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Tax News, Views and Clues

Year-end Tax Planning

As another income year comes to a close on 30 June 2006, it is important that taxpayers take the time to focus on tax planning and the tax issues that affect their business.

We have covered the recent Federal Budget changes elsewhere in the Client Alert. We note the proposed changes to superannuation which if enacted, will make savings and investments via superannuation considerably more attractive.

Some of the key tax issues to consider are outlined below. Although not all taxpayers may be able to utilise them.

Deferring income

When considering the deferral of income, note the following points:

- As directed by the *Arthur Murray* principle, taxpayers may be able to defer recognition of income received before year-end for services not yet performed.
- Most interest, dividend or rent income will not be assessable for until it is received (unless otherwise paid or credited on the taxpayer's behalf). Therefore, such income may be deferred.
- In general, income may be deferred until the 2007 year, significantly delaying tax payments. For example, where taxpayers on a cash/receipts basis of income bill clients on 30 June, assessable income will not arise until after year-end. Conversely, taxpayers on an accruals method may choose to perform services after year-end.
- Royalties and insurance proceeds are typically assessable on a cash basis.
- Work-in-progress of professional practices will not be assessable until there is at least an entitlement to bill.

Maximising deductions

Some initiatives to consider to accelerate deductions are:

- Review debtors and write off bad debts before year-end.
- Realise foreign exchange losses and defer the realisation of gains.
- Bring forward the outlay for deductible expenses.
- Value stock at a lower replacement value or market value, where appropriate.
- Ensure that audit fees are incurred before year-end, based on Taxation Ruling IT 2625.

Superannuation

- Ensure that employers pay all superannuation contributions by year-end to maximise deductions and avoid potential exposure to the non-deductible superannuation surcharge.
- Consider increasing personal superannuation contributions in light of the abolishment of superannuation surcharge.
- Consider the splitting of superannuation contributions between spouses, where they have significantly disproportionate superannuation balances.

Blackhole expenditure

- Review expenditure to ensure that any deductible 'blackhole' expenditure is identified.
- The types of expenditure to consider include expenditure on a business plan, the establishment of business premises, research into likely markets or profitability of a business, and capital investment in assets of the business.

Capital Gains Tax

Some strategies to minimise CGT are:

- Utilise the CGT small business and retirement concessions.
- Consider the availability of rollover relief for disposals to related parties.

- Match gains and losses, where possible, to avoid carrying forward a capital loss.
- Defer a disposal to ensure the asset has been held for at least 12 months. This will potentially allow individuals and trusts to benefit from the 50% CGT discount.
- Review the cost base of assets to ensure all expenditure available under the expanded definition is included. Such expenditure includes, for example, certain selling costs, capital costs of ownership, and expenditure to preserve, move or install assets.
- Consider whether non-deductible costs may be included in an asset's cost base including, for example, holding costs such as interest which are non-deductible.
- Consider whether it is most beneficial to utilise the 50% discount, where available, or frozen indexation.
- Defer a disposal to the subsequent income year where a gain is anticipated. Consider bringing forward a loss transaction if there are gains to offset.

Tax consolidation

- Consider whether an election to form a consolidated group should be made for tax purposes.
- If ACA is to be used, or if there are losses, consider whether valuations should be obtained as part of the consolidation process.
- Review the potential tax treatment of losses within company groups. In particular, consider whether tax losses should be best utilised within a consolidated group (subject to available fractions) or whether the group should remain unconsolidated.
- If a loss group consolidates, consider the potential impact of capital injections into the group, which may reduce access to losses.

Trust distributions

- Make sure a trustee resolves to distribute the net income of the trust before 30 June 2006, or by 31 August 2006 (relying on Tax Office administrative concessions).
- Remember that year-end trust distributions and income injections may affect a trust's ability to recoup prior year tax losses and bad debt deductions.
- Where the trust has derived capital gains, consider the ATO's Practice Statement in relation to the taxation of beneficiaries and the trustee on the trust income and capital and the different potential approaches available.

Family trust elections

- Consider whether a family trust election should be made because of losses or bad debts in trusts.
- Ensure optimum utilisation of franking credits and consider making a family trust election where a trust holds shares acquired post-31 December 1997.
- Make sure no distributions are made outside the family group to avoid any potential liability for family trust distributions tax.
- Where a company is owned by discretionary trusts, there may be a need for family trust elections at the trust level if the company has losses. Elections may also be required to enable utilisation of franking credits as noted above.

Simplified imputation

- Ensure all dividends paid within a franking period have been franked to the same extent.
- Ensure that there are adequate franking credits.
- Ensure a company paying a franked dividend has issued a distribution statement in the approved form.

Other key issues

Other important matters include the following:

- Consider the effective lives of depreciable assets.
- Where individuals incur losses from business activities, the non-commercial loss rules should be considered because, under the rules, such losses may not be eligible for offset against other assessable income during the year.
- Where a private company provides loans to shareholders, a careful review of the loan arrangement must be undertaken, as certain rules may deem the loan to be an unfranked dividend. It may be necessary to ensure appropriate loan agreements are in place and repayments are made.
- Review any similar loans by trusts where a corporate beneficiary has an unpaid present entitlement to trust income. These loans can also result in deemed dividends.
- Where an individual applies personal efforts and skill in performing services to third parties through an interposed entity (e.g. a company), the personal services income rules may deem the individual to be assessable on the income generated. Careful consideration of such arrangements should be undertaken to avoid the application of the rules.

International

- Plan to utilise foreign tax credits against Australian tax on foreign income of the same class.
- Consider international related party transactions — whether arm's length prices have been charged, and whether there are transfer pricing issues to address.
- Identify and address other international tax issues such as permanent establishments and controlled foreign companies.

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Personal Tax Cuts

The 2006/07 Federal Budget will provide personal tax cuts worth \$36.7 billion over the next four years.

Significantly, the top marginal tax rate will drop from 47% to 45% and will apply to taxable income over \$150,001.

The 42% marginal rate will also be cut to 40% and will apply from \$75,001 and the 30% band will again be widened.

The resident tax rates for the 2005/06 and 2006/07 years are summarised below:

2005/06	
\$ Income	Rate
6,001–21,600	15%
21,601–63,000	30%
63,001–95,000	42%
95,001+	47%

2006/07 as per 2005/06 Budget	
\$ Income	Rate
6,001–21,600	15%
21,601–70,000	30%
70,001–125,000	42%
125,001+	47%

2006/07 as per 2006/07 Budget	
\$ Income	Rate
6,001–25,000	15%
25,001–75,000	30%
75,001–150,000	40%
150,001+	45%

FBT Changes

- FBT rate reduced from 48.5% to 46.5% with effect from 1 April 2006.
- In-house fringe benefits tax-free threshold increased from \$500 to

\$1,000, with effect from 1 April 2007.

- Minor benefits threshold increased from \$100 to \$300, with effect from 1 April 2007. Tax Office to review existing guidelines and provide further clarification in relation to what is 'irregular' and 'infrequent'.
- Reportable fringe benefits threshold increased from \$1,000 to \$2,000 (pre gross-up), with effect from 1 April 2007.

Superannuation

The Government proposes dramatic changes to superannuation from 1 July 2007.

Contributions

- Abolition of age-based limits for deductible superannuation contributions.
- Concessional deductible contributions subject to an effective annual ceiling of \$50,000 per person p.a. to age 75 (transitional rules for employees aged over 50).
- Deductible contributions exceeding \$50,000 taxed at the highest marginal rate.
- Undeducted contributions subject to an annual limit of \$150,000 from Budget night.
- Self-employed persons able to claim full deduction for their superannuation contributions.
- Employer ETPs unable to be rolled over.

Benefits

- Abolition of Reasonable Benefit Limits.
- Benefits paid from a taxed fund to retirees from age 60 or above (either as a lump sum or pension) are tax-free.
- Benefits paid to persons aged 55–60 generally taxed under existing arrangements.
- Members who have reached preservation age may establish pension income streams or leave

money within superannuation indefinitely and draw on it at their discretion (abolition of compulsory withdrawal).

- Pensions subject to simplified rules.
- Lump sum death benefit payments to dependants are tax-free.

Untaxed Superannuation Schemes

For members aged over 60, lump sum benefits of up to \$700,000 taxed at 15%, any excess taxed at top marginal rate.

Pensions taxed at recipient's marginal rate less 10% offset.

Depreciation

The diminishing value rate applied for calculating depreciation deductions will increase from 150% to 200% over the prime cost rate.

The new rate will apply to assets acquired on or after 10 May 2006.

Small Business: CGT

The Government has announced the following changes to the small business Capital Gains Tax (CGT) concessions:

- The net asset value test will increase from \$5 million to \$6 million.
- A 'significant individual' test based on 20% ownership will replace the controlling individual test (based on 50% direct ownership).
- Modifications to the operation of the 15-year exemption, the retirement exemption, the small business rollover and the application of the concessions to partnerships.

These changes will apply to CGT events that occur in 2006/07 and subsequent income years

Venture Capital

The Government has announced a new investment vehicle called an

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early stage venture capital limited partnership (ESVCLP). The ESVCLP will allow income and capital gains to flow through to venture capital investors on a tax-exempt basis.

The rules will be limited to funds of up to \$100 million investing in companies with total assets of up to \$50 million. These rules will replace the existing PDF concessions.

Small Business Tax

The Government has announced a greater alignment of the various small business tax concessions, including those under the STS, CGT, GST, FBT and PAYG instalment regimes, including:

- Align the STS and GST definitions of 'turnover'.
- Align the period over which STS and GST turnover is calculated.
- Increase the STS annual turnover threshold from \$1 million to \$2 million.
- Increase the GST cash accounting turnover threshold from \$1 million to \$2 million.
- Removal of the requirement that related businesses must have total depreciating assets of less than \$3 million.
- STS taxpayers will be able to pay quarterly PAYG instalments on the basis of GDP-adjusted notional tax.
- The depreciating asset rollover relief has been extended in certain circumstances.

These reforms are effective 1 July 2007.

Elected Family Trusts

Family trust elections and interposed entity elections will be able to be revoked or varied in certain limited circumstances. The definition of family group will be

broadened to include lineal descendants. Trust distributions to certain former members (including ex-spouses) will be exempt from family trust distribution tax.

Trusts

The following new integrity measures concerning trusts have been announced:

- Resident trustees will be required to pay the tax on distributions to non-resident trustee beneficiaries from 1 July 2006.
- Trustees of closely held trusts to identify and report first-tier trustee beneficiary receipt of trust distributions only, (rather than the ultimate beneficiary(ies)).

High Wealth Individuals

The Government has provided the Tax Office with additional resources to fund its tax compliance program for high wealth individuals and associated entities.

The High Wealth Individual Taskforce will focus on the timely identification of tax compliance risks and undertake additional audit activity for high-risk cases, including closely held private company groups.

GST

Additional funding of \$46.4 million directed towards increased audit activity to raise an additional \$190 million.

GST integrity changes to the Margin Scheme to ensure anti-avoidance measures apply to GST and property.

Import entry threshold for courier and post will be raised to \$1,000. This will mean that a person can privately import goods to the value of \$1,000 without paying GST or import duty.

Backdating of the GST measure to 1 July 2000 to ensure that GST does not apply to bonus supplies of credits and text messages for phone cards.

GST on vouchers will only need to be remitted on the face value of the vouchers.

Research and Development

R&D offset claim period will be extended.

The 175% premium deduction can now be allocated to individual companies in a group that has increased R&D expenditure over the last three years.

R&D expenditure by a registered research agency (RRA) is now eligible for the tax offset and may be claimed by all the companies in the R&D group.

Fuel Tax Credit Regime

The Energy Grants (Credits) Scheme will be replaced by the Fuel Tax Credit regime (FTC).

The FTC will have dramatic impact on road users and users of fuel off-road.

The FTC will be claimed through the Business Activity Statement (BAS).

A draft of the BAS has been released. Due to the claiming of credits through the BAS, the Tax Office has indicated that a GST review will also focus on any fuel tax credits claimed.

Tax Return Checklist

2006 — Individual Tax Returns

Income

- Gross salary, wages, allowances, benefits, earnings, tips and director's fees
- Income from business activities
- PAYG payment summary amounts
- Any non-cash benefits received
- Lump sum and termination payments [All documentation should be provided, including an ETP payment summary from the employer or fund]
- Government social security payments, including pensions, unemployment and sickness benefits
- Capital gains from CGT asset sales (e.g. shares and real estate) [Information relating to dates and costs associated with acquisition and disposal will be required to determine the capital gain (if any). Remember that individuals, companies, trusts and superannuation funds can save tax if they qualify for the various CGT concessions]
- Annuities, including allocated pensions
- Income from trusts and partnerships [Statements of distribution should be provided]
- Rental income
- Interest and dividends (franked or unfranked) including any tax deducted [Dividend distribution statement will be required to confirm the dividend received]
- Foreign source (employment and pension) income [Details of any foreign tax paid will be required]
- Personal services income [Individual contractors who operate through a company or trust can potentially be taxed personally on the income instead of income being taxed at the company or trust level]

Deductions

- Investment and property expenses [Carefully detail interest claims]
- Professional subscriptions (not including sporting or social clubs)
- Expenditure records related to a taxpayer's employment, such as work-related motor vehicles, self-education, protective clothing, uniform expenses and home office expenses
- Donations of \$2 and over, depending on the recipient
- Superannuation contributions made by self-employed persons and those without employer superannuation support
- Tax agent's fees and other accounting and tax audit fees associated with managing tax affairs
- Special deductions (e.g. Australian films, investment shelters and forestry-type schemes)
- Bank fees (where the credit or deposit represents assessable income)
- Un-recouped prior year losses
- Non-commercial losses [Individuals must satisfy one of four tests to offset losses from certain non-commercial business activities against other income. A prime example is an employee who seeks to offset hobby-type farming or other business losses against salary or investment income]
- Sickness and accident insurance premiums, provided the premium incurred is against the loss of income

Rebates

- Details of private health insurance, unless the premium is net of the rebate [Statement from health insurance provider will be required to determine entitlement to rebate]
- Details of superannuation contributions where no tax

deduction can be claimed (maximum rebate of \$540 for \$3,000 superannuation spouse contribution)

- Any changes in dependants [Income of spouse will be required]
- Details of any income received in a lump sum which was accrued in earlier income years (e.g. assessable pensions)
- Details of medical expenses where the total exceeds \$1,500 [Tax offset of 20% available]
- Superannuation co-contributions for contributions made by eligible employees [Assessable income must be less than \$58,000]

Note: Low income taxpayers with a dependent child (under 21) or qualifying dependent student should check to see if they are eligible for Family Tax Assistance.

2006 — Companies, Partnerships, Trusts and Other Businesses

Income

- Trading income
- Other income (e.g. rent, interest, royalties)
- Stock on hand (and basis of valuation) — note any obsolete stock
- Work in progress
- Primary producer subsidies (if assessable)
- Capital gains from CGT assets sold (e.g. real estate) [Documentation should include dates and costs associated with acquisition and disposal]
- Dividends [Details of any franking credits will be required]
- Income from foreign sources [Details of foreign tax paid will be required]

Deductions

- Losses can no longer be transferred between group companies

Tax Return Checklist

- Repairs and maintenance (not capital)
- Salaries, including fringe benefits
- Fringe benefits tax paid
- Rates, land taxes and insurance premiums
- Advertising expenses
- Interest on borrowed monies
- Deductions relating to foreign-source income are only deductible against foreign income of a similar class
- Prepayments are no longer immediately deductible, unless under \$1,000 or required to be prepaid by law
- Retirement payments and golden handshakes
- Bad debts actually written off during the year
- Donations of \$2 and over, depending on the recipient
- Commissions
- Legal expenses (not capital)
- Lease expenses for motor vehicles, premises and equipment
- Losses from previous years
- Superannuation contributions
- Subscriptions
- Car expenses [Remember to include petrol, repairs and parking and maintain a log book where necessary]
- Tax agent's fees and other accounting and tax audit fees
- Royalties paid [Only deductible where withholding tax has been paid]
- Travel expenses [Details of the purpose and destination of any interstate or overseas trip should be provided. Expenses must be fully documented where travel involves at least one night away from home. Travel diaries should be included where travel exceeds five nights]
- Eligible research and development expenditure by registered R&D company
- Bank fees (where the credit or deposit represents assessable income)
- Borrowing costs which are deductible over the shorter of five years or the life of the loan/facility
- Blackhole expenditure which may be deductible over five years

Liabilities

- New loans taken out during the year and their purpose, including any new lease or hire purchase agreements
- Statements from the lending authority detailing the opening and closing balances of existing loans during the financial year
- Provisions for long service leave and annual leave
- Creditors on hand at the end of the financial year
- Details of loan accounts to directors, shareholders, beneficiaries and partners
- Accrued expenses (e.g. audit fees, interest payments and bonuses) and unearned revenue
- Commercial debts forgiven

Assets

- Details of depreciable assets acquired and/or disposed of during this income year, including:
 - type of asset
 - date of acquisition/ disposal
 - consideration received/paid
- Details of CGT assets acquired, including the purchase price and other related costs
- Lease commitments
- Debtors on hand at the end of the financial year
- Commercial debts forgiven
- Division 7A interest and repayments made on any prior year loans to shareholders and associates

Other Information Required

- Franking account details/movements
- Overseas transactions with related parties
- Exchange gains/losses
- Private companies — remuneration or loans to directors, shareholders and their relatives
- Changes to the capital of the company
- Whether family trust elections have been made in relation to trusts
- Consider if a group of companies should consolidate for tax purposes

ASIC – Change of Address

If you are a Shareholder Director or Secretary of a company and change your address we need to be notified as soon as possible. ASIC does impose penalties for late notification of change in details.

Salary Packaging Opportunities

A common misconception is that salary packaging is only worth-while in the not-for-profit sector. However, employers in the commercial and government sectors should be aware that they can pass on significant savings to their employees through salary packaging, with very little effort.

These days employees expect to be offered salary packaging, and given the importance of staff retention in today's competitive employment market, having a salary packaging policy can be crucial.

Please contact us should you require any information in this area.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without prior approval. This firm respects your privacy. You have received this communication because you are currently on our mailing list. If you wish to be removed from our mailing list and receive no further communications of this nature in the future, please contact our office.