A capital loss occurs when you dispose of a capital asset for less than its tax cost base. A capital loss can only be offset against any capital gains in the same income year or carried forward to offset against future capital gains – it cannot be offset against income of a revenue nature.

Your business structure can affect how you can claim tax losses. For example, companies can generally choose the year in which they claim a deduction for a carried forward tax loss. This can be useful as it means, for example, that a company can choose not to utilise prior year losses in a particular year in order to pay sufficient tax to be able to distribute franked dividends. However, if you operate as a sole trader, partnership or trust, you cannot choose the year or years in which you claim a deduction for your prior-year tax losses.

SOLE TRADERS

Individuals can generally carry forward a tax loss indefinitely, but must claim it at the first opportunity (that is, the first year that there is taxable income). You cannot choose to hold on to losses to offset them against future income if they can be offset against the current year's income.

Carried forward tax losses are offset first against any net exempt income (such as pension income, government allowances and so on) and only then against assessable income. Losses must be claimed in the order in which they were incurred.

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What is a tax loss, and how can it be turned to good use? *cont*

NON-COMMERCIAL LOSSES

If you're in business as an individual, either alone or in a partnership, and your business makes a loss, you must check the non-commercial loss rules to see if you can offset the loss against your income from other sources, such as wages.

You can ask us about the non-commercial loss rules, but briefly these rules dictate that you can't claim a loss for a business that is little more than a hobby or lifestyle choice (based on the legal tests, not on your intentions). Even if it has business-like characteristics, if it is unlikely to ever make a profit and doesn't have a significant commercial purpose or character, you generally can't offset the loss against your other income.

In these cases, if you are thinking of ramping up your efforts and are sure you will make a profit in the future, you might decide to defer the loss until you realise that profit from the business.

The non-commercial business loss requirements are:

- your business is a primary production business or a professional arts business and you make less than $40,000 (excluding any net capital gains) in an income year from other sources
- your income for non-commercial business loss purposes is less than $250,000, and either
    - your assessable business income is at least $20,000 in the income year
    - your business has produced a profit in three out of the past five years (including the current year)
    - your business uses, or has an interest in, real property worth at least $500,000, and that property is used on a continuing basis in a business activity (this test excludes your private residence and adjacent land)
    - your business uses certain other assets (excluding motor vehicles) worth at least $100,000 on a continuing basis.

If you fail all of the tests but you believe that you should be allowed to claim the loss due to special circumstances, you can apply to the ATO for the "Commissioner's discretion" to apply, which would allow you to utilise the loss (we can help you with this application).

COMPANIES

Companies can carry forward a tax loss indefinitely, and use it when they choose, provided that since the loss was incurred they have either:

- maintained the same majority ownership and control, or
- carried on the same business once the ownership test is failed.

If there is a change of ownership or control of a company during an income year and the company does not maintain the same business, it must work out its taxable income and tax loss. In broad terms, a company in this situation has both a taxable income and a tax loss for the same year. In some circumstances, the loss may be carried forward and used in later years, subject to the usual restrictions.

Also note that with tax losses, you must keep proper records relating to your tax affairs for at least five years. If you use information from those records in a later tax return, you may have to keep records for longer. So, if you carry forward a tax loss, you must keep the records until the end of any period of review for the income tax return in which the loss is fully deducted.■

ⓘ Certain deductions that would otherwise be allowable cannot be claimed as deductions where doing so would give rise to a tax loss. They are:

- payments of pensions, gratuities or retirement allowances to employees, former employees, or their dependents
- gifts or contributions made to deductible gift recipients
- payments made under conservation covenants, and
- personal superannuation contributions.

The transitional CGT relief measure and your SMSF

Transitional capital gains tax (CGT) relief is temporary relief available to all complying superannuation funds, not just SMSFs, for certain CGT assets that would otherwise give rise to a taxable capital gain through the necessary efforts to comply with the new transfer balance cap and new conditions to be applied to transition to retirement income streams (TRIS).

Upon the introduction of the transfer balance cap, effective July 1, 2017, it is expected that some SMSF trustees will need to scale back existing pensions so that the super fund's members do not exceed their transfer balance cap, which is $1.6 million for the 2017-18 financial year.

If CGT assets are sold to enable the commutation and withdrawal from existing pensions, then the current law will apply to these disposals and the transitional CGT relief is of no relevance.

Conversely, if a fund member decides to commute a portion of their superannuation interest that currently is in the pension phase back into the accumulation phase, then the transitional CGT relief will be relevant. This is because investment earnings, including capital gains, are taxable in the accumulation phase.

Additionally, from July 1, 2017, income from assets supporting a TRIS will not be eligible for an exemption from income tax on earnings, so the CGT relief provisions will be relevant for superannuation fund members receiving a TRIS.

Essentially, the transitional CGT relief ensures any capital gains that might arise as a result of superannuation fund members complying with the transfer balance cap or because of a TRIS losing the tax exemption will continue to receive concessional treatment.

The application of CGT relief

Trustees can choose to apply temporary CGT relief if they hold the asset throughout the period November 9, 2016 to June 30, 2017 (the "pre-commencement period"), and must do so before they are required to lodge the fund's 2016-17 tax return. Assets purchased or sold during the pre-commencement period are not eligible for relief.

Applying CGT relief will:

- reset the cost base of an asset to its market value (this is where trustees reallocate or re-proportion assets from retirement phase to accumulation phase). The market value would be determined under the ATO's valuation guidelines for SMSFs on the date of the asset transfer, or June 30, 2017 where assets are re-apportioned
- defer a capital gain that arises when resetting the cost base for re-proportioning assets where you use the proportionate method.

If a trustee has been using the segregated method, and either continues to use it or switches to the proportionate method, an asset must cease being a segregated current pension asset at a time during the "pre-commencement period" to be eligible for relief. The capital gain or loss for that asset will then be entirely disregarded.

An asset ceases to be a segregated current pension asset when:

- it is transferred out of the pool of segregated current pension assets; or
- the trustee makes and records an election to switch to the proportionate method.

The ATO has published a Law Companion Guideline on the relief measures, and we are happy to provide you with a link to this and discuss your options. ■

Q: WHO IS ASSESSABLE ON INTEREST INCOME?

A: THOSE WHO "BENEFIT"

It is a fairly well-established and welcome act for an aunt or uncle or of course a parent to start a savings account for a new addition to the family. It is not so common however, to factor in the taxation obligations that may arise from this generosity.

A young child may not be able to reach the buttons at the ATM, but they can certainly have bank accounts in their own name. Naturally it is a child's guardian who will manage their financial matters, and therefore a parent may operate a savings account on behalf of their child.

For taxation however, while the account may be in the child's name, the underlying tax principle that prevails is that investment income (in this case, the bank account's interest) is assessable to the person who beneficially owns the money (not necessarily who legally owns it).

The tax rules in operation here are not limited to children's saving accounts, but it is a scenario that is useful in describing the principles at work. In fact, the Taxation Commissioner has recently issued guidance that consolidates previous rulings and determinations in relation to not just children's savings accounts but also monetary gifts to a child, joint bank accounts, and joint signatories to a bank account.

In each situation, it has been determined that interest income on a bank account is assessable to the person or persons who beneficially own the money in the account.

TAX RATES FOR MINORS

The ATO and other government agencies determine a "minor" to be those under the age of 18, however some people are surprised to find out that the tax rates that can be applied to the "unearned" (that is, passive) income of such young taxpayers can seem so punitive.

For minors, the tax free threshold is a mere $416. Between $417 and $1,307 the rate is set at 68% (66% after June 30, 2017, when the Temporary Budget Repair levy expires). From $1,308, the top (adult) marginal rate applies.

But the reason for the seemingly harsh rates has little to do with punishing the kids and more to do with the behaviour of the older generation. These rates (and other measures, such as the exceptions dealt with below) were introduced to stop or discourage adults from channelling a portion of their income through their child's bank account, thus taking advantage of lower marginal and effective tax rates for themselves.

EXCEPTED INCOME, EXCEPTED PERSONS

There are, of course, exceptions. Broadly, the income derived by minors is taxed at a punitive rate unless the minor is an "excepted" person or the income is "excepted" income (so called as these are an exception from the minors tax regime).

An "excepted person" is a minor who is any of the following (with special conditions to be met):

- a full time worker
- a person with a disability, or
- a person with a double orphan pension.

"Excepted income" includes:

- employment income
- taxable pensions or payments from Centrelink or the Department of Veterans' Affairs

Who is assessable on interest income? *cont*

- compensation, superannuation or pension fund benefits
- income from a deceased person's estate
- income from property transferred to the minor as a result of the death of another person or family breakdown, or income in the form of damages for an injury the minor suffered
- income from the minor's own business
- income from a partnership in which the minor was an active partner
- net capital gains from the disposal of any property or investments listed above, and
- income from the investment of any of the amounts listed above.

Excepted net income (that is, excepted income less related deductions) is taxed at adult rates and the tax liability on that income can be reduced by any low income tax offset entitlement. Any other income derived by the minor is taxed at the higher minor's rates. The low income tax offset cannot be used to offset the tax liability.

JOINT ACCOUNTS

Interest income on a joint bank account is assessable to the account holders in proportion to their beneficial ownership of the money. Unless there is evidence to the contrary, the ATO will presume that each joint account holder beneficially owns the money in equal shares.

Relevant evidence that the joint account holders do not beneficially own the money in equal shares can include information regarding:

- who contributed to the account
- in what proportions contributions were made
- the nature of the contributions
- who drew on the account, and
- who used the money (and accrued interest) as their own property.

Taxpayers may also provide evidence that an account holder holds money in the account on trust for others (for which there may of course arise the requirement for the account holder to lodge a trust tax return).

LEADING BY EXAMPLE

The ATO also issued four case studies to help illustrate how the rules operate.

Child saving account (child has no "beneficial" ownership) *David, aged 10, has an account in his name. The account was opened by his mother, who initially deposited $7,000 of her own money into it. David's mother is a signatory to the account, and makes regular deposits and withdrawals to pay for his school and other expenses.*

David's mother spends the money in the account as if it belongs to her. She is considered to be the beneficial owner. David's mother is assessable on the interest income earned from the account.

Child savings account (parent operates as trustee) *Matthew, aged 14, has accumulated $7,000 over the years from birthdays and other special occasions. His mother has placed the money into a bank account in his name, which she operates on his behalf. Matthew's mother does not use the money in the account for herself or others. He earns $490 in interest during an income year.*

Matthew has beneficial ownership of the money in the account and is therefore assessable on all of the interest income (the birthday gifts are not assessable income). However, as he is under 18 years of age, Matthew will be subject to higher rates of tax under the minor's taxation rules.

If Matthew shows the interest in his tax return for that income year, his mother will not need to lodge a trust tax return. (Note that he is not an "excepted person" because he is a minor and not within one of the exceptions noted above.) The interest is "eligible assessable income" because it is not within any of the categories of "excepted income".

Joint signatory (no beneficial ownership) *Julia's elderly aunt has a bank account in the aunt's name, and Julia is a joint signatory to that account. Julia will only operate the account if her aunt is unable to do so due to ill health. All the funds in the account are the aunt's, and Julia is not entitled to personally receive any money from the account.*

Julia does not have any beneficial ownership of the money in the account and is therefore not assessable on the interest income.

Joint bank account (rebutting presumption of equal ownership) *Jane and Stephanie are each assessed to income tax on half of the interest not returned on their joint bank account.*

Jane later establishes that Stephanie contributed all of the money to the account and usually treated all of the interest as her money. Jane has only once drawn funds from the account.

Stephanie has beneficial ownership of the money in the account and is therefore assessable on all of the interest income. The ATO amends Stephanie's and Jane's income tax assessments accordingly. ■