

YEAR END TAX PLANNING

Usually published in the June *Tax IQ Monthly*, we are bringing forward our annual feature on year end tax planning to the May issue to give you more time to adequately plan your tax affairs and take a serious look at your tax position well before the end of the financial year.

None of us likes paying tax and it would be especially irksome to discover that we are paying tax unnecessarily.

At this time of the year your accounting records should be up to date. You have lodged BAS for three quarters. Prepare interim financial statements for your business, review these and estimate your profit for the full year.

Discuss these with your accountant or tax agent. Decide on action you need to take to obtain all the deductions to which you are entitled and to ensure that your affairs are in order and would meet the scrutiny of tax auditors.

Tax laws in Australia are extremely complex. You need to be vigilant in taking action to eliminate risks of paying unnecessary tax and ensuring that your tax affairs are in order. Try not to leave these important tasks to the last minute.

Are you expecting to receive income which can be deferred to the following year. Are windfall profits expected in the following year which could be brought forward to be taxed at a lower rate. Can a capital gains tax obligation or other substantial tax impost be avoided, minimised or deferred by taking action prior to 30 June? Should you defer the sale of a capital asset or bring forward the sale of a capital asset which may produce a capital loss?

Each year we provide a number of strategies to assist your year end tax planning. Read through these and highlight any which may be appropriate for your business. These strategies, repeated from last year, have been updated, improved and expanded and have taken account of changes in the law and recent Court decisions.

Accelerating Deductions

Are you expecting a high taxable income this year? You may be able to reduce this by bringing forward expenses likely to be incurred in the following year.

For instance, do you have plant or property in need of repair? Get this done before the end of June and you can claim a deduction this year.

Bad Debts

You can claim a deduction for bad debts if the amounts have previously been included as income.

The debts must be bad and you should write them off before 30 June. Make sure that the debtor's account in your accounting records has actually been written off.

An STS taxpayer does not have to account for debtors (unpaid invoices) until they are actually paid (unless you have elected to adopt the accruals method). If you delay sending out your invoices you can delay receipt of the money until next year.

Do not acquire debt from a vendor of a business as you cannot claim a deduction for any of those which subsequently turn bad.

Bill Finance

The decision in *FCT v. Energy Resources of Australia* contradicts Taxation Ruling TR93/21.

Are you using bill finance to discharge existing liabilities or for working capital? If so you may have a reasonably arguable case to claim bill discounts up front (provided you meet the pre-payment requirements referred to earlier). You should be able to claim the line fee.

Do not use commercial bill finance to acquire a capital asset as there is a strong risk that the discount may not be deductible at all.

Bringing Forward Income

Are you expecting a low profit this year but a high one next year? It may help to bring forward income that would normally be taxed next year. You can do this by valuing trading stock on hand at selling price rather than cost. This can be done on an item by item basis.

Alternatively, you can defer paying expenses with a view to claiming them in the following year. Possibly you can arrange for customers to bring forward income payments to you.

Capital Gains

Are you looking at a taxable capital gain? Can you sell other assets before 30 June which will result in capital losses, thereby offsetting the gain? Provided you adopt market value you can dispose of the asset to another entity within your family group. Your dominant purpose must be commercially based and not just to obtain the tax benefit. Alternatively, you may be able to offset the gain by making a personal superannuation contribution or an employer contribution on behalf of employees.

You can use proceeds from the sale of assets for your contribution or make an in specie super contribution of listed company shares or business real property.

If the asset sold is an active asset (used in a business) you may be able to make use of the small business CGT concessions. The CGT retirement exemption amount can be rolled over into a superannuation fund.

OUR VIEW

Anzac Day, as well as being the day of commemoration and reflection, was also a day of celebration. Why? The Centre for Independent Studies has nominated it as Tax Freedom Day. It marked the day of the year when Australians finished paying for the Government's annual spending and commenced to be able to keep what they earned.

This means that, effectively, every cent you earned during the first four months of the year finds its way into Government coffers and it is only after Anzac Day that you get to keep what you earn.

According to Peter Saunders, Social Research Director at the Centre for Independent Studies, Tax Freedom Day has been steadily marching forward. One hundred years ago, it fell on 24 January when it took less than four weeks national earnings to pay for Federal, State and Local Government needs.

By the outbreak of World War II, Tax Freedom Day had stretched to the end of February. It reached 19 March by the 1950's and jumped to April during the Whitlam years when Government spending skyrocketed.

Government spending continues to expand. By 2000, Tax Freedom Day stood at 21 April. In 2005 it was 23 April and it is now 25 April.

Saunders considers that while some of the money taken by Governments has been spent wisely, much of it has been wasted. The best possible people to judge how money should be spent are not politicians, but the people who earned it in the first place. Governments must get their spending under control and start reducing taxes, otherwise we may be celebrating Tax Freedom Day on the Queen's Birthday holiday!

This month we concentrate on year end tax planning. This feature has been steadily expanding over the years and we have had to postpone answers to reader questions until next month. Read through our suggestions carefully – perhaps you may be able to send your personal Tax Freedom Day backwards.

Tony Lovett

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CGT – Improvements

Have you incurred expenditure on improving an asset acquired before 19 September 1985 (pre CGT)?

Substantial expenditure on improvements means that the improvement will be regarded as a separate post CGT asset and, on a subsequent disposal, the proceeds will have to be apportioned between the exempt original cost and the non-exempt improvement.

Aim to keep expenditure below the improvements threshold so that the original asset plus the improvement continues to be treated as CGT exempt. The threshold figure for 2005/06 is \$109,447.

Child Care Rebate

This rebate is not means tested and amounts to 30% of out of pocket expenses for approved child care. Maximum rebate per child is \$4,000 (indexed each year).

Keep all your receipts and similar records for child care expenses and your Child Care Benefit (CCB) letter which you will receive from the Family Assistance office so that you can make a claim for 2004/05 expenses in your 2005/06 tax return.

Consumable Stores

These include printing, stationery, office supplies, oils, greases, fuels, factory supplies, restaurant, hotel and motel supplies, tools, uniforms, protective clothing and safety gear intended to be supplied to staff.

Consumable stores for farmers include fuel, fertilizer, fencing materials, shearing supplies, dips, drenches, chemicals, sprays, etc.

The cost of these items is deductible in the year of purchase. Unlike trading stock, they do not have to be counted and valued at year end. You can stock up on consumables before the end of June and obtain a deduction this year instead of next.

Discretionary Trust Distributions

Does your trust deed allow attribution of income? If so, you may distribute different types of trust income (e.g. primary production income, capital gains, franked dividends, business profits) to different beneficiaries in the most tax efficient method (refer Taxation Ruling TR92/13).

Distributions to Companies

Does your discretionary trust have a corporate beneficiary? You can make distributions to a company to be taxed at the company rate of 30% instead of the highest individual rate of 48.5%.

You can establish corporate beneficiaries to receive such distributions prior to 30 June. An alternative is to consider paying administration fees or trustee remuneration to your corporate trustee.

Caution! Will your trust subsequently make a loan to a shareholder or associate? If it does you will have to take action to put the loan on a commercial footing or repay it in order to prevent it being treated as a deemed dividend (Division 7A).

Leasing of Plant

Are you contemplating the purchase of plant, equipment or vehicles? If you finance the purchase by bank loans or hire purchase, your depreciation claims will be on a pro rata basis – or limited to 15% if you are an STS taxpayer. An STS taxpayer can lease the items and negotiate an advance lease payment for the first 12 months to obtain a substantial tax deduction this year.

It could be that your trade-in will provide the finance necessary to make your first lease payment.

Ensure that you do not allow the trade-in value to be deducted from the price of the new vehicle. This will prevent the transaction from being treated as a lease for tax purposes. You should receive a cheque from the dealer for your trade-in and lease the new equipment at its full value.

Check that your trade does not produce such a high balancing charge that it negates the benefit of your lease pre-payment. Sometimes trades are over valued and discounts on new vehicle otherwise available are foregone. Make sure the dealer quotes a fair price for your trade and allows normal discounts on your new vehicle. The changeover price does not change but any taxable balancing charge is reduced or eliminated.

Leasing of Fitout

Are you planning a new fitout for your office or shop premises? If you borrow the funds necessary or pay for the fitout in cash your depreciation claim will be quite low as the Commissioner has determined a long effective life for office and shop shelving, stands and similar.

It is better to lease the fitout and negotiate a low residual value at the end of the lease term. You can use a low residual value because a secondhand fitout has a very low market value which can be easily justified commercially.

Leasing of Luxury Cars

Luxury cars leased (other than short term hire arrangements) are treated as loan transactions. If you are planning to lease a car, ensure that the cash value of the car does not exceed the depreciation cost limit of \$57,009.

Leasing – Sale and Lease Back

You can negotiate with a finance company for a sale and lease back of plant and equipment.

If you are an STS taxpayer and your lease provides a 12 months' advance lease payment the transaction will be cash positive. You will be able to claim a substantial tax deduction this year.

You can undertake these transactions in respect of plant and equipment which constitute fixtures. Recent decisions in the *Metal Manufacturers* and *Eastern Nitrogen* cases found that Part IVA does not apply and the companies were entitled to their claims for rentals and associated costs.

Loans to Shareholders

If your private company has a revenue or capital surplus and has made loans to shareholders or associates after 4 December 1997 there are stringent requirements concerning written documentation, security, length of term, interest and repayment arrangements.

If these have not been followed the loan will be treated as a deemed dividend and taxed. The deemed dividend will also be debited against the franking account. If an old (pre 4/12/97) loan has been "freshened up" by adding to it or changing its terms, the whole of the old loan will also be treated as a deemed dividend.

The rules also catch payments or property transfers provided by the company to its shareholders or their associates.

Check all payments and loans to shareholders and any associated entities or persons. If any loans or payments have been made, make sure that Division 7A requirements have been attended to.

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If you do not have the funds to pay any required loan repayment you can arrange for a dividend to be declared in favour of the shareholder. If there is a credit in the franking account, this dividend can be franked. If unfranked, it will not result in a debit to the franking account.

Do you have a company which is a beneficiary of a trust? If this trust has made loans to shareholders or associates during 2005/06 these must be repaid or put on a commercial footing by the lodgement date or due date of the trust's tax return for that year.

Medicare Levy

If your income is below a threshold figure, you will not have to pay the Medicare Levy of 1.5% of your taxable income. If your income is above another threshold and you do not have private health insurance you have to pay an additional 1% levy surcharge.

Can you salary sacrifice or otherwise defer income to keep your taxable income for this year below one of these thresholds?

Threshold figures for Medicare Levy exemption are set out in this table. They relate to the 2004/05 year as the 2005/06 figures are not yet available.

Individual	\$15,902
Pensioner	\$19,252
Senior Australian	\$20,500
Individual with spouse	\$26,834

Threshold figures for the levy surcharge are \$50,000 for individuals and \$100,000 for families. The latter figure increases by \$1,500 for each dependent child after the first.

Directors' Fees and Bonuses

Companies can claim directors' fees and bonuses even if not actually paid during the year. The shareholders of the company must pass a resolution prior to 30 June to authorise payment of the directors' fees and bonuses. These amounts are deductible to the company this year. The directors and employees are taxed next year when the directors' fees and bonuses are received.

PAYG Withholding should be deducted at time of payment.

This avenue is not available to STS companies using the cash accounting method.

Interest

You can purchase negatively geared property and pay interest in advance prior to 30 June. The interest will be fully deductible if it covers a period not greater than 12 months provided you are an STS taxpayer or an individual not carrying on a business. You qualify as an individual not carrying on a business if you have a separate trust or company operating your business.

It is possible to claim a tax deduction without using capital or savings to physically pre-pay the interest? You can arrange a loan that includes establishment costs, the purchase price of the property and the first year's interest. The loan is drawn down and the surplus funds are used to pre-pay interest.

Instalment warrants are another risk free way of acquiring a substantial portfolio and obtaining a deduction for the interest content to be paid in advance. You can obtain protected equity loans which ensure that you do not have to meet any losses if the shares go down in value. Interest on protected equity loans can be paid in advance and a substantial part of the interest is tax deductible.

The deductibility of interest is determined by the use to which the borrowed funds are put.

Interest on funds borrowed for the following purposes is tax deductible:

- Repayment of partner's capital contributions;
- Payment of undrawn partnership profits;

- Repayment of partner's, beneficiary's or shareholder's loan accounts (provided they have not arisen from distribution of unrealised capital gains);
- Payment of declared dividends;
- Re-financing of other borrowings currently used to produce assessable income;
- Acquisition of income producing assets or property;
- Repayment of business borrowings.

Motor Vehicle Expenses

Review your motor vehicle expenses and decide which method of apportioning the expenses between business and private use produces the greatest tax benefit.

If operating as an individual or partnership you have four methods from which to choose:

- Log book method;
- One-third of total expenses method;
- 12% of cost method;
- Cents per kilometre method

If you are operating as a company or trust, claim all motor vehicle expenses in full. If motor cars have been provided to employees you need to take a further step.

Either pay FBT or have your employees pay your entity the amount applicable to private use. This is known as cashing out the fringe benefit.

The amount can be calculated on:

- The log book method; or
- The statutory method.

Consider which method is most beneficial and apply it. It is usually better to have the employee pay your entity for the private use rather than pay FBT. You can increase the employee's wage to compensate them.

Non-Commercial Business Losses

Are you operating a business as the sole trader or partner? If the business has incurred losses you must meet some tests before you can deduct that loss from other income. You need to pass only one of these tests:

- *Assessable Income Test* – The business must have a gross income of at least \$20,000;
- *Profits Test* – The business must have earned a profit in three out of the past five years;
- *Real Property Test* – The business must have used real property valued at \$500,000 or more (excluding your dwelling);
- *Other Assets Test* – The business must have used other assets valued at \$100,000 or more (not including vehicles and land).

Will you fail all four tests? Can you bring forward income which would normally be received next year in order to pass the assessable income test?

Can you delay expenses in order to pass the profits test? It may be worthwhile to refrain from claiming deductions in order to pass this test.

Partnership Salaries

Are you operating a partnership with your spouse with one of you employed outside the partnership? If your partnership agreement permits, you can pay a salary to the partner not employed externally thereby helping to even out taxable income between spouses.

A partnership salary is additional remuneration paid to a partner as agreed where this is paid before the remaining parties divided in appropriate proportions.

Keep in mind that a partnership salary cannot cause or increase a partnership loss. To be effective, an agreement to pay a partnership salary must be entered into before 30 June.

Salaries and interest payable to associates of partners are not affected by this ruling.

Pension Bonus Scheme

Are you working past retirement age? The present age pension is 65 for men and 63 for women. Under the pension bonus scheme, eligible persons may be entitled to a tax free bonus payment.

To qualify you must be eligible for the age pension, delay retirement and continue working for at least 12 months. You should register for the scheme as soon as you reach pension age.

Personal Services Income (PSI)

Is your entity likely to be caught by the PSI rules? Check these out at page 52 of the *Australian Taxation Manual*. If you are caught you will need to pay PAYG Withholding on the entity's income which will be included in your personal return.

Plant and Equipment

If you are an STS taxpayer you can claim immediate deductions for plant items costing up to \$1,000. Pooling arrangements are available for other plant.

This means you can claim a full 15% depreciation on plant purchased, even on the last day of June.

Non-STS taxpayers can pool plant items costing up to \$1,000 and claim depreciation at 37.5% for plant items acquired in the previous year, or 18.75% for plant items acquired any time during the current year.

Items costing \$100 or less can be claimed in full.

Prepayments

If you are an STS taxpayer you can pay expenses up to 12 months in advance.

For instance, if you pay 12 months' rent in advance before the end of June you can claim the full amount. You can also pay leases, insurance, rates and services to be provided in the future.

If you have a lease agreement requiring monthly payments during 2005/06 you could elect to pay up to 12 instalments in advance before 30 June.

Check your contracts and lease agreements to see that you have an option to make advance payments. Make your prepayments for commercial reasons rather than just to gain a tax advantage.

You can also claim prepayments if you are an individual not operating a business. Interest paid in advance on borrowings for purchase of investment or investment properties can be claimed. The advance period must not exceed 12 months. Other prepayments could include lease expenses, insurance, payments for seminars booked in advance. If you are an STS taxpayer operating on a cash basis you must have actually paid the expense before you can claim a deduction. If a non business individual you must have incurred the expense.

Non-STS businesses can fully claim prepayments up to \$1,000 and also any amounts required to be paid by law (e.g. vehicle registration). Other prepayments must be apportioned.

Redundancy

Should a senior family member currently employed or any other employee in the business be made redundant?

A bona fide redundancy payment is deductible to the employer and exempt to the employee as long as the amount does not exceed \$6,491 plus \$3,246 for each completed year of service.

The Tax Office considers that directors of a family company do not qualify when they make a decision to end the company or cease trading.

Retirement and Redundancy

Are you planning to retire or take bona fide redundancy? Consider deferring your retirement date to 1 July or later.

If you do this you will have the advantage of higher limits and thresholds for:

- The post 1 July 1983 tax free threshold;
- The higher Reasonable Benefit Limit (RBL);
- Higher tax free amounts for bona fide redundancy or approved early retirement.

Additionally, your marginal tax rate may be lower due to absence of salary income.

Retiring Allowances

Under Section 25-50 of the 1997 Tax Act you can claim a deduction for amounts paid as a pension, gratuity or retiring allowance to an employee or dependant provided the payment does not create or increase a loss.

The recipient is taxed at concessional rates. If under 55 the rate, including Medicare Levy, is 31.5% while if 55 or over the rate is 16.5% on the allowance received up to \$129,751. Above that, the rate is 31.5%. Section 109 of the 1936 Tax Act requires the Commissioner to be satisfied that the amount is reasonable. In determining an appropriate amount to be paid as a retiring allowance, the following factors should be taken into account:

- Term of employment;
- Length of service;
- Level of remuneration;
- Other benefits;
- Commercial practice;
- Value of services provided.

If the recipient has a debit loan account balance causing Division 7A difficulties, the retiring allowance can be used to repay the loans.

Service Trusts

The Tax Office is looking carefully at the operation of service trusts and has recently issued a Ruling on acceptable procedures and charges for service trusts providing services to professionals and professional partnerships.

The Tax Office is looking closely at cases where service fees paid are over \$1 million and represent over 50% of gross fees earned by professional firms.

If you are in this category carefully check your procedures and documentation to ensure that your arrangements do not come under attack.

Simplified Tax System (STS)

If your business (including any associated or related businesses):

- Carries on business in the year;
- Has an STS average turnover of less than \$1 million; and
- Has depreciating assets (other than land or buildings) with a written down value of less than \$3 million

it will be eligible.

Read more about STS in *Australian Taxation Manual* Chapter 10.

If an STS taxpayer you can elect to account for your income and expenses on a cash or accruals basis.

You can claim an immediate write-off for assets costing less than \$1,000 and can claim much higher depreciation on other assets.

There is no need to count trading stock if the difference between opening and closing values is \$5,000 or less. You can claim full deductions for pre-payments provided the period covered does not exceed 12 months and concludes before the end of the following financial year.

Additionally, if an STS taxpayer, you will have an amendment period of two years instead of the usual four. This means that after the two year period has expired the Tax Office cannot amend your assessment unless it can prove fraud or evasion.

Have a look at your 2005 income tax return. Should you have elected to enter the STS? You can lodge an object or an amendment application and at the same time notify the Tax Office of a choice to become an STS taxpayer.

Statute Barred Loans

Prior to 4 December 1997 you could borrow money from your company without having to comply with the strict Division 7A rules. If these loans have remained unacknowledged and unchanged since that date they will be considered to be *statute barred*.

Previously the Tax Office advised that it would deem such loans to have been forgiven and be subject to full tax as a deemed dividend unless such loans were fully repaid or put on a commercial footing by 30 June 2005.

The Tax Office has since backed down on this and has issued a Practice Statement which states that *as a matter of practical compliance and sensible administration, the Commissioner has decided to take no active compliance action on private company and trustee loans made prior to the enactment of Division 7A.*

This means that you do not have to be concerned about loans made to shareholders and associates prior to 4 December 1997.

Superannuation Co-Contributions

If you are a low income earner the Government will make a co-contribution to your superannuation fund of up to \$1,500 to match a \$1,000 personal contribution. The maximum co-contribution is available to employees making personal contributions provided their taxable incomes are below \$28,000. Above this amount the maximum co-contribution reduces by 5 cents for each dollar of income, phasing out at \$58,000.

Be sure to make your personal contribution of \$1,000 to your superannuation fund before 30 June.

Superannuation Contributions

You can pay higher contributions and obtain deductions up to the age based limits for specified employees or key staff. Total paid must not exceed the following limits:

Age of Member	Deduction Limit
Under 35 years	\$14,603
35-49 years	\$40,560
50-70 years	\$100,587

If a super fund benefit to an employee exceeds the Reasonable Benefit Limit (RBL), the excess may be subject to tax at maximum rate when it is received by the employee. RBLs for 2005/06 are:

- If paid as a lump sum - \$648,946;
- If paid as a pension - \$1,297,886.

Are you working for two employers (who are not associated)? Perhaps as a company director on two different boards or as a doctor employed by different hospitals? You can salary sacrifice and effectively double the age based contribution limits as each employer can contribute up to the age based limit.

Superannuation Contributions - Spouse

You can obtain a tax offset of up to \$540 for spouse superannuation contributions of up to \$3,000 if your spouse is aged under 70 and has assessable income plus reportable fringe benefits of no more than \$10,800. The offset reduces with higher income and cuts out at \$13,800.

Superannuation for Over 55's

If you are aged over 55 you can draw a *transition to retirement* pension while still in the workforce. This is intended to supplement work income but is available to both part time and full time workers. The pension must be in the form of a complying pension or term allocated pension payable from income derived from investments in bonds, shares or property.

There is a strategy which can save you tax and help build your superannuation nest egg. The strategy involves:

- Making a large salary sacrificed contribution into superannuation;
- Arranging, at the same time, to receive a pre-retirement pension.

Employees are normally not entitled to make tax deductible personal super contributions. You can do so if your assessable income, tax exempt income and reportable fringe benefits is less than 10% of your total assessable income and reportable fringe benefits. (Super is not a taxable fringe benefit)

You can make a large personal super contribution and be entitled to a tax deduction for that contribution.

By calculating the figures carefully and taking advantage of this strategy you can reduce your tax and build a substantial superannuation nest egg.

Superannuation Guarantee

Have you complied with your superannuation guarantee obligations? You must make your superannuation guarantee payments (9% of ordinary time earnings) each quarter by not later than the 28th day of the following month. Payments in respect of the June quarter must be made not later than 28 July however you must make that payment by 30 June if you want a tax deduction this year.

Superannuation contributions can only be claimed in the year that they are actually paid.

You do not have to pay superannuation guarantee contributions to employees aged over 70, part time employees (not more than 30 hours per week) aged under 18 and employees receiving wages of less than \$450 per month.

Superannuation Recontribution

Are you due to retire and contemplating taking your superannuation as a pension? Consider withdrawing it as a lump sum, getting the benefit of the tax free threshold and concessional rates for pre 1 July 1985 employment.

Then re-contribute the lump sum to your superannuation fund as an *undeducted contribution*.

Once your fund is converted to a pension fund, no further tax will be payable by the fund and additionally, because the bulk of your pension comes from an undeducted contribution, the pension will be virtually tax free as well.

Superannuation Splitting

Is the amount in your superannuation fund getting close to your RBL? If so, you can redirect contributions made since 1 January 2006 to your spouse.

After 30 June you must notify your superannuation fund using the form which can be downloaded from the Tax Office website. Visit www.ato.gov.au and type *superannuation contribution splitting* in the search box. This will take you to a host of items. Then click *exact phrase search* and you will be taken to the superannuation contributions splitting application form and instructions.

You can divert up to 85% of total deductible contributions paid on your behalf to your spouse.

Superannuation Surcharge

This was abolished as from 1 July 2005. This impost of up to 13.5% of superannuation contributions paid for the benefit of employees whose adjusted taxable income exceeded a certain figure was a serious drawback to effective retirement planning.

This is no longer of concern. Employees can now effectively plan for their retirement.

Tax Effective Investments

You can borrow money to invest in rural, agricultural or forestry projects. Substantial tax deductions are generated in the early years. These are offset by taxable income later on.

This means that you can obtain a benefit by deferral of tax. This can generate significant cash flow advantages in the early years of the project.

Tax effective investment opportunities include primary production enterprises, grape growing, forestry, macadamia nuts and olive trees. Many of these have reached a mature stage and are soundly managed. Some are offering a secure source of income for future years. Other investment opportunities include property investments, share investments, films and research and development projects.

You should obtain independent professional advice before investing in these projects. Always ensure that the promoters have obtained a product ruling from the Tax Office. Peruse the prospectus carefully and obtain advice from your financial advisors and accountants before proceeding. Make sure the investment stacks up commercially.

A Tax Office product ruling does not guarantee the success of the investment. Product rulings can be later withdrawn by the Tax Office if the project does not comply with its requirements.

Here are four tax saving strategies published in *BRW* last year:

- Buy high growth low income investments to defer tax for as long as possible;
- Hold investments in the name of the spouse with the lower tax rate, in partnership with a person with a lower tax rate, or through a discretionary trust to make distributions to low earning beneficiaries;
- Make salary sacrificed superannuation contributions and then split those to the low income earning spouse;
- Adopt a buy and hold investment policy to minimise CGT. If held by a super fund and not sold until funds converts to pension phase, CGT will be eliminated entirely.

Tax Related Expenses

Do you have a company or corporate trustee and find that your personal tax rate is higher than the company's? If you are a public officer of your company you can claim the cost of managing tax affairs of that company. As public officer you are bound to ensure that the company's tax obligations are complied with and the relevant provision in the Tax Act concerning claims for tax related expenses permits you to personally claim these expenses. Deductibility of these costs has been confirmed by the Full Federal Court in two cases (*Falcetta v. FCT*; *FCT v. Bartlett*).

Trading Stock

If you are not an STS taxpayer you need to count stock on hand at 30 June. This will not be necessary if your accounting system produces perpetual inventory figures and you physically check your stock regularly. You must have written evidence available to prove the accuracy of your trading stock values.

You can choose whether to value each item of your trading stock at:

- Its cost price;
- Its market value; or
- Its replacement price.

You have the right to change your method of valuation in respect of each item of trading stock each year. Usually it would be best to value your stock at the lowest of the three alternatives. However, if you are expecting a high income in the following year you may wish to bring forward some of the income by valuing your stock at a higher figure. Perhaps market value. You can elect to value items of trading stock at even lower figures if it is warranted because of obsolescence or other special circumstances and the value you elect is reasonable.

To determine whether your stock is obsolete you must consider:

- The age of the stock;
- Quantities expected to be sold during the year;
- Length of time since the last sale;
- Industry experience;
- Price of the last sale and price for which you are prepared to sell.

If you intend to sell the items as scrap, you can value them at scrap value. If the items remain on hand but cannot be scrapped and have no other use, you can value them at nil.

Travel Allowances

Are you employed by your own family company or trust? Do you travel extensively? If your entity pays you reasonably based travel allowances you can claim deductions at the public service rate as outlined in Taxation Determination TD 2005/32.

Daily rates covering accommodation, food, drink and incidentals range from \$248 for trips to Sydney to \$158 for country centres (for employees on salary of \$81,400 per annum or below). If your claim is limited to the public service rates the amounts do not have to be substantiated. The amounts will be tax deductible to the entity but not taxable to the employee.

Employee truck drivers may receive a daily travel allowance for meals when they are required to sleep away from home. For truck drivers on salaries of \$81,400 or below, allowances up to \$69.45 per day need not be substantiated.

Wages – Accruals

If your pay week ends some days before 30 June, you can accrue the wages relating to the days prior to the end of June which are paid at next pay day. You cannot accrue or claim a deduction for unclaimed holiday pay, sick leave or long service leave. Review salary sacrifice arrangements to ensure they provide maximum tax benefits. Can salaries payable to family members or others be reduced to below the co-contribution threshold?

Any salary sacrifice arrangement must be in place before the relevant salary has been actually earned. If someone in your family earns a salary within the co-contribution threshold, ensure that the personal superannuation contribution is made before 30 June so that there is an entitlement to the Government co-contribution.

Wages – Family Members

Does your business employ family members? If so, ensure that their wage entitlements are paid up to date before 30 June. The Tax Office does not look kindly on journal entries for unpaid wage entitlements. You must have clear and compelling evidence of your obligation to pay wages which are unpaid at 30 June.

Wash Sales

Are you looking down the barrel of a substantial capital gain but have another asset which has gone down in value? If this second asset is sold on normal commercial terms before 30 June the resulting capital loss is available to offset the earlier capital gain.

A case went before the Administrative Appeals Tribunal last year where a taxpayer had set up a second trust to acquire the loss making asset. The AAT disallowed the loss under Part IVA because it considered that the dominant purpose in establishing the second trust and transferring the asset to that trust was to gain a tax benefit.

Matters which went against the taxpayer were the lack of legal formalities in relation to the transfer of the asset and failure to obtain financial approval to pay for the acquisition. If you are contemplating the sale of a loss making asset which may offset an earlier capital gain, you must ensure that the sale is effected for proper commercial reasons and is carried out on an arm's length basis.

Work in Progress

If you are operating a trading or manufacturing business you should bring any work in progress to account at cost. The Tax Office says that your cost calculation should be on the absorption principle – costs includes a share of direct or overhead costs.

Are you operating a professional or service business? You do not need to bring to account work in progress unless a recoverable debt has been crystallized (it is at the point that it can be invoiced). Are you engaged in construction and have a construction job extending past 30 June? You need to account for progress payments received or certified. You do not need to account for uncertified works or for retention monies which have not yet been approved for payment.

CGT – COMPULSORY ACQUISITIONS

How's this for swift action! Section 124-70 of the 1997 Tax Act provides rollover concessions when an asset is compulsorily acquired by an Australian Government agency or is sold to that agency after receipt of a notice of intention to acquire.

On 11 November 1999 the Treasurer announced that the rollover relief would be extended to cover cases where a private acquirer compulsorily acquired an asset through recourse to a statutory power (other than a compulsory acquisition of minority interest under company law).

More than five years later a Bill is now before Parliament to amend the law accordingly. This will take effect after Royal Assent but will apply to CGT events which happened from 11 November 1999.

Similar provisions will be enacted in relation to obtaining a balancing adjustment for depreciable plant. Rollover relief will also apply in relation to compulsory acquisitions of land subject to a mining lease.

SUPER GUARANTEE – SALARY SACRIFICE

The Super Guarantee (Admin) Act deems certain people who are not common law employees to be employees for super guarantee purposes. These are:

- People working under contracts wholly or principally for labour;
- Entertainers, artists, sports persons, etc.

The Tax Office has issued draft Superannuation Guarantee Determination SGD 2006/D1 which confirms that superannuation contributions paid for such workers are tax deductible in the same way as contributions paid for common law employees. Similarly, superannuation contributions can be made under an effective salary sacrifice arrangement. This ruling does not apply to contractors who are not deemed employees under the super guarantee legislation.

FBT CHANGES

On 7 April the Prime Minister and Treasurer jointly issued a press release indicating the Government's interim response to the report of the task force on reducing regulatory burden on business.

Two important measures announced are:

- **FBT minor benefit threshold.** A benefit to an employee paid on an infrequent and irregular basis to the value of less than \$100 is exempt from FBT. The exemption is to be increased to \$300 and the Tax Office is to review existing guidelines on what is considered irregular and infrequent.

Although announced only seven days after the commencement of the FBT year we will, unfortunately, have to wait another 12 months before this new measure commences.

- **FBT reporting threshold.** Employers must report the grossed up taxable value of most fringe benefits where the value of the benefit exceeds \$1,000. Although not subject to tax in the employee's hands, these amounts are used to determine his or her entitlement to income tested tax concession surcharges, debt repayments and child support.

The reporting exclusion threshold is to be increased to \$2,000 but this again will not be effective until 1 April 2007.

GST – BUSINESS ACTIVITY STATEMENTS

The Tax Office plans to revise activity statement instructions and allow capital items with a cost of \$1,000 or less to be reported on BAS at Item G11 rather than G10 if the business does not record capital acquisitions separately and expects its annual turnover to be less than \$1 million.

SMALL BUSINESS COMPLIANCE COSTS

Some recommendations in the task force report have been referred to the Board of Taxation with a view to identifying how small business compliance costs can be reduced. These include the simplified tax system, trust loss provisions, content of activity statements, reduction in PAYG Withholding tables and the development of a systematic approach to adjusting thresholds in the tax law.

COMPANY INCORPORATION

The fee payable to ASIC for incorporating a new company is to be reduced from \$800 to \$400 as from 1 July 2006.

(Let's not be cynical by suggesting that this Federal Government initiative is a move to encourage small business to incorporate and thereby become subject to its new industrial relations laws which constitutionally can only apply to incorporated businesses!)

Another measure which will please environmentalists and save many trees annually, is a proposal to allow companies to publish their annual reports on the internet and only send hard copies to shareholders if they actually request them.

TAX LAW REDUCTION

Following a report by the Board of Taxation, the Treasurer has released draft legislation containing proposals to repeal more than 4,100 pages of tax legislation. The Treasurer said that this will reduce income tax law by more than 31% and reduce the 1936 Act to half its current size. Inoperative sections will be removed and there are a number of minor improvements to the usability and readability of the tax law.

The amending legislation which is 190 pages long contains six schedules and is awaiting comment by interested parties. When the drafts are finalised and become law they will apply at varying dates through to 2008/09 and later years.

HELP REPAYMENT RATES

Previously known as HECS, tertiary students must contribute to the cost of their education once they commence earning income above a certain threshold. The HELP repayment income is calculated by adding together the following:

- Total taxable income;
- Reportable fringe benefits; and
- Net rental property losses.

Repayment rates and thresholds applicable to 2006/07 have been announced. These are:

HELP Repayment Income (\$)	Repayment Rate (%)
0-38,148	Nil
38,149-42,494	4
42,495-46,838	4.5
46,839-49,300	5
49,301-52,994	5.5
52,995-57,394	6
57,395-60,414	6.5
60,415-66,485	7
66,486-70,846	7.5
70,847 and above	8

FBT – LOAN FRINGE BENEFITS

If an employer provides a loan to an employee, interest must be charged at a rate known as the benchmark interest rate in order to avoid FBT. The rate for 2005/06 FBT year is 7.05%. This has been increased to 7.30% for the 2006/07 FBT year. *Taxation Determination TD 2006/24.*

FBT – LIVING AWAY FROM HOME ALLOWANCE

If an employee has to live away from home to carry out work duties, an allowance or benefit provided to compensate the employee for additional costs of food and accommodation may be exempt from FBT. The Tax Office has indicated that normal home food costs are to be taken into account at \$42 per week for each adult and \$21 per week for each child under 12. Food costs above those figures paid by an employer because the employee is required to live away from home are FBT exempt. In addition, any accommodation costs paid by the employer will be FBT exempt. Alternatively, it is possible for a reasonable allowance to be paid to the employee to cover these additional expenses.

The Tax Office has provided rates for reasonable food component for expatriate employees working in Australia for the 2006/07 FBT year (the year ending 31 March 2007). The rates for 2005/06 and 2006/07 are:

No of Persons	Rate Per Week	
	2004/05	2005/06
1 adult	\$180	\$191
2 adults	\$289	\$306
3 adults	\$326	\$344
2 adults and 1 or 2 children	\$326	\$344
2 adults and 3 children	\$379	\$401
3 adults and 1 child	\$379	\$401
3 adults and 2 children	\$433	\$458
4 adults	\$433	\$458

For larger family groupings, each additional adult will increase the amount by \$110 (2005/06) or \$115 (2006/07) whilst each additional child will increase the amount by \$54 (2005/06) or \$57 (2006/07). The FBT exempt amounts are the above figures reduced by the amounts to cover normal home food costs. The employer must hold a living away from home declaration completed and signed by the employee. *Taxation Determination TD 2006/23*.

GST – COMMERCIAL RESIDENTIAL PREMISES

If you operate an enterprise involving residential premises (rental houses, flats or units), these are input taxed. You cannot claim input tax credits on your expenses and you do not charge GST on your supplies. However, commercial residential premises are not input taxed. You claim input tax credits on your acquisitions and charge and account to the ATO for GST on your supplies. Although quite clearly defined in the GST Act, GST Ruling GSTR 2000/20 has dealt with this matter at considerable length. The result is rather confusing – in the hands of an individual investor, a strata titled unit in a block of serviced apartments is *residential premises*, but those same premises in the hands of an operator can be *commercial residential premises*.

Since inception of GST people have learned to live with these rather confusing interpretations until a Full Federal Court decision was handed down in 2004. In *Marana Holdings Pty Ltd v. FCT* (2004) 57ATR521 the Court's decision favoured the ATO and clarified the definition of *commercial residential premises*. In its judgement the Court held that *commercial residential premises* are those which are mainly available for short term occupancy whilst *residential premises* are mainly for longer term occupancy such as flats or units.

It is the task of the Court to interpret legislation and, once interpreted by the Court (unless appealed to a higher Court) it is the state of affairs on which ordinary people should be able to place reliance. Unfortunately, with our complex tax law and procedures, this does not always follow.

The Government announced and has now produced draft legislation and explanatory material to overcome the Court decision and to make this new legislation retrospective to the beginning of the GST era. The Assistant Treasurer, in announcing the Government's intention, said that it was doing so in order to "remove uncertainty in relation to the GST treatment of supplies of some types of real property". In fact it was the Court which removed uncertainty – the Government is simply aiming to validate a defective ATO Ruling by retrospective legislation.

GST – PARTIAL INPUT TAX CREDITS

The Tax Office has recently issued GST Ruling GSTR 2006/4 relating to acquisitions on which only partial input tax credits are available. You can only claim input tax credits on acquisitions *to the extent they are made for a creditable purpose*. Hence if you are making an acquisition which is partly for a creditable purpose and partly for an input taxed or private or domestic purpose then your input tax credit claim will be less than 100% of the GST paid on the acquisition.

Hence you are required to apportion the acquisition cost between multiple uses. The best way to make that apportionment is directly, based on the inherent characteristics or factors directly connected with the acquisition. For example it may be kilometres travelled by a motor vehicle, the floor area of property or time a computer is used for business purposes. If such a direct method is not possible then a fair and reasonable apportionment must be made.

This can be input based where the use is established at commencement or output based such as a percentage value of taxable supplies to total supplies. In some circumstances it is possible to use the income tax apportionment method for GST but it should be remembered that income tax apportionment is determined annually whilst GST is normally attributed quarterly or monthly.

The Tax Office will accept the income tax figure as a reasonable estimate for the GST periods falling within that financial year unless you are aware of a significant change in the extent of business use.

HORTICULTURAL PLANTS

The Tax Office has issued draft Taxation Determination TD 2006/D15 which advises what should be included as *establishment expenditure* for horticultural plants. Section 40-545 provides depreciation rates based on effective lives and provides that the rate is to be calculated on *establishment expenditure*. This is the amount of capital expenditure incurred that is attributable to the establishment of the horticultural plant. The Tax Office considers that capital expenditure includes expenses incurred in establishing or extending a plantation up to the stage of planting horticultural plants in their long term growing medium.

The draft Ruling states that establishment expenditure includes:

- The cost of purchasing plants or seeds;
- Costs incurred in preparing to plant;
- Costs of planting the plants or seeds;
- Costs of pots and potting mixtures (for potted plants);
- Costs incurred in grafting trees.

DATA MATCHING PROJECTS

Luxury Vehicles

The Tax Office will collect details of approximately 600,000 individuals or entities who have acquired a motor vehicle valued at \$70,000 or more. These details will be obtained from roads and traffic authorities in all States and Territories.

The intention is to trace high risk non-lodgers and those with undeclared income based on the value of assets they acquire which indicate conspicuous wealth. The Tax Office believes that some high income earners may actually hide their ownership of expensive vehicles and will be looking at details of car sellers and other companies which may have been used to cover the tracks of high income earners. The activities will be extended on a sampling basis to investigate sellers, licensed dealers, fleet managers and leasing companies.

Vehicles from manufacturers including Alfa Romeo, Bentley, Jaguar, Lamborghini, Maserati and Rolls Royce valued at more than \$70,000 and sold between July 1995 and June 2002 will be targeted.

Sales of all passenger vehicles and 4WD's made between July 2002 and June 2005 will also be examined.