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As the end of financial year quickly draws to a close, we have had one of our senior accountants, Tim Hase, put together a newsletter with the various tax planning tools available for businesses, self-employed individuals, employees and investors. Whilst our newsletter is not exhaustive, we hope it provides clients with some key issues to consider with their tax planning. Happy reading – we look forward to seeing you in our office in the very near future.

TAXPAYER ALERT

The ATO are again conducting a national awareness program to help taxpayers protect themselves against promoters marketing dodgy tax schemes.

There has been increased marketing by promoters of high risk tax schemes such as mortgage management and early release of super schemes.

Some investments offer tax benefits such as reducing assessable income or increasing deductions, but end up being outside the law. Find out as much as you can about the arrangement before investing. Make sure the arrangement has a prospectus or product disclosure statement and get independent advice about the promised tax benefits from a professional advisor. A person associated with the scheme is not independent.

It is important to check if the arrangement you are considering is covered by an ATO product ruling confirming the tax benefits or if a taxpayer alert has been issued by the ATO warning about the arrangement.

Doing your research will help you avoid negative consequences including having to repay tax and incurring interest and penalties.

ATO Imposes Changes to Deemed Dividend Rules for Trust Distributions

In issuing Draft Ruling TR2009/D8, the ATO has single handedly sought to change the law in relation to unpaid distributions by trusts to corporate beneficiaries and thereby increase the tax impost on many private business owners. There has not been any actual change to the law. The outcome simply results from a changed interpretation by the ATO of existing law. Despite intense lobbying by accounting firms and the various professional bodies, the ATO is persisting with this change in policy.

The Issue

Prior to the Draft Ruling, a trust could distribute income to a corporate beneficiary which would be taxed at 30%. Instead of making the actual distribution to the company, the after tax amount of cash was often retained by the trust for business working capital or investment purposes. There was no need for a Division 7A compliant loan agreement and no additional tax was required to be paid unless the company paid a dividend.

From the date of effect of the Draft Ruling (16 December 2009), if a trust has declared a distribution to a company and has not actually paid that distribution to the company, the unpaid present entitlement will be regarded as a loan by the company back to the trust and this loan will need to comply with the Division 7A provisions. This will require a written loan agreement and annual principal and interest repayments. At this stage, unpaid present entitlements arising prior to 16 December 2009 will not be affected.

Why the change in interpretation by the ATO?

The ATO change in view appears to have been formed as a consequence of issues identified during many high wealth audits. They appear to be particularly concerned about funds being accessed by the controllers of the trusts for private purposes rather than being used within the trust. However, the new approach is viewed by some as not necessary as amendments were made to Division 7A many years ago which already capture such situations. This has been drawn to the ATO's attention to no avail.

Furthermore, the ATO has extended their view in considering that there is still an issue, even where the funds are used within the trust for business or investment purposes and are not used outside the trust for private purposes.

Implications for taxpayers?

Taxpayers will seriously need to consider their options in terms of distributions for 2010 and beyond. Scenarios will include the following:

- The deemed loan from the company to the trust must be put on Division 7A compliant terms, with a written loan agreement and annual principal and interest repayments.

- Business owners may decide not to distribute to a corporate beneficiary but distribute to themselves and invest the after tax money back in the business owned by the trust. This will give rise to the top marginal tax rate of 46.5% in many cases.

- Others may decide to make the distribution but send the cash to the company rather than retain it in the trust. The distribution is not then subject to the 46.5% tax rate (although it still potentially is in the longer term when a dividend is paid out). However, if a capital asset is acquired by the company, the effective rate on any profit on disposal of that asset increases as a company is not eligible for the 50% CGT discount, whereas a trust is able to flow that benefit on to individual beneficiaries.

Under the new interpretation, many taxpayers will be clearly worse off as they will be paying the top marginal tax rate on profits reinvested into their business to fund working capital needs, capital expenditure, debt repayments, or investment assets held by trusts. To the extent that they change their approach and have the funds invested by the company, the tax payable on income will not change but they will lose the benefit of access to the 50% CGT discount.

YEAR END TAX PLANNING STRATEGIES

As 30th June fast approaches, it is important to consider various tax planning strategies to legally minimize tax. These may be in the form of maximizing deductions and/or deferring income where possible.

Superannuation

- Consider implementing a salary sacrifice arrangement with your employer for the remaining period of this financial year. This also has the added benefit of reducing the tax you pay whilst increasing the overall contribution to your super.

- If you are eligible to claim a deduction for personal contributions (e.g. you are substantially self employed), then consider maximizing your super contributions before 30th June.

- The concessional contributions caps are summarized in the following table.

Age category	09/10 Concessional Contributions Cap
Under age 50	$25,000
Over age 50	$50,000

- Salary sacrifice arrangements may need to be reduced to ensure that your total concessional contributions do not exceed $25,000 if under age 50, or $50,000 if age 50 or over. It is very important to take into account employer contributions made under Superannuation Guarantee (SG) requirements. By exceeding the cap you are liable for an additional 31.5% excess contributions tax.

Bad Debts Write Off

- A deduction is allowed if the debt was previously included in income and it is actually written off during the year in which it is claimed. Check your debtors before 30 June to determine which debts are not recoverable and can be written off.

- To be deductible, bad debts must be actually written off during the tax year – a physical entry must be made in the books of the business not later than 30th June. Have a realistic look at your debtors during the months before the end of the year and make an effort to collect the old and doubtful debts.

- Sort out the debts you cannot realistically collect and write these off not later than 30 June to at least avoid paying tax on income you are not going to receive. The Tax Act allows a deduction for even a partial write off of bad debts. Review your debtors and write off that part of any debt you know will never be paid. If you are using the cash method of tax accounting, this does not apply.

- If you are paying GST on an accruals basis, GST is paid on all income whether or not it has actually been received. If your outstanding debtors are more than 12 months old, you can claim a decreasing adjustment resulting in a reduction of GST. In other words, you can treat the debt as a bad debt.

Deferral of Income

- In determining when income is derived, different rules apply to different types of income and taxpayers.

- In most cases, it will be advantageous to return income on a receipts (cash) basis as income is deferred until receipt, rather than being declared when it is invoiced. Given the size and nature of the business concerned, it may not be possible to return income on a cash basis.

- A simple end of year tax planning strategy for businesses on a cash basis is to delay 'receipt' of the income until after 30th June 2010. Businesses on an accruals basis can defer income by delaying the 'issuing of invoices' until after 30th June 2010.

- Also, realizing a capital gain after 30th June 2010 will defer tax on the gain by 12 months and can also be an effective strategy to extend the holding period of the asset so that a 50% discount may be applied (where the asset is held longer than 12 months).

- Importantly, income needs to be 'earned' before it is returned as assessable income. This was highlighted in the *Arthur Murray case* where although payments had been received, they did not represent income until the services required for payment had been performed.

- In practical terms the decision in the *Arthur Murray case* may allow business taxpayers who receive income in advance to defer the recognition of that income until the services are actually provided. Business taxpayers who want to apply the principles in Arthur Murray must ensure they have a refund policy (whether legally enforceable or not) and the prepaid income is separately recognized in their accounts. Some common examples of services to which the Arthur Murray principle may apply include the following:

    - Professional services (e.g. accounting services and legal services)
    - Music lessons
    - School tuition
    - Driving lessons
    - Cleaning services

  It is important to note that the principles espoused in Arthur Murray are generally only relevant to those taxpayers who account for their income on an accruals basis. As such, any business taxpayers who provide professional services and recognize their income on a cash basis generally cannot benefit from the Arthur Murray case.

Small Business Entities

- Tax planning opportunities for Small Business Entities ('SBE') are more abundant than for non-SBE taxpayers, as more concessions may be claimed. Expenditure can be accelerated and/or prepaid.

- In broad terms, an entity qualifies as an SBE where their annual turnover is less than $2 million. Under the SBE rules, a business taxpayer is not required to make a formal election to access the range of small business tax concessions.

- A positive feature with the SBE concessions is the ability of an SBE business taxpayer to claim a deduction for all business expenses on an **incurred** basis, regardless of whether the taxpayer recognizes income on a cash or accruals basis. It is therefore possible for an SBE to confront a situation whereby they recognize income purely on a cash basis and yet, still claim deductions on an incurred basis.

Small Business Entity: Cash or Accruals Basis Accounting Method

- Entities with income who qualify as a small business entity are now able to use the most appropriate method of accounting, be it the cash or accruals basis. Small Business Entities are no longer required to only use the unique STS accounting cash method as was the case prior to 1 July 2005. Under that method income was recognized when received and deductions were deductible when paid. However, there is the choice to continue to use this 'cash' basis for recording income and expenses where the business was in the STS during 2006/07 and continually used the cash basis prior to 1 July 2005.

- Under the accruals basis, income is taxable when an invoice is raised, whereas under the traditional cash basis, income is not taxed until it is received. Under either system, you may claim for expenses incurred, whether or not they have been paid by the end of the tax year.

Checklist for Accelerating Expenditure for SBE Taxpayers

1. Maximise depreciation deductions

- Depreciable assets costing less than $1,000 can be immediately written off.
- Other assets are automatically pooled and depreciated at accelerated rates.

2. Staff salary and wage expenses

- The gross salary amount that is payable to an employee for the number of days worked up to 30th June 2010 (but not yet paid) is an

  accrued salary expense which can be claimed as a tax deduction for the 2010 income year.

3. Staff bonuses

- A tax deduction can be claimed where a business is definitely committed to the payment of a staff bonus as at 30th June 2010.

4. Directors' fees

- A company is entitled to claim a deduction for directors' fees it is definitely committed to paying at 30th June 2010. The effect of the accrual is that the company claims a deduction for the directors' fees in the current year and the director is **not** required to include the amount in their income tax return until the amount is actually received.

5. Commissions

- Where an employee or third party is owed a commission payment but has not been paid as at 30th June 2010, the accrued amount can be claimed as a tax deduction.

6. Superannuation Contributions

- An SBE taxpayer can claim a deduction for superannuation contributions in the year the contribution is **actually made** to the superannuation fund, regardless of whether the contribution relates to an employee or for a self employed taxpayer.

7. Rent

- In most cases, rent will be payable in advance and this means that most businesses will be unable to accrue any outstanding rental expenses for the 2010 income year. However, to the extent that rent is paid in arrears, that part that has accrued to 30th June 2010 may be claimed.

8. Interest

- Any accrued interest owing on a business loan that has not been paid as at 30th June 2010 can be claimed as a deduction. This is assuming the interest is incurred as at 30th June 2010.

9. Repairs, legal advice, advertising, tax agent fees, etc.

- The cost of deductible goods or services which have been invoiced/billed (i.e. incurred) but not paid for at 30th June 2010 can be claimed as a deduction in the 2010 income year.

Prepayment Rules for Taxpayers

- Small Business Entities and non-business individuals are able to claim an immediate deduction for certain prepaid business expenses irrespective of cost where the payment covers a period of 12 months or less that ends in the next income year.

- Other business taxpayers must apportion these prepayments over the relevant period covered. However for all taxpayers, if the prepayment is under $1,000, it is immediately deductible regardless of the period to which it relates. This expenditure is excluded from the prepayment rules.

Year end prepayments checklist

1. Lease payments

- Consider prepaying the lease payments on business assets such as non-luxury cars and office equipment.

2. Car registration

- Consider paying deductible annual car registration fees by 30 June 2010.

3. Rent

- Consider prepaying rent on business premises.

4. Insurance

- Consider paying annual (deductible) insurance premiums by 30 June 2010. Where an annual premium is paid periodically (e.g. monthly), consider prepaying some or all outstanding premiums.

5. Interest

- Where there are outstanding business loans, overdrafts or other finance facilities, consider organizing with the financier to prepay interest or to be charged interest in advance.

6. Business trips

- Consider paying for business travel costs (e.g. airfares, accommodation and other costs) in connection with a business trip prior to 30th June 2010.

7. Seminars, conferences and training

- Consider booking and paying (by 30 June 2010) for a training course, seminar or conference that will take place after this date.

8. Subscriptions

- Consider paying (deductible) annual subscriptions by 30 June 2010. Where annual subscriptions are paid periodically (e.g. monthly), consider prepaying some or all of the outstanding subscriptions.