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Client Information Bulletin

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Tax planning tips – Before 30 June 2008

To minimise the tax payable on taxable income, implementation of the following is recommended prior to 30 June 2008:

- if possible defer income from being earned in June 2008 by completing the job in early July, and invoicing in July 2008
- undertake expenditure on repairs and maintenance for any business asset if in need of such attention within the next few months, prior to 30 June 2008
- maximise contributions to superannuation:
    - $100,000 for > 50 years of age
    - $50,000 for < 50 years of age
    - self employed persons can claim 100 per cent of contributions up to above limits into superannuation for the first time
- Loans relating to funds borrowed by directors and shareholders from companies have significant tax implications under Div 7A and S108 of the *Income Tax Assessment Act 1936* (Cwlth). It is recommended advice be obtained prior to 30 June 2008 with regard to these loans
- consider realising capital losses made in the recent share market downturn to offset actual capital gains made during the year
- accrue expenditure incurred but not yet paid by 30 June 2008

Instalment warrants – Borrowing in a SMSF

An Instalment Warrant has been an effective way to purchase shares without having to pay the full capital amount upfront, whilst still enjoying the benefits of full ownership.

It was previously viewed that this type of investment was a breach of the borrowing rules in the *Superannuation Industry (Supervision) Act 1993* (Cwlth). However, the government saw this as a flaw, and amended the SIS Act on the 24 September 2007 to allow this form of borrowing.

The change in legislation meant the term 'Instalment Warrant' needed defining. Rather than defining this term, the government defined the allowable borrowing structure, meaning the term 'Instalment Warrant' was much broader than initially anticipated, giving a self managed super fund (SMSF) the ability to borrow in order to purchase other asset types such as real property.

A SMSF has always been an effective investment vehicle due to its asset protection and tax advantages, but the new 'Instalment Warrant' will mean the SMSF industry will be able to become an even more formidable investment vehicle creating more investment options for the trustees.

With the introduction of the 'Instalment Warrant' arrangements, structure is a vital component that must be considered. To ensure the complying status of the SMSF, it is imperative that appropriate advice is sought in this area.

Part IVA and 'wash sales'

The Australian Taxation Office (ATO) has issued a taxation ruling in relation to 'wash sales' which is used to describe the sale and purchase of the same or substantially the same asset within a short period of time. The sale and purchase cancel each other out with the result that there is effectively no change in the economic exposure for the owner of the asset.

Often these 'wash sales' are effected in order to apply a resulting capital loss or allowable deduction against the capital gain or assessable income already derived or expected to be derived.

The ATO advises in such arrangements that Part IVA may apply – the impact being the Tax Commissioner will make a determination to cancel tax benefits obtained in connection with the 'wash sale'.

Before considering your capital gains or losses it is important that you obtain advice in relation to your strategy to ensure that there is a clear understanding between the commercial risk or advantage versus the tax purpose.

Loan fringe benefits

Loan Fringe Benefits can arise where an employer recognises they have mistakenly paid their employee an amount to which the employee was not legally entitled. The employee is then obliged to repay the amount afterwards, but is given time to repay the amount.

By allowing time for the repayment of the mistakenly paid amount the employer is effectively making a loan to the employee. This loan gives rise to a loan benefit for the fringe benefits tax year. The benchmark interest rate for the 2007/08 FBT year is 8.05 per cent for the period that the loan is outstanding.

Personal services income

The Australian Taxation Office (ATO) has recently identified the common mistakes businesses make with relation to Personal Services Income rules. In summary they are as follows:-

1. Self assessing that the first condition of a results test has been passed when paid on an hourly or daily rate, not when tax payers must be paid as a result of achieving a specific result.
2. Not obtaining a determination from the ATO when failing to meet the results test and 80 per cent or more of the income is from one client.
3. Self assessing that the unrelated clients test has been met when the services are provided are not a direct result of making offers to the public. This is common where services are through a labour hire firm or through an agency.
4. Applying the personal services business test to the whole entity and not to the individual where the test needs to be applied on an individual basis, by the individual.
5. Retaining profits from personal services income when any profit made must be paid as a salary and wage to the individual who performed the services.
6. Not complying with the additional PAYG obligations.
7. Failing to complete and attach a personal services income schedule with their tax return.
8. Claiming deductions for personal services income where there is no entitlement. They may include rent, mortgage interest, rates for their home or their associate's home that is the place of business, payments to a spouse and the like for support service work such as secretarial duties.

In order to get a clear understanding and to ensure compliance it is strongly recommended that you obtain advice in relation to any personal services income.

It is also important to note that these personal services income rules not only apply to companies but also to trust structures.

Taxation measures applicable to drought affected farmers - Water facilities

In drought times water becomes a precious commodity. Deductions can be claimed by persons engaged in a business of primary production for expenditure on water facilities used primarily and principally for the purpose of conserving or conveying water.

Examples of a water facility include a dam, tank, tank stand, bore, well, irrigation channel, pipe, pump, water tower and windmill.

You can claim a deduction for the decline in value of a water facility in equal instalments over three income years.

In addition these standard relief measures are available, namely:

- more time to lodge activity statements or tax returns without incurring a penalty
- additional time to pay tax debts without any interest charges
- arranging for tax debts to be paid in instalments
- remitting penalties or interest that may have been imposed
- fast tracking refunds.

Banks to get tough on finance

With the boom times seemingly over and the credit market generally tightening, it is prudent to prepare finance applications knowing the banks will be taking a tougher stance and lending only to the more blue chip borrower.

In the current economic climate successful finance applications should include:

- a detailed plan that will ensure the financier understands your business
- evidence of business success if the business is less than 5 years in operation
- the most up to date tax returns and tax assessments and tax returns from the previous 2 years as well as financial statements from the previous 3 years
- long term contracts with significant customers

Businesses should also enquire about alternative sources of finance such as debtor finance using receivables as security.

As local banks continue to increase interest rates and the overseas markets face a financial crisis, exacerbated by the sub-prime lending debacle it will be difficult for businesses to secure finance.

Blaze Acumen can assist with loan applications and loans.

Business structures analysis

In considering the most appropriate business structure for a business it is important to identify the 'must have requirements' for that business and the 'important requirements'. It is, however also vital to consider the 'business characteristics' of a business structure. Below are just two examples:

<u>Business Characteristics of a Private Company</u>

- they involve risk
- the assets do not appreciate in value
- they have a high taxable income
- the ownership or appreciating asset can often be split from the business.

<u>Business Characteristics of a Discretionary Trust</u>

- losses are not likely
- appreciating assets are involved
- all stakeholders are related parties
- The allocation of profits changes from year to year.

When dealing with business structures Blaze Acumen can also assist to identify:

- risk management issues with respect to the business
- related parties not to be involved/exposed to the risk of the business
- tax efficiency with respect to the profits and capital gains
- simple and inexpensive structures for the day to day operations.

It is always worthwhile reviewing your business' structure from time to time to ensure the most appropriate structure is in place.

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