the Spry Roughley report

explanatory memorandum

April and May 2012

CURRENCY:

This issue of Client Alert takes into account all developments up to and including 16 April 2012.

Tax anti-avoidance rules to be tightened

On 1 March 2012, the then Assistant Treasurer, Senator Mark Arbib, announced that the Government would amend Pt IVA to ensure it "continued to be effective in countering tax avoidance schemes that are carried out as part of broader commercial transactions". The amendments would apply to schemes entered into or carried out after 1 March 2012.

Mr Arbib said Pt IVA was enacted in 1981 and was intended to counter schemes that comply with the technical requirements of the tax law but, when objectively viewed, were conducted or carried out in a particular way primarily to avoid tax.

The then Assistant Treasurer said despite Pt IVA working effectively since its introduction, there was a need to clarify its operation in order to continue that effectiveness. He said that in recent cases, some taxpayers had argued successfully that they did not get a "tax benefit" because, without the scheme, they would not have entered into an arrangement that attracted tax. For example, they could have entered into another scheme that also avoided tax, deferred their arrangements indefinitely or done nothing at all. Mr Arbib said such an outcome could potentially undermine the overall effectiveness of Pt IVA and the Government's proposed amendments will seek to ensure that "such arguments will no longer be successful". He said the proposed amendments would "confirm that Pt IVA always intended to apply to commercial arrangements which have been implemented in a particular way to avoid tax. This also includes steps within broader commercial arrangements".

Mr Arbib said the Government was mindful that any amendments should not interfere with genuine commercial transactions and activities of taxpayers. To ensure that this is the case, the Government will consult extensively and will obtain advice from independent experts about how to best implement the proposed changes, "without unintentionally affecting genuine commercial and business activity," Mr Arbib said. He said the Government would obtain this advice before preparing the draft amendments as well as during the drafting process.

The consultation process will involve public consultation on the draft amendments. Treasury will also conduct roundtable discussions at key stages in the development of these amendments.

The Government intends to introduce the necessary amendments into Parliament in the Spring 2012 sittings (scheduled to run from 14 August 2012 to 29 November 2012).

Source: Assistant Treasurer's media release No 010, 1 March 2012
www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/010.htm&pageID=003&min=mva&Year=&DocType=0

Check your small business benchmarks regularly

The ATO has advised that its small business benchmarks have been updated with data from the 2010 financial year. The ATO says it has also added two new activity statement benchmark ratios for a wide range of industries. The ATO has published benchmarks for businesses with different turnover ranges across more than 100 industries.

The new activity statement ratios are considered to be "key benchmark ratios" which the ATO can use to identify businesses that may not be reporting some or all of their income. The ATO may also use

these ratios to quantify income that it has identified as not reported. According to the ATO, the key benchmark ratios provide the "most accurate predictor of business turnover for each industry".

The ATO recommends taxpayers review their business benchmarks regularly.

Details of the new activity statement benchmark ratios are as follows:

- Non-capital purchases / total sales (G11 / G1):
  - Non-capital purchases includes trading stock and normal running expenses that are reported at G11 on the activity statement.
  - Total sales includes all GST-free sales, input taxed sales and taxable sales that are reported at G1 on the activity statement.
- GST-free sales / total sales (G3 / G1):
  - GST-free sales do not include GST in the sales price that are reported at G3 on the activity statement.
  - Total sales includes all GST-free sales, input taxed sales and taxable sales that are reported at G1 on the activity statement.

The ATO says the ratios have been developed using a complete financial year's activity statement data from a particular industry. It says activity statement ratios are another way that businesses can compare their performance against others within their industry. To compare their performance against the benchmarks, the ATO says businesses should use their activity statements for the entire financial year.

Source: ATO publication "Cash economy frequently asked questions", 21 February 2012
www.ato.gov.au/content.aspx?ms=businesses&doc=/content/00277134.htm

ATO data matching coffee sellers and builders

The ATO has announced data matching programs targeting coffee sellers and hardware store trade account holders as part of its latest compliance activities aimed at detecting businesses participating in the cash economy. If the ATO identifies a taxpayer who appears not to have declared all or part of their income, the ATO said it will either write to them asking them to explain and offer them an opportunity to make a voluntary disclosure, or it may contact them directly through the ATO's audit area. The ATO adds that in cases where businesses fail to comply with their obligations (even after being reminded of them), other actions may be taken, including default assessments of a business's tax liabilities.

Coffee suppliers data matching

The ATO has obtained coffee supplier data which it says identifies businesses that have purchased more than 15kg of coffee per week in the 2009–10 and 2010–11 financial years. It said the information about coffee sellers in the program will be checked by the ATO to ensure they are reporting all of their business income. The ATO expects to match records of more than 8,000 individuals.

The following organisations have provided data to the ATO:

- Segafredo Zanetti Australia Pty Ltd, suppliers of Segafredo;
- Cantarella Bros Pty Ltd, suppliers of Vittoria Coffee, Aurora and Delta;

- SL-DE Holdings (Australia) Pty Ltd, suppliers of Piazza d'Oro and Douwe Egberts;
- Valcorp Pty Ltd, suppliers of Lavazza;
- Primo Coffee Pty Ltd;
- Complete Coffee Pty Ltd, suppliers of Primo Caffe Bar Coffee Range and Caffe Di Stefano Signature blend; and
- Coffex Coffee Pty Ltd.

Building industry data matching

The ATO has obtained details of individuals or businesses that hold a trade account with purchases between $10,000 and $3m in the 2009–10 financial year from Wesfarmers Limited (Bunnings Group Ltd). The ATO said individuals and businesses in the program will have data purchases cross-checked with reported income.

The ATO has also obtained data on complaints and licensing information for the 2009–10 and 2010–11 financial years from NSW Fair Trading, Qld Building Services Authority and Government of SA Consumer and Business Services. The ATO said the data will be used to identify those in the building industry who use cash transactions to avoid tax or fail to report correctly.

The ATO expects to match records of around 20,000 individuals in both of the above programs.

Sources: ATO media release 2012/01, 22 February 2012
www.ato.gov.au/corporate/content.aspx?doc=/content/00309226.htm;

ATO publication "Coffee suppliers data matching", 29 February 2012
www.ato.gov.au/businesses/content.aspx?doc=/content/00307254.htm;

ATO publication "Building industry data matching", 22 February 2012
www.ato.gov.au/businesses/content.aspx?doc=/content/00307259.htm;

Commonwealth Gazette No GN 7, 22 February 2012 [pp 499-500]
152.91.15.12/portal/govgazonline.nsf/C20B254BCD750ABECA2579AC00057152/$file/GN%207.pdf

Private health insurance rebate changes

The three bills designed to means test the 30% private health insurance rebate have passed all stages with four Government amendments. They now await Royal Assent. The bills are the *Fairer Private Health Insurance Incentives Bill 2012*, the *Fairer Private Health Insurance Incentives (Medicare Levy Surcharge) Bill 2012* and the *Fairer Private Health Insurance Incentives (Medicare Levy Surcharge – Fringe Benefits) Bill 2012*. The changes as originally introduced were to apply from 1 January 2012, but the Government amendments mean they will apply from 1 July 2012. Individuals earning more than $84,000 or families earning more than $168,000 would start to lose the rebate in the 2012–13 financial year. In the 2012–13 financial year, the rebate would only cut out completely for singles once they were earning more than $130,000 a year and for families earning $260,000 or more. The income test thresholds are based on income for Medicare levy surcharge purposes.

The three new "Private Health Insurance Incentive Tiers" have income thresholds as follows:

- Tier 1: singles whose income for Medicare levy surcharge purposes (see below) is between $84,001pa and $97,000pa inclusive and couples/families whose income for surcharge purposes is between $168,001pa and $194,000pa inclusive in the 2012–13 financial year. For these people

who hold a complying private health insurance policy, they will have their private health insurance rebate reduced by 10% (to 20%) in relation to premiums and amounts in respect of premiums paid on and after 1 July 2012.

- Tier 2: singles whose income for surcharge purposes is between $97,001pa and $130,000pa inclusive and couples/families whose income for surcharge purposes is between $194,001pa and $260,000pa inclusive in the 2012–13 financial year. For these people who hold a complying private health insurance policy, they will have their private health insurance rebate reduced by 20% (to 10%) in relation to premiums and amounts in respect of premiums paid on and after 1 July 2012.
- Tier 3: singles whose income for surcharge purposes is $130,001pa or more and couples/families whose income for surcharge purposes is $260,001pa or more in the 2012–13 financial year. For these people who hold a complying private health insurance policy, they will not receive any private health insurance rebate after 1 July 2012.

The following table illustrates how the changes will operate:

Table: Private Health Insurance Incentive Tiers from 1 July 2012

Tier	**Income ($)**		**Private health insurance rebate**			**Medicare levy surcharge**
	Singles	**Families**	**Under 65 yrs old**	**65 – 69 years old**	**70 years or over**	
	0 - 84,000	0 - 168,000	30%	35%	40%	Nil
1	84,001 - 97,000	168,001 - 194,000	20%	25%	30%	1%
2	97,001 - 130,000	194,001 - 260,000	10%	15%	20%	1.25%
3	130,001+	260,001+	0%	0%	0%	1.5%

Note: The thresholds increase annually, based on growth in Average Weekly Ordinary Time Earnings (AWOTE). Single parents and couples (including de facto couples) are subject to the family tiers. For families with children, the thresholds are increased by $1,500 for each child after the first.

The income test thresholds are based on the income for Medicare levy surcharge purposes. The income test used to determine a person's liability for the Medicare levy surcharge includes the sum of a person's:

- taxable income; plus
- reportable fringe benefits; plus
- total net investment losses; plus
- reportable super contributions;

less:

- where the person is aged 55 to 59 years old, any taxed element of a lump sum superannuation benefit, other than a death benefit, which they received that does not exceed their low rate cap.

The rebate can currently be claimed in one of three ways:

- the health fund can provide the rebate as a premium reduction;
- where the full, upfront cost of the private health cover premium has been paid, people can receive a cash payment from the Government through their local Medicare office or by lodging the claim form by post; or
- the rebate can be claimed on annual income tax returns as a private health insurance tax offset if the full, upfront cost has been paid.

Examples (from the revised explanatory memorandum to the bills)

Greg is a single 35 year old with a complying health insurance policy. In 2012–13, Greg's income for surcharge purposes is $97,000. Greg is likely to be assessed as a tier 2 earner in 2012–13 and will receive a private health insurance tax offset of 10%.

Tony and Kate live together as a couple with Kate's children – Liz (aged 15) and Alan (aged 9). Tony is aged 40 years. Kate is aged 48 years. In 2012–13, Tony's income for surcharge purposes is $120,000 and Kate's is $50,000. Tony has an individual policy and Kate has a family policy with her two children. Their combined income for surcharge purposes is $170,000. Tony and Kate are both likely to be assessed as tier 1 earners in 2012–13 and will each receive a private health insurance tax offset of 20% on their respective insurance policies, despite the fact Tony and Kate have separate policies.

Opposition vows to restore rebate

The Opposition leader has indicated that, in government, the Coalition would restore the rebate.

Tribunal finds businessman a resident for tax purposes

The Administrative Appeals Tribunal has affirmed income tax assessments and penalties imposed by the Commissioner in respect of a taxpayer for the 2002, 2003, 2005 and 2006 income years.

The taxpayer arrived in Australia in 1995 and has permanent residency status in Australia. Since coming to Australia, the taxpayer had purchased a property to house his wife and children and investment properties for which he received rent. The taxpayer was a director of a company (A Co) incorporated in NSW and he worked for A Co as a sales agent on commission selling Australian residential property to overseas investors mainly in Indonesia.

The taxpayer claimed he had spent more than 183 days in each of the relevant tax years outside Australia and, accordingly, was not a resident of Australia for those years. However, the Tribunal said the submission was "misconceived" and failed to take into account the provisions of subpara (a)(i) of the "resident" definition contained in s 6(1) of the *Income Tax Assessment Act 1936* ie a person whose domicile is in Australia. The Tribunal was satisfied, notwithstanding absences in Indonesia to sell

properties, that the taxpayer had his home, or settled place of abode, in Australia and was therefore a resident in Australia.

The next question before the Tribunal concerned withdrawals allegedly made by the taxpayer from bank accounts of A Co (some $194,000 in total). The taxpayer claimed the amounts were reimbursements for expenses. However, the Tribunal noted the accounts of A Co showed the sums as being "commission". In conclusion, the Tribunal was not satisfied the taxpayer had proved the income assessments were incorrect.

The Tribunal also confirmed the Commissioner's decision to impose a 50% penalty for "recklessness". Among other things, the Tribunal noted material obtained by the Commissioner showing the taxpayer had incurred "considerable interest expenses" on properties purchased (around $254,000) for which "no substantial source of income had been disclosed". Accordingly, the decisions of the Commissioner were affirmed.

AAT Case [2012] AATA 119, Re Gunawan and FCT, AAT, Ref Nos: 2010/4223-4225; 2011/2792-2795; 2010/4217-4219, Allen SM, 28 February 2012

http://www.austlii.edu.au/au/cases/cth/AATA/2012/119.html

Super rules breached for investment in related entities

The Administrative Appeals Tribunal has upheld a non-compliance notice issued to a self-managed superannuation fund (SMSF) for regulatory breaches in respect of "book entry" loans made via a related party unit trust.

Background

The taxpayer (Montgomery Wools Pty Ltd) is the corporate trustee of an SMSF and also acts as the trustee of a discretionary trading trust operating a family wool trading business. In 1997, the family trust transferred real property for $450,000 to a related unit trust. The SMSF acquired all of the units in the trust. A related company is the trustee of the unit trust holding the property.

From 2000, the trading trust drew down loans totalling $1.6m from a bank using the unit trust property as security. The property was sold in 2004 for $725,000 but the proceeds were used to discharge the debts of the trading trust. In simple terms, the major asset of the unit trust was effectively replaced with a loan to the trading trust.

In September 2008, the Commissioner issued the taxpayer with a notice of non-compliance under s 40 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) for contravening the regulatory provisions in ss 62, 67 and 109. As a result of the non-compliance notice, the SMSF was issued with amended assessments totalling $397,194. In September 2010, the Commissioner re-affirmed his decision to issue the notice of non-compliance but varied his reasons to rely on regulatory breaches of:

s 62 (sole purpose test);

s 84 (in-house assets rule); and

s 109 (investments at arm's length).

The taxpayer argued there had never been a "loan" from the SMSF to the unit trust as no distribution was in fact made. Rather, the taxpayer said the financial statements merely recorded "book entries" and the SMSF had no right to require a distribution from the unit trust. Alternatively, the taxpayer submitted that the Commissioner should have exercised his discretion under s 42A(5)(b) of the SIS Act to treat the SMSF as a complying fund despite the contraventions.

Decision

The Tribunal held that the taxpayer had contravened the regulatory provisions in ss 62 and 84 of the SIS Act after concluding that there was a distribution of income to the SMSF and a loan-back to the unit trust.

As a preliminary matter, the Tribunal rejected the taxpayer's argument that in reviewing the notice under s 40, the Tribunal was confined to considering the reason set out in the notice of 2008 (and not the reconsidered decision in 2010). The Tribunal regarded its role as standing in the shoes of the Commissioner and considering all relevant matters to make the correct or preferable decision to issue the notice of non-compliance. In doing so, the Tribunal said it must form a view about whether there were contraventions of regulatory provisions in 2004 as this was a threshold issue.

In-house assets and loans

The Tribunal held that the taxpayer had contravened the in-house assets rule in s 84 after concluding that there was a distribution of income to the SMSF and a loan back to the unit trust.

Based on the financial statements (and tax returns), the Tribunal concluded that there was a distribution of income to the SMSF in the amount of $192,999 and a loan back from the SMSF to the unit trust for the 2004 year. Pursuant to s 1305 of the *Corporations Act 2001*, the Tribunal said the financial statements are prima facie evidence of the distribution and loan. It also ruled there was insufficient evidence to rebut this presumption. To this end, the Tribunal considered that where a beneficiary does not demand payment of unpaid distributions, the beneficiary has provided a benefit to the trustee: *Corporate Initiatives Pty Ltd & Ors v FCT* (2005) 59 ATR 351.

Financial accommodation

In any event, the Tribunal said there was a loan in the form of "financial accommodation" under s 10(1) of the SIS Act by reason of a "consensual arrangement" approved by the controlling mind of both trustees. The Tribunal agreed with the Commissioner that the definition of a "loan" in 10(1) should be given a broad interpretation. To this end, the Tribunal adopted the finding in *FCT v Radilo Enterprises Pty Ltd* (1997) 34 ATR 635 that the provision of credit or financial accommodation "implies a consensual transaction".

The Tribunal considered that an agreement to delay the payment of the distribution, or the failure to make demand for payment of the distribution, could amount to financial accommodation. While the SMSF did not have the right to call for a distribution or to direct where the proceeds should be paid, the Tribunal said it did have the right to terminate the trust and give reasonable directions about the assets, which it chose not to do. Accordingly, the Tribunal held that the taxpayer (as trustee of the SMSF)

intended the result and thereby provided financial accommodation to the trading trust, even if there was no distribution of income and no present entitlement.

Sole purpose test

The Tribunal held that the taxpayer also breached s 62 as the sole purpose of the SMSF was not to provide retirement benefits to members. The Tribunal found that one of its purposes was to provide support to the family business. Although the taxpayer intended that any surplus from the trading trust would be transferred to the unit trust (and then the SMSF), the Tribunal said this was not guaranteed. The Tribunal found that the taxpayer breached s 62 in 2004 and had continued to do so by failing to call up the loan from the unit trust and/or failing to consider terminating the trust deed.

Arm's length investment

The Tribunal ruled that the SMSF did not breach s 109(1A) after finding there was no sale or dealing in the units of the trust (but rather the underlying investment). In this respect, the Tribunal observed that the wording of s 109(1A), which only applies if the trustee is "required to deal", appears to be curiously narrow.

Commissioner's discretion

Finally, the Tribunal upheld the Commissioner's decision not to exercise his discretion under s 42A(5)(b) to treat the fund as a complying fund despite the contraventions.

The Tribunal considered that the nature and extent of the contraventions were serious and the impact on the SMSF had been significant. It found there had been no attempt to rectify the contraventions in the five years following the sale of the unit trust property or to ensure compliance in the future. Following the approach in Tribunal Case [2009] AATA 522, *Re JNVQ and FCT* (2009) 74 ATR 730, the Tribunal said it would be inconsistent with the objects of the SIS Act to issue a notice of compliance under s 42A(5) in the circumstances of the case.

AAT Case [2012] AATA 61, Re Montgomery Wools Pty Ltd (as trustee for Montgomery Wools Pty Ltd Super Fund) and FCT, AAT, Ref No 2009/3486, Redfern SM, 6 February 2012 www.austlii.edu.au/au/cases/cth/AATA/2012/61.html

Tax planning

Put simply, tax planning is the arrangement of a taxpayer's affairs so as to comply with the tax law at the lowest possible cost. A common mistake is to believe that tax planning is optimised when every opportunity to reduce tax is taken. This is because some opportunities to reduce tax rely on strained interpretations of the law. Therefore, tax planning involves much more than taking the option that, at first, appears to result in lower tax costs. It involves objectively assessing and actively managing tax risk.

Common tax planning techniques include deferring the derivation of assessable income and bringing forward deductions. It is equally important that consideration be given to any pending changes to the tax legislation, especially when a proposed amendment will be backdated.

Deferring assessable income

The timing of when income is included in the assessable income of a taxpayer will depend on whether it is statutory income or ordinary income. Statutory income is included in assessable income at the time specified in the relevant provisions dealing with that income. Ordinary income is included in assessable income when it is derived, unless a specific provision includes the amount in assessable income at some other time.

Consideration must be given to the nature of income – is it revenue or capital? – because the difference in their tax treatment will ultimately have an impact on the taxpayer's tax position.

Business income

When ordinary income of a business is derived and when it is to be included in assessable income will depend on whether the business returns income on a cash basis or on an accruals basis.

If a business uses the cash basis, ordinary income is, generally, derived in the year in which the business receives the income. Conversely, if the business is reporting income on an accruals basis, ordinary income is derived when a recoverable debt is created such that the taxpayer is not obliged to take any further steps before becoming entitled to payment.

Payment received in advance

Income received in advance of services being provided is, generally, not assessable until the services are provided (the *Arthur Murray* principle). This principle applies regardless of whether a taxpayer reports its income on an accruals basis or on a cash basis.

Work in progress

In relation to manufacturers, partly manufactured goods that are not "finished" goods are treated as trading stock and it is necessary to determine the difference between the opening and closing value of the trading stock for the income year. (*See* **Trading Stock** on page 9.)

TIP: Taxpayers who provide professional services may consider, in consultation with their clients, rendering accounts after 30 June to defer the income.

Income from property

Income from property is essentially all income that is not personal exertion income and includes interest, rent, dividends, royalties and trust distributions. The time when such income is derived for non-business taxpayers is as follows:

Category	When income is derived
Interest	In the year of receipt
Rental income	In the year of receipt
Dividends	In the year of receipt
Royalties	In the year of receipt
Trust distributions	In the year the distribution is declared

- **STOP:** If the income has been applied or dealt with on behalf of a taxpayer, the taxpayer is taken to have received the income as soon as it is so applied or dealt with (the principle of constructive receipt, which applies even though the taxpayer has not physically received the income): see s 6-5(4) of the *Income Tax Assessment Act 1997* (ITAA 1997).

Sale of depreciating assets

A taxpayer is required to calculate the balancing adjustment amount resulting from the disposal of a depreciating asset. The balancing adjustment amount is calculated by comparing the termination value against the adjustable value. If the termination value is greater than the adjustable value, the difference is included as assessable income of the taxpayer. If the termination value is less than the adjustable value, the difference is a deduction available to the taxpayer.

TIP: If the disposal of an asset will result in assessable income, a taxpayer may want to consider postponing the disposal to the following income year. However, if it is not possible to delay the disposal, consideration may be given to whether balancing adjustment roll-over relief is available. If the disposal of an asset will result in a deduction, it may be beneficial to bring the disposal forward to the current year.

Balancing adjustment roll-over relief

Balancing adjustment roll-over relief effectively defers a balancing adjustment until the next balancing adjustment event occurs. Broadly, the roll-over relief will apply automatically if the conditions listed in s 40-340(1) of ITAA 1997 are satisfied. If the automatic roll-over relief applies, the transferor must give a notice containing sufficient information about the transferor's holding of the asset for the transferee to work out how Div 40 applies to the transferee's holding of the depreciating asset.

Optional roll-over relief is available in a partnership scenario if the composition of the partnership changes or when assets are brought into or taken out of the partnership. To defer any balancing adjustments, the existing partners and the new partner can jointly elect for the roll-over relief to apply.

TIP: A small business entity can access the optional roll-over relief.

- **STOP:** The optional roll-over relief is not available unless the original holder retains an interest in the asset after the change.

Maximising deductions

Deductions are divided into general deductions and specific deductions. General deductions are allowable under s 8-1 of ITAA 1997, whereas specific deductions are those provided for by sections of the *Income Tax Assessment Act* 1936 (ITAA 1936) and ITAA 1997. If an item of expenditure would be a deduction under more than one section, it is deductible under the provision that is most appropriate.

Meaning of "incurred"

In Taxation Ruling TR 97/7, the Commissioner states his view on the meaning of "incurred" for the purposes of s 8-1 of ITAA 1997. In most cases, the following general rules assist in defining whether and when an outgoing has been incurred:

(a) a taxpayer need not actually have paid any money to have incurred an outgoing, provided the taxpayer is definitively committed in the year of income. There must be a presently existing liability to pay a pecuniary sum;

(b) a taxpayer may have a presently existing liability notwithstanding that the liability may be defeasible by others;

(c) a taxpayer may have a presently existing liability even though the amount of the liability cannot be precisely ascertained, provided it is capable of reasonable estimation;

(d) in each case, whether there is a presently existing liability is a legal question and to be answered having regard to the circumstances under which the liability is claimed to arise; and

(e) if a presently existing liability is absent, an outgoing is incurred when the money is paid.

The phrase "presently existing liability" means that a taxpayer is definitively committed (or completely subjected) to the outgoing, ie the liability is more than impending, threatened or expected.

An outgoing is still incurred even if the amount cannot be quantified precisely, provided it is capable of approximate calculation based on probabilities.

TIP: An outgoing may be incurred in one income year even if the liability is not discharged until a later year. Therefore, a taxpayer can claim a deduction for the outgoing.

- **STOP:** Small business entities who were Simplified Tax System (STS) taxpayers and who are still using the mandatory cash accounting rules under the former STS can only deduct an outgoing under ss 8-1 (general deductions), 25-5 (tax-related expenses) and 25-10 (repairs) of ITAA 1997 when the outgoing is paid.
- **STOP:** The ATO has issued Taxpayer Alert TA 2011/4 which warns taxpayers of an arrangement where a company claims a deduction for director fees, even though there is no intention to ever make the payment in full or otherwise and even though the company had passed a resolution that the fees would be paid at some future time. The ATO said it was not concerned with normal business practices where a company passes a resolution that creates an unconditional commitment to pay directors' fees and the payment occurs within a reasonable time period that could extend outside the immediate year of income.

Bad debts

A debt that is written off as "bad" in an income year is an allowable deduction under s 25-35 of ITAA 1997, provided:

- the amount owed was either previously brought to account as assessable income in the current or a former income year or lent in the ordinary course of a money-lending business of the taxpayer;
- there is a bad debt in existence at the time of writing off;
- the debt is bad; and
- the debt is written off as bad during the income year in which the deduction is claimed.

TIP: Taxpayers should review their debtors prior to year end and assess which debts may be written off as "bad".

In Taxation Ruling TR 92/18, the ATO sets out the list of circumstances in which a debt may be considered to have become bad. These circumstances may include the death or the disappearance of

a debtor leaving little or no assets out of which the debt may be satisfied, or a corporate debtor going into liquidation or receivership with insufficient funds to pay the debt.

Before a debt can be written off as "bad", a taxpayer must have taken appropriate steps in an attempt to recover the debt. In TR 92/18, the ATO lists the steps to be taken to establish that a debt is bad. These include attempting to contact a debtor, issuing reminder notices and taking more formal measures.

It is important to note that while the factors listed in TR 92/18 are indicative of the circumstances in which a debt is considered bad, ultimately the question of whether the debt is bad is one of fact and will depend on all the facts and circumstances surrounding the debt.

TIP: If a bad debt is not deductible under s 25-35, it may be deductible under s 8-1.

TIP: A bad debt does not need to be written off in the account books of a taxpayer. In the case of a company, the requirements of s 25-35 will still be satisfied in the following circumstances:

- a board meeting authorises the writing off of a debt and there is a physical record of the written particulars of the debt and the board's decision before year end, but the writing off of the debt in the taxpayer's books of account occurs subsequent to year end; and
- there is a written recommendation by the financial controller to write off a debt, which is agreed to in writing by the managing director prior to year end and which is followed by a physical writing off in the books of account subsequent to year end.

TIP: A bad debt deduction is also available for a partial write-off of a debt, provided the requirements of s 25-35 are satisfied. One debt may, over a period, be subject to several partial write-offs.

Additional requirements for companies

A company must pass either the "continuity of ownership test" (the primary test to be applied) or the "same business test" in addition to satisfying the requirements of s 25-35.

Companies that have undergone a change in underlying ownership due to a sale of the business during the year will need to pass the "same business test" to claim a deduction for bad debts.

- **STOP:** A company cannot claim a deduction for a debt incurred and written off as bad on the last day of an income year.
- **STOP:** Consideration must be given to the specific anti-avoidance provisions contained in Subdiv 175-C of ITAA 1997.
- **STOP:** Where, as part of the purchase of a business, the purchaser takes over the vendor's debts and those debts subsequently become bad, the purchaser is not allowed a bad debt deduction. This is because the debts have not been included in the assessable income of the purchaser, but rather (assuming the vendor is an accruals taxpayer) in the assessable income of the vendor: see *Easons Ltd v C of T (NSW)* (1932) 2 ATD 211.

Additional requirements for trusts

Special rules apply to deny trusts a deduction for bad debts unless certain strict tests are passed. The applicable tests will depend on the nature of the trust.

Managed investment schemes

Expenses incurred in a managed investment scheme (MIS) are generally deductible. In *Hance v FCT* (2008) 74 ATR 644, the Full Federal Court allowed two taxpayers deductions relating to their investment in an almond MIS. In that test case, the Full Federal Court concluded that the relevant outgoings of the taxpayers would be incurred as operating expenses in carrying on each taxpayer's business and that they were deductible pursuant to s 8-1 of ITAA 1997.

The following Taxation Determinations issued by the ATO deal with various scenarios and whether participants are entitled to relevant deductions:

- TD 2010/7: Does a change of responsible entity of a registered agricultural MIS affect the tax outcomes for participants if the arrangement continues to be implemented in accordance with the relevant product ruling?
- TD 2010/8: Does the disposal or termination of an interest in a non-forestry MIS that arises as a result of circumstances outside the control of the taxpayer result in the denial of deductions previously allowed under s 8-1(1)(b) of ITAA 1997 in respect of contributions to the scheme?
- TD 2010/9: Is a payment received by an investor in a non-forestry MIS upon the winding-up of the scheme, that does not involve the disposal of the interest in the scheme to another person, necessarily ordinary or statutory income under ITAA 1997?
- TD 2010/14: Does a failure to plant trees intended to be established under a forestry scheme affect the timing of deductions for expenditure on seasonally dependent agronomic activities where s 8-1(1)(b) of ITAA 1997 and s 82KZMG of ITAA 1936 have previously been ruled to be satisfied?
- TD 2010/15: Does failure to plant all the trees intended to be established under a forestry MIS covered by Div 394 of ITAA 1997 mean that no deduction is allowable under Div 394 in respect of a participant's initial contribution to the scheme?

TIP: Each of the above Taxation Determinations contains an example illustrating the Commissioner's view on the operation of the tax law. Taxpayers seeking to claim a deduction should ensure that the facts surrounding their circumstances are similar to the facts in the examples.

Government assistance payments – pending changes

The Government has introduced legislation to implement its 2011 Federal Budget announcement to change the law to prevent deductions being claimed against all government assistance payments from 1 July 2011 (see *Tax Laws Amendment (2012 Measures No 1) Bill 2012).* Government assistance payments include Austudy living allowance, ABSTUDY living allowance, Newstart Allowance, Youth Allowance (Student) and Youth Allowance (Jobseeker). The Budget announcement was made in response to the 2010 High Court decision in *FCT v Anstis* (2010) 241 CLR 443 which had allowed a full-time student to claim various self-education expenses as they were considered to be incurred in deriving the Youth Allowance, which was assessable income.

TIP: Individuals who have maintained records of their expenditure following the High Court decision are not precluded from claiming a deduction for relevant expenditure for the 2010–11 income year. For

each of the 2006–07 to 2009–10 income years, the Commissioner allowed eligible taxpayers to receive an automatic deduction of $550, but they can claim a higher deduction if substantiated. The ATO has published information on how to claim study expenses following *Anstis* for the 2011 income year and prior years: www.ato.gov.au/individuals/content.asp?doc=/content/00263565.htm.

Carried forward losses

The deductibility of tax losses carried forward from previous income years will depend on the entity claiming the losses.

Corporate tax entities

The entitlement of corporate tax entities to deductions in respect of prior year losses is subject to certain restrictions. An entity needs to satisfy the "continuity of ownership test" before deducting the prior year losses. If the continuity of ownership test is failed, the entity may still deduct the loss if it satisfies the "same business test".

TIP: A corporate tax entity can choose the amount of prior years' losses it wishes to deduct in an income year. That is, the entity can choose to "ignore" the carried forward tax losses and pay tax for the income year to generate franking credits for its distributions.

Other taxpayers

The method for deducting earlier tax losses incurred by other taxpayers is governed by s 36-15 of ITAA 1997. If a taxpayer derives net exempt income for an income year, the carried forward loss will need to be firstly offset against net exempt income before being available for deduction against assessable income.

TIP: It is net exempt income against which any carried forward tax losses are offset and not exempt income. Net exempt income is defined in s 36-20 of ITAA 1997 and exempt income is defined in s 6-20 of ITAA 1997.

TIP: Try to avoid deriving exempt income in an income year if there are carried forward losses.

Depreciation (capital allowances)

A deduction may be available on the disposal of a depreciating asset if a taxpayer stops using it and expects never to use it again. Therefore, asset registers may need to be reviewed for any assets that fit this category.

The effective life of an asset can be recalculated at any time after the end of the first income year for which depreciation is claimed by a taxpayer if it is no longer accurate because of changed circumstances relating to the nature of use of the asset. Therefore, consideration may be given to the use of an asset to determine whether its effective life can be recalculated, which may result in an increased or decreased rate of depreciation.

Immediate deduction

Non-business taxpayers

Non-business taxpayers are entitled to an immediate deduction for assets costing $300 or less, provided:

- the asset is used predominantly to produce assessable income that is not income from carrying on a business;
- the asset is not part of a set of assets that the taxpayer started to hold in the income year where the total cost of the set of assets exceeds $300; and
- the total cost of the asset and any other identical, or substantially identical, asset that the taxpayer starts to hold in that income year does not exceed $300.

TIP: If two or more taxpayers jointly own a depreciating asset, a taxpayer is still eligible to claim an outright deduction, provided his or her interest does not exceed $300 (even if the asset costs more than $300).

Small business entities

A small business entity (*see* **Small Business Entities** on page 18) that chooses to apply the capital allowance rules contained in Div 328 of ITAA 1997 is entitled to an outright deduction for the taxable purpose proportion of the adjustable value of a depreciating asset if: (i) the asset is a "low-cost asset"; and (ii) the taxpayer starts to hold the asset when the taxpayer is a small business entity.

Note that from 2012–13, the small business instant asset write-off threshold will be increased from $1,000 to $6,500 (ie a "low-cost asset" will be an asset costing less than $6,500).

The entity is also entitled to an immediate deduction for any addition to a low-cost asset, provided the cost of the addition is less than $1,000 (or $6,500 from 2012–13). If an addition costs more than $1,000 (or $6,500 from 2012–13), the entity is required to pool the asset in the general small business depreciation pool. (*See* **Pooling**.)

A small business entity will also be allowed an instant tax write-off for the first $5,000 of the cost of any motor vehicle purchased in 2012–13 or a later income year. For example, a tradesman on a 30% marginal tax rate who buys a new $33,960 ute would receive an extra tax benefit of $1,275 in the year they purchased the vehicle. The remainder of the purchase value can be transferred into the general small business depreciation pool. (*See* **Pooling**.) This measure will effectively replace the entrepreneurs' tax offset. This will not apply if the vehicle can be written off immediately under s 328-180(1).

Business taxpayers

For business taxpayers that are not small business entities, all capital items must be written off over their effective life under Div 40 of ITAA 1997, regardless of the cost (including low-value items). However, the ATO has adopted an administrative practice allowing an outright deduction for low-cost capital assets in certain cases. (See ATO Practice Statement Law Administration PS LA 2003/8.)

Broadly, an expenditure of $100 or less (inclusive of GST) incurred by a taxpayer to acquire a capital asset in the ordinary course of carrying on a business will be assumed to be revenue in nature and therefore deductible in the year of the expenditure. It is important to note that, because the threshold includes GST, the threshold is effectively $90.91 for a business registered for GST.

Note that the administrative practice does not apply to expenditure incurred in establishing a business or building up a significant stockpile of assets, nor to a variety of assets, including those held under a lease or hire purchase or similar agreement, certain assets included in an assets register, trading stock, spare parts and assets that are part of another composite asset.

Pooling

Certain depreciating assets can be pooled with the result that the decline in value is calculated for the pool instead of the individual assets.

Starting from the 2012–13 year, for a small business entity there will be one general small business depreciation pool (ie the "general pool" and the "long-life pool" will be consolidated). The closing balance of a small business' long-life pool and general pool for the 2011–12 income year will be added together to calculate the opening balance of the general small business pool for the 2012–13 income year. The calculation of the opening balance of the general small business pool for the 2012–13 income year is also adjusted by changes in the proportion of the taxable purpose use of the assets allocated to the depreciation pools. A taxpayer will be able to write off the total balance of the pool when it falls below $6,500.

For other taxpayers, there is the option of pooling "low-cost" and "low-value" assets to a low-value pool. A "low-cost" asset is a depreciating asset that costs less than $1,000. A "low-value" asset is a depreciating asset that has been depreciated using the diminishing value method, has an opening adjusted value of less than $1,000 in an income year and is not a "low-cost" asset. If a taxpayer sets up a low-value pool, all low-cost assets have to be allocated to the pool. However, low-value assets do not need to be allocated to the pool.

Category of taxpayer	Assets allocated to pool during year are depreciated at:	Assets allocated to pool in a previous income year are depreciated at:
Small business entity – General pool (from 2012–13)	15%	30%
Other taxpayers – Low-value pool	18.75%	37.5%

TIP: If two or more taxpayers jointly own a depreciating asset, a taxpayer can set up a low-value pool to take advantage of the accelerated rate of depreciation, provided his or her interest is less than $1,000 (even though the asset costs more than $1,000).

"Blackhole" expenses under s 40-880

Special provisions (s 40-880 of ITAA 1997) provide systematic treatment for certain business expenditure of a capital nature – sometimes termed "blackhole" expenses – incurred on or after 1 July 2005. The ATO in Taxation Ruling TR 2011/6 sets out the Commissioner's views on the interpretation of the operation and scope of s 40-880. It identifies the key issues that need to be resolved to establish entitlement to a deduction under s 40-880.

Small business and general business tax break

Division 41 of ITAA 1997 provides a one-off deduction for new investment in tangible depreciating assets made after 12 December 2008 and before 1 January 2010. The total new investment must be at least $1,000 for small business entities and $10,000 for other business taxpayers. The one-off deduction, which is also known as the "Business Tax Break" (or the temporary investment allowance), is in addition to the decline in value (depreciation) deductions under Div 40.

The one-off deduction is available in the 2008–09, 2009–10, 2010–11 or 2011–12 income year. It is claimed in the income year for which the depreciation deduction under Div 40 is first available in respect of the expenditure (ie the year in which the depreciating asset is first used or installed ready for use).

The one-off deduction is limited to new tangible, depreciating assets for which a deduction is available under Subdiv 40-B of ITAA 1997 and new investment in existing tangible depreciating assets: s 41-10. An asset is new if it has never been used or installed ready for use by anyone, anywhere. The asset must also be used principally in Australia for the principal purpose of carrying on a business: s 41-30.

The deduction is worked out using a rate of 50%, 30% or 10%. The applicable rate depends on the entity type, when the taxpayer committed to investing in the asset and when the asset is first used or installed ready for use.

The following table summarises the different rates relating to key dates for different entities:

Business entity	**Investment commitment time (inclusive)**	**Date of first use or installed ready for use (inclusive)**	**Rate**
Small business	13 December 2008 to 31 December 2009	By 31 December 2010	50%
Other business	13 December 2008 to 30 June 2009	By 30 June 2010	30%
		1 July 2010 to 31 December 2010	10%
	1 July 2009 to 31 December 2009	By 31 December 2010	10%

Donations

A taxpayer may make a written election to spread a deduction for a donation over a period of up to five years if:

- the donation was a gift of money of $2 or more;
- the donation was property valued by the ATO at more than $5,000;
- the donation was made under the Cultural Gifts Program; or
- the donation was a heritage gift.

TIP: A taxpayer must specify in the written election the percentage (if any) to be deducted each year. If a taxpayer anticipates an increase in assessable income in a future year, a taxpayer may consider allocating a greater percentage to that year.

TIP: As a general proposition, try to avoid making donations in a year of losses. This is because a deduction for a donation cannot add to or create a tax loss for a taxpayer.

TIP: For donations over $10, written evidence must be kept in order to claim a tax deduction.

FBT and salary sacrificing donations

Donations to a deductible gift recipient (DGR) made under salary sacrificing arrangements, which are prima facie expense payment fringe benefits, are exempt benefits: s 148(2A) of the *Fringe Benefits Tax*

Assessment Act 1986. In contrast, donations collected through an employer's Workplace Giving arrangements are made from an employee's after-tax income and are not fringe benefits.

Legal expenses

It is impossible to formulate an all-encompassing "rule" as to the deductibility of legal expenses because each expense must be considered on its own merits.

Non-commercial losses

An individual taxpayer should consider whether a loss from his or her business activity (whether carried on alone or in partnership) will be deferred under the non-commercial loss rules, which are contained in Div 35 of ITAA 1997. This is because the individual's overall tax position will be impacted when the loss is deferred.

In essence, an individual may only offset a loss arising from a business activity against other income derived in the same income year if the business activity satisfies at least one of the four commerciality tests – the assessable income, profits, real property, and other assets tests. If the individual does not satisfy at least one of the tests, the loss is carried forward and applied in a future income year against assessable income from the particular activity.

The Commissioner has the discretion to override the provisions of Div 35. Further, an exemption is available for individuals who carry on a primary production or professional arts business and whose assessable income for the year from other sources (eg salary and wages) does not exceed $40,000.

TIP: The $40,000 threshold excludes net capital gains derived by a taxpayer.

High-income earners

From 1 July 2009, losses incurred by individuals with an adjusted taxable income of $250,000 or more from non-commercial business activities will be quarantined even if they satisfy the four commerciality tests. The effect of this is that they will not be able to offset excess deductions from non-commercial business activities against their salary, wage or other income.

The "adjusted taxable income" is the sum of an individual's:

- taxable income;
- reportable fringe benefits;
- reportable superannuation contributions; and
- total net investment losses.

Any excess deductions from a non-commercial business activity that are subject to Div 35 are to be disregarded in working out the adjusted taxable income of the individual.

While an individual with an adjusted taxable income of $250,000 or more is precluded from accessing the four commerciality tests, they will be able to apply to the Commissioner to exercise his discretion to not apply the non-commercial loss rules. The discretion may be exercised where the taxpayer can satisfy the Commissioner, based on an objective expectation, that the business activity will produce

assessable income greater than available deductions within a commercially viable period for the industry concerned.

Prepayments

One of the simplest methods to accelerate deductions is the prepayment of deductible expenses.

Excluded expenditure

The prepayment rules do not apply to "excluded expenditure", ie a taxpayer is able to claim an outright deduction. Excluded expenditure is defined as expenditure that is:

- less than $1,000;
- required to be made under a court order or by law (eg car registration fees); and
- for salary or wages.

TIP: If a taxpayer is entitled to an input tax credit in respect of an expenditure, the $1,000 is the *GST-exclusive* amount. If the taxpayer is not entitled to an input tax credit, the $1,000 is the *GST-inclusive* amount.

Small business entities and non-business individuals

Small business entities and non-business individuals are able to access the 12-month prepayment rule. If the prepaid expenditure is not excluded expenditure, it is deductible outright in the income year it is incurred, subject to two provisos: the eligible service period does not exceed 12 months and that period ends in the expenditure year or the income year immediately following. If the prepayment has an eligible service period of greater than 12 months, the expenditure will be apportioned over the relevant period (on a daily basis) up to a maximum of 10 years. The eligible service period is the period over which the relevant services are to be provided.

Other taxpayers

If the eligible service period covers only one income year, the expenditure will be deductible in that particular year. If the eligible service period covers more than one income year, the expenditure is apportioned (on a daily basis) over those years up to a maximum of 10 years in accordance with the following formula:

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

Speculators and losses from shares

Generally, speculators are denied a revenue deduction for any losses arising for the disposal of shares unless a speculator is carrying on a business in relation to the shares.

By way of example, in *AATA Case 6297* (1990) 21 ATR 3747, the Administrative Appeals Tribunal (AAT) concluded that a taxpayer's share activities did not amount to carrying on a business and that, as a result, the taxpayer was not entitled to a deduction for losses arising from the disposal of his shares.

By contrast, in AAT case [2011] AATA 545, the AAT held that a taxpayer was not a passive investor in relation to share trading activities and was carrying on a business of share trading for the relevant year. Some of the significant factors in determining whether a person carries on a share trader business include:

- an intention to buy and sell at a profit rather than hold for investment;
- the frequency and volume of transactions;
- whether the taxpayer is operating to a plan;
- setting budgets and targets and keeping records;
- whether the taxpayer maintains an office;
- whether the share transactions are accounted for on a gross receipts basis; and
- whether the taxpayer is engaged in another full-time profession.

If the taxpayer is carrying on a business of share trading, losses may be deductible against other income. If the taxpayer is not carrying on a business of share trading, capital losses can only be applied to reduce capital gains following the method statement in s 102-5(1) of ITAA 1997.

Trading stock

The tax treatment of trading stock, which is contained in Div 70 of ITAA 1997, impacts on year end tax planning. This is because a taxpayer is required to either include in or deduct from its assessable income for an income year the difference between the opening and closing value of the trading stock.

Valuation of trading stock

A taxpayer can elect to use the cost, market selling value or replacement value in order to value each item of trading stock on hand. However, this does not apply to obsolete stock or certain taxpayers.

There is no requirement to adopt permanently any one of the three methods of value.

TIP: There is no compulsion to use the same method to value all closing stock. A taxpayer can use different methods for different items of trading stock to maximise its deductions or minimise its assessable income.

Small business entities

If a small business entity elects to apply the trading stock concession under Div 328, it is permitted to ignore the difference between the opening and closing value of trading stock if the difference between the opening value of stock on hand and a reasonable estimate of stock on hand at the end of that year does not exceed $5,000. The effect of electing to apply this concession is that the value of the entity's stock on hand at the beginning of the income year is the same as the value taken into account at the end of the previous income year.

However, a taxpayer could choose to account for changes in the value of trading stock even if the reasonably estimated difference between opening and closing values was less than $5,000.

TIP: Accounting for the difference between the opening and closing stock is a good tax planning method to avoid a large adjustment in the calculation of taxable income in a future year when the benefit of Div 328 is not available or to claim a deduction in the current year for a reduction in the value of trading stock.

Other business taxpayers

Taxpayers are required to value each item of trading stock at the end of an income year at its cost, market value or replacement value. There is no requirement to permanently adopt any one of these three methods of valuation. Further, there is no compulsion for a taxpayer to use the same method across all items of trading stock.

Obsolete stock

A deduction may be available for obsolete stock. Therefore, a taxpayer should review its closing stock to identify whether any obsolete stock exists. In Taxation Ruling TR 93/23, the ATO states that obsolete stock is stock that is either:

- going out of use, going out of date, becoming unfashionable or becoming outmoded (ie becoming obsolete); or
- out of use, out of date, unfashionable or outmoded (obsolete stock).

When valuing obsolete stock, a taxpayer does not need to use any of the prescribed methods (ie cost, market value or replacement value). Rather, provided adequate documentation is maintained, the ATO will accept any fair and reasonable value that is calculated taking into account the appropriate factors: see s 70-50 of ITAA 1997.

Repairs and maintenance

A deduction is available for repairs to premises, part of premises or a depreciating asset (including plant) held or used by a taxpayer solely for the purpose of producing assessable income: see s 25-10(1) of ITAA 1997. If the relevant premises or assets are held or used only partly for income-producing purposes, expenditure on repairs is only deductible to the extent that it is reasonable in the circumstances: see s 25-10(2).

A common issue that arises is the distinction between restoration of an item to its former condition (deductible) and improvement of the item (capital and thus not deductible). It is important to realise that the mere fact that different materials from those replaced are used will not of itself cause the work to be classified as an improvement, particularly in circumstances where the previous materials are no longer in current use. If the change is merely incidental to the operation of the repair, the deduction, generally, will be allowed.

Initial repairs, the replacement of the entire item and improvements are not deductible, but may qualify for a periodic write-off under the capital allowance provisions. In addition, the expenditure may form part of the cost base of an asset for capital gains tax purposes.

TIP: The ATO has stated that if a taxpayer replaces something identifiable as a separate item of capital equipment, the taxpayer has not carried out a repair. Therefore, the taxpayer is required to depreciate the item over its effective life.

TIP: Taxpayers should seek an itemised invoice to separate the costs of work if the work includes both repairs and improvements.

Superannuation contributions

Deductions for employer contributions

Employers are entitled to a tax deduction for contributions made to a complying superannuation fund or a retirement savings account (RSA) for the purpose of providing superannuation benefits for their employees. The contributions are only deductible for the year in which they are made: see s 290-60(3) of ITAA 1997. To maximise the deductions available, employers should ensure that the contributions are paid to their employees' superannuation funds or RSAs before 30 June.

TIP: A mere accrual of a superannuation liability or a book entry is not sufficient to qualify for a deduction.

TIP: For employees turning 75, the contribution must be made by an employer within 28 days after the end of the month in which an employee turns 75 in order to obtain a deduction. However, from 1 July 2013, an employer will be able to deduct the amount of a contribution that reduces the superannuation guarantee charge (SGC) percentage in respect of an employee aged 75 or over, following the abolition of the superannuation guarantee age limit from that date.

TIP: The SGC rate will increase from 9% to 12%, phasing in from 1 July 2013.

TIP: Taxation Ruling TR 2010/1 sets out the Commissioner's view regarding specific rules about deducting superannuation contributions.

Superannuation guarantee charge

The SGC is imposed if an employer does not make sufficient quarterly superannuation contributions for each employee by the relevant quarter due date. The SGC is also imposed where the employer pays the contributions after the due date, even though there might be no shortfall for the quarter.

Employers who have made a contribution for an employee after the due date for the quarter and who have an outstanding SGC for the employee for that quarter may elect (using the approved form) to use the late payment offset to reduce their SGC liability (the election is irrevocable).

However, the late contribution can only be offset against an SGC that relates to the same quarter and to the same employee. The offset cannot be used to reduce the administration component. Where an employer has been assessed on its SGC for a quarter, the employer can seek an amendment of the assessment to elect to use the offset. However, the amendment must be made within four years after the employer's SGC for the quarter became payable.

TIP: The SGC and late payment offset are not deductible to an employer. Therefore, the employer still has a strong incentive to continue making its superannuation guarantee quarterly payments on time.

TIP: The SGC is the only tax that the Commissioner wants employers to avoid paying.

Personal superannuation deductions

The self-employed and other eligible persons are entitled to a deduction for personal superannuation contributions if less than 10% of the individual's total assessable income, reportable fringe benefits and

reportable employer superannuation contributions for an income year is attributable to activities that result in the taxpayer being treated as an "employee" for superannuation guarantee purposes.

The contribution is only deductible for the year in which it is made. The contribution is deductible in full, subject to the restriction that the maximum amount that is deductible is the amount stated in the notice of intention to claim a deduction, which is given to the trustee of the relevant superannuation fund. However, excess contributions tax may apply for contributions above the contributions cap. (*See* **Excess contributions tax** on page 19.)

TIP: A personal superannuation contribution for which a deduction is intended to be claimed should only be made towards the end of the income year when it is certain the taxpayer will satisfy the 10% rule (and other eligibility conditions) and not breach the taxpayer's concessional contributions limit of $25,000.

Note that from 1 July 2012, the annual concessional contributions cap for those aged 50 and over is expected to revert from $50,000 to $25,000. The Government has also proposed to temporarily "pause" indexation of the cap so that it will remain fixed at $25,000 up to and including the 2013–14 financial year, meaning the cap is not expected to increase until 2014–15 year (when it is expected to increase to $30,000).

TIP: A taxpayer who realised a significant capital gain during the year should evaluate his or her eligibility to claim a deduction for personal superannuation contributions. If the taxpayer is eligible, he or she should consider contributing an amount of the capital gain to superannuation which may reduce the tax payable on the capital gain derived.

Valid notice to claim deduction

To be eligible for a deduction for a personal superannuation contribution, the individual must give a notice to the fund trustee or RSA provider of his or her intention to claim a deduction and must receive an acknowledgment of receipt of the notice: s 290-170 of ITAA 1997. The notice must be given by the time the person lodges his or her income tax return for the year in which the contribution is made or, if no return has been lodged by the end of the following income year, by the end of that following year.

A notice will not be valid where:

- the person is no longer a member of the fund (eg because the person's benefits have been paid to them or they have rolled over their benefits in full to another fund);
- the trustee no longer holds the contribution;
- the trustee has commenced an income stream based in whole or part on the contribution; or
- the taxpayer has made a spouse contributions-splitting application that has not been rejected.

If the member has chosen to roll over a part of the superannuation interest held by a fund, a valid deduction notice is limited to a proportion of the tax-free component of the superannuation interest that remains after the roll-over.

A valid notice cannot be withdrawn or revoked, but it may be varied so as to reduce the amount stated in relation to the contribution (including to nil). A notice of intent to vary a deduction cannot increase the amount to be claimed.

The ATO provides a "Notice of intent to claim or vary a deduction for personal super contributions" (NAT 71121.04.2008) form on its website: www.ato.gov.au/content/downloads/spr86434n71121.pdf.

- **STOP:** The ATO says it will only accept notices that include all of the mandatory information and the member declaration.
- **STOP:** Note that a deduction is not available in respect of any financing costs on a loan connected with a personal superannuation contribution.

Capital gains tax

A taxpayer may consider crystallising any unrealised capital gains and losses in order to improve his or her overall tax position for an income year. For example, if the taxpayer is anticipating a significant capital gain in an income year, consideration may be given to reducing the gain by crystallising a capital loss in the same income year. However, consideration must be given to the Commissioner's view on "wash sales" contained in Taxation Ruling TR 2008/1, particularly if a taxpayer reacquires the assets being disposed or identical assets, or somehow retains dominion or control over the original assets.

Small business CGT concessions

Broadly, the small business CGT provisions contained in Div 152 of ITAA 1997 provide a range of concessions in relation to a capital gain made on a CGT asset that has been used in a business, provided certain conditions are met.

There are two basic conditions that must be met for a capital gain made by a taxpayer to qualify for the small business concessions.

Firstly, the taxpayer must satisfy the "maximum net asset value" test or be a small business entity, or be a partner in a partnership that is a "small business entity" where the CGT asset is an interest in an asset of the partnership.

Secondly, the CGT asset that gives rise to the gain must be an "active asset". This can include shares or trust interests, subject to satisfying certain conditions.

The concessions are:

1. **the 15-year asset exemption:** a capital gain may be disregarded if the relevant CGT asset has been continuously owned by the taxpayer for at least 15 years. If the taxpayer is an individual, he or she must be at least 55 years of age and the CGT event must happen in connection with the taxpayer's retirement, or alternatively he or she must be permanently incapacitated at that time. If the taxpayer is a company or trust, a person who was a "significant individual" just before the CGT event must satisfy the requirements;
2. **the 50% reduction:** a capital gain resulting from a CGT event happening to an "active asset" of a small business may be reduced by 50%;

3. **the retirement exemption:** a taxpayer can choose to disregard all or part of a capital gain up to a lifetime maximum of $500,000; and
4. **the asset roll-over concession:** a taxpayer can disregard all or part of a capital gain if a replacement asset, which is an active asset, is acquired.

TIP: The 15-year exemption has priority over the other concessions because it provides a full exemption for the capital gain. In addition, the exemption is applied without first having to use prior year losses or the CGT discount.

TIP: The concessions do not apply to deny capital losses that a taxpayer has for an income year. That is, the taxpayer is still able to utilise any capital losses against any other capital gains for the income year.

TIP: The capital gain remaining after the 50% reduction may be further reduced by the retirement exemption and/or the asset roll-over concession, provided the gain qualifies for those concessions. Note that if the gain qualifies for both the retirement and roll-over concessions, the taxpayer can choose the order in which to apply them.

TIP: There is no age limit on using the retirement exemption, nor any requirement to retire. However, where an individual is under 55 at the time of choosing to apply the exemption, the amount chosen to be disregarded by the individual must be rolled over to a complying superannuation fund or an RSA. Further, any prior year losses and the CGT discount must be applied to a gain before the retirement exemption.

TIP: The concessions are available to the legal personal representative (LPR) or beneficiary of a deceased estate, a surviving joint tenant and the trustee of a testamentary trust provided: (a) the deceased would have qualified for the concessions just before his or her death; and (b) the CGT event that gives rise to the gain in the hands of the LPR or beneficiary occurs within two years of the deceased's death (or such further time as the Commissioner allows).

- **STOP:** Under the maximum net asset value test, the net value of all the CGT assets of the taxpayer, the taxpayer's “affiliates” and entities “connected with” the taxpayer (subject to certain exceptions) must not exceed $6 million. A debt owed to the taxpayer, affiliate or connected entity would be such a CGT asset and would, prima facie, be brought into account at its face value. However, some CGT assets are specifically excluded from the test eg shares in an affiliate: see s 152-20(2) of ITAA 1997.
- **STOP:** Consideration should be given to the integrity measures contained in the CGT regime: see ss 115-40 and 115-45, Div 149 and CGT event K6.

Roll-over relief

Roll-over relief is available to provide taxpayers with the option to defer the consequences of a CGT event. Apart from disregarding any capital gains or capital losses that would otherwise arise from a CGT event, a roll-over usually places the transferee under the rearrangement in the same CGT position that the transferor was in before the event occurred. Some types of roll-over relief will apply automatically while some will require taxpayers to elect the use of the roll-overs, which is indicated by the way their tax returns are prepared.

Two types of roll-overs are available: the replacement asset roll-over and the same asset roll-over. A replacement asset roll-over allows the deferral of a capital gain or loss until a later CGT event happens to the replacement asset. A same asset roll-over allows the deferral of a capital gain or loss arising from the disposal of the asset until the later disposal of the asset by the successor entity.

The table below sets out the common types of roll-over relief that may be considered for tax planning purposes:

Type of roll-over	Brief description	Election required
Roll-over from individual to company	Individual disposes of assets to a resident company	Yes
Roll-over from trust to company	Trustee of a trust disposes of assets to a resident company	Yes
Roll-over from partnership to company	Partnership disposes of assets to a wholly-owned resident company	Yes
Assets compulsorily acquired, lost or destroyed	Disposal of an asset by virtue of being compulsorily acquired, lost or destroyed	Yes
Fixed trust to company	Fixed trust disposes of all of its assets to a resident company	Yes
Marriage breakdown	Taxpayer disposes of assets to his or her spouse pursuant to an order of a court under the *Family Law Act 1975*	No
Small business replacement asset roll-over	Taxpayer who is eligible for the small business CGT concessions acquires a replacement asset or improves an existing asset	Yes

Companies

The tax treatment of companies will depend on their classification, ie whether a private company or a public company. For example, only a private company is subject to the operation of Div 7A of ITAA 1936. Companies are subject to a flat rate of tax (currently 30%) on the entirety of their taxable income. This rate applies whether the company is public, private, resident or non-resident.

- **STOP:** The Government has proposed to reduce the corporate tax rate for small business entities (with an aggregated turnover of less than $2 million in an income year) from 30% to 29% for the 2012–13 and subsequent income years, and for other entities for the 2013–14 and subsequent income years. At this stage, the amendments have not yet been introduced.

Dividends – benchmarking rule

Companies should ensure that all dividends paid to shareholders during the relevant franking period (generally the income year) are franked to the same extent to avoid breaching the benchmark rule.

If an entity to which the benchmark rule applies franks a distribution in breach of the benchmark rule (by either over-franking or under-franking the distribution), the recipient of the distribution will still be able to get the benefit of the franking credits attached to the distribution but a penalty (in the form of over-franking tax or a debit) will be imposed on the entity.

Loans and payments by private companies

Loans, payments and debts forgiven by private companies to their shareholders and associates of their shareholders may give rise to unfranked dividends that are assessable to the shareholders and associates. To minimise any adverse Div 7A consequences, taxpayers must consider the following:

- repaying private company loans by the earlier of the actual lodgment date or the due date for lodgment of the company's return for that year;
- ensuring a loan agreement is in place by the earlier of the actual lodgment date or the due date for lodgment of the company's return for that year;
- ensuring minimum repayments are made on loans from prior years;
- that a deemed dividend can only arise to the extent of a company's distributable surplus, so this issue needs to be considered along with planning opportunities;
- that payments under a guarantee can trigger a deemed dividend, which must be considered carefully;
- any exemptions available, which should be considered and used, if possible; and
- that a deemed dividend can also apply if property is provided, so companies should consider requiring shareholders to pay market value.

Section 109RB gives the Commissioner the discretion to disregard a dividend that would otherwise be deemed to arise under Div 7A, or to allow the company to frank a deemed dividend, where the failure to satisfy Div 7A is the result of an honest mistake or inadvertent omission. The meaning of these terms is considered in Taxation Ruling TR 2010/8. A request for the discretion must be lodged in writing.

➢ **STOP:** Practice Statement PS LA 2011/29 provides guidance for ATO staff exercising the discretion. The Practice Statement describes a two-step procedure, the first step being the identification of an honest mistake or inadvertent omission giving rise to a Div 7A deemed dividend, and the second step being the application of factors in s 109RB(3) to determine whether the discretion should be exercised. Potentially relevant matters include the sophistication of the taxpayer, corrective action (if any) taken by the taxpayer, the complexity of the Div 7A provisions at issue and whether the taxpayer should have sought professional advice.

Div 7A and "present legal obligations"

The ATO has replaced Taxation Determination TD 2008/28 with Draft TD 2012/D1 (yet to be finalised at the time of writing) and revised TD 2007/28 to broadly reflect the decision of the Full Federal Court in *FCT v H* (2010) 188 FCR 440. That case concerned when income tax and general interest charge (GIC) assessed by an amended assessment are "present legal obligations" for the purposes of calculating a company's net assets and distributable surplus.

The case involved a taxpayer who was a director and shareholder of a company. In 2004, the taxpayer made a voluntary disclosure of an arrangement whereby the company had understated its income. In addition, under the arrangement payments were made by the company to the taxpayer's bank account. The years in question were the income years ended 30 June 1999 to 30 June 2003. In 2007, the Commissioner issued amended assessments to the company for tax on the undeclared income plus

penalties and interest. At the same time, the ATO issued assessments to the taxpayer for deemed dividends pursuant to s 109C(1) of ITAA 1936 in respect of the payments made to him or on his behalf.

In calculating the company's distributable surplus for Div 7A purposes, the Commissioner did not subtract any amount of tax payable by the company under the amended assessments made in 2007 from its net assets because the tax payable under the amended assessments was not considered to be a present legal obligation of the company as at the end of the relevant income years. Similarly, the Commissioner did not subtract any amount of GIC in calculating the company's net assets.

The Full Federal Court dismissed the Commissioner's appeal from the earlier decision of the AAT and held that the obligation to pay tax at the amount that was subsequently properly ascertained, assessed and determined was a "present legal obligation" as at the end of the financial year in respect of which the income was derived. It also held that GIC becomes a "present legal obligation" on each day on which tax that should have been paid remains unpaid.

Tax consolidation

Companies may want to consider consolidating for tax purposes prior to year end to reduce compliance costs and take advantage of tax opportunities available as a result of the consolidated group being treated as a single entity for tax purposes. However, a careful analysis of an entity's circumstances should be undertaken prior to making such a decision.

- **STOP:** The Government has released the Board of Taxation's report into the consolidation rights to future income and residual tax cost setting rules. The Board had raised concerns with the Government that, due to uncertainty in the scope of the rules following amendments in 2010, tax deductibility may be argued for types of assets that were not contemplated when the rules were introduced. The Government said there is some evidence that the rights to future income and residual tax cost setting rules "may have a substantially greater revenue impact than anticipated" and has proposed tax law changes that will depend on the time when the relevant acquisition took place (and this includes possible retrospective impacts). At the time of writing, draft legislation had not yet been released for public consultation.

Losses

The ATO has reported that it is seeing compliance issues when small-to-medium enterprises report losses and offset losses against income or capital gains. Common issues include:

- errors in the calculation of the loss amount reported in the tax return;
- incorrect classification of the loss on either revenue or capital account; and
- limited awareness of the requirement to satisfy the continuity of ownership test and same business test when using a carried forward loss against income or capital gains.

Trusts

The provisions governing trusts, including those that govern in whose hands trust income is assessed and the amount assessed, is complex. A good starting point is always the trust deed. This is because the deed governs the operation of the trust.

Trust deeds

Taxpayers should review trust deeds to determine how trust income is defined, eg whether capital gains are included or whether trust income is equated with taxable income. This may have an impact on the trustee's tax planning.

Income of a trust estate

The existence or absence of a beneficiary's present entitlement to "income of the trust estate" is used in Div 6 to determine the liability of the beneficiary or the trustee, in a particular income year, to tax on the "net income of the trust estate". Although the term "net income of the trust estate" is defined in s 95, the term "income of the trust estate" is not defined in the ITAA 1936 and there remains some uncertainty as to its meaning. Note that the Government has committed to redrafting the trust income tax laws, partly to better align the concept of "income of the trust estate" with "net income of the trust estate".

In *FCT v Bamford* (2010) 240 CLR 481, the trust deed permitted the trustee to determine that a capital gain should be treated as income of the trust estate. For the 2001–02 income year, the trustee made such a determination and distributed equal shares of a capital gain to Mr and Mrs Bamford. The Commissioner argued that the capital gain, by its nature, was not "income of the trust estate". The High Court held that the term "income of the trust estate" took its meaning from "the general law of trusts, but adapted to the operation of the 1936 Act upon distinct years of income". The High Court noted that "income", under the general law of trusts, can include a capital gain. Therefore, in *Bamford*, the "income of the trust estate" included a capital gain treated by the trustee as distributable income in accordance with the terms of the trust deed. In contrast, capital gains were found not to be part of the income of a trust estate in *Colonial First State Investments Ltd v FCT* (2011) 192 FCR 298. The basis for this decision was that there was no provision in the constitution of the trust that permitted the trustee to treat capital gains as income of the trust estate.

The ATO now accepts that a provision of a trust instrument, or a trustee acting in accordance with a trust instrument, may treat the whole or part of a receipt as income of a period and it will thereby constitute "income of a trust estate" for the purposes of s 97: see the ATO's Decision Impact Statement on the *Bamford* case and Practice Statement PS LA 2010/1. However, the ATO considers that the *Bamford* case has not resolved "the effect of a recharacterisation clause that requires or permits a trustee to treat as capital what is otherwise received as income".

Tax returns for the 2009–10 income year and previous income years that were prepared on the basis of an interpretation of the law that was reasonably open prior to the *Bamford* litigation will not be disturbed unless there has been a deliberate attempt to exploit Div 6 or there is a dispute for some other reason: see Practice Statement PS LA 2010/1.

Note that the ATO has recently issued draft Taxation Ruling TR 2012/D1 which outlines the ATO's views on the meaning of the expression "income of the trust estate" as used in Div 6 and related provisions. The draft Ruling says there is no set or static meaning of the expression "income of the trust estate" as used in Div 6 and the meaning in the case of a particular trust will depend principally on the terms of that trust and the general law of trusts. Following *Bamford*, the ATO says it considers that "it is clear that the determination of the income of a trust is grounded in trust law and generally involves a focus on the receipts and outgoings for an income year". Further, the ATO says the statutory context in which the expression is used may also influence its meaning.

TIP: Taxpayers should avoid retaining income in a trust because it may be taxed in the hands of the trustee at the top marginal tax rate of 46.5%.

Pending changes relating to trust income

Following the High Court's decision in *Bamford*, the Government announced that it will update and rewrite Australia's trust taxation laws.

In December 2010, the Government released a Treasury consultation paper that explores the current issues impeding the effective operation of Div 6 as well as those hampering the effective taxation of trusts more broadly. The paper also outlines a number of options for reform, ranging from minor changes to the current operation of Div 6 to the introduction of a new model for the taxation of trust income.

The Government considers that, where used appropriately, trusts are a legitimate structure through which Australians should be able to conduct their personal and business affairs. The Government says that any options for reform would be developed within the broad policy framework currently applying to the taxation of trust income. That is, the taxable income of a trust will continue to be assessed primarily to beneficiaries, with trustees being assessed to the extent that amounts of taxable income are not otherwise assessable to beneficiaries.

The Government has also indicated that it intends to issue a separate Treasury discussion paper for public consultation on the appropriateness of the current definition of "fixed trust".

The Government has provided an indicative target start date of 1 July 2013. However, it warned that actual timeframes will depend on the scope of its review and on broader government priorities.

Trusts and Div 7A

Taxation Ruling TR 2010/3 sets out the Commissioner's view regarding whether a private company with an unpaid present entitlement (UPE) from an associated trust results in a loan by the corporate beneficiary to the trust.

If this contention is correct then the "loan" by the company to the trust would come within the "ordinary" provisions of Div 7A and, unless there was a specific exclusion (such as the loan being recorded in a written agreement under s 109N of ITAA 1936), the amount of the loan would be deemed to be a dividend to the trust by the associated private company.

UPEs for 2009 and prior years

For the 2009 and prior tax years, any existing UPEs may be quarantined unless the UPE is classified as an "ordinary loan", in which case the standard Div 7A rules would apply. Such a loan would then be treated as a deemed dividend, unless a specific exclusion applied.

If the loan is considered to be an ordinary loan, the ATO could amend up to four prior years' tax returns.

The ATO considers a UPE to be an "ordinary loan" where any of the following apply:

- both the company and the trust have recorded the transaction as a loan;
- the company has agreed to lend the UPE back to the trust; or
- the trust deed provides for the conversion of the UPE to a loan.

It is noted that a mere acquiescence by the corporate beneficiary to ask for payment of their UPE does not in itself amount to an "ordinary" loan.

What does this mean for UPEs?

For the 2010 and later tax years, and assuming that a sub-trust with specific investments has not been created, the UPE will be considered a loan, in which case Subdiv EA of Div 7A will have no application to loans made by the trust to either the shareholders or associates of the shareholder.

Where the UPE is in fact a loan, the trust will need to either:

- pay the UPE to the corporate beneficiary by company's due date for lodgment in respect of the year of income in which the UPE arises; or
- enter into a written loan agreement in respect of the UPE by the company's lodgment date.

Guidance on the administration of the Ruling is contained in Practice Statement Law Administration PS LA 2010/4. Note the ATO has also issued a supplementary guide which should be read in conjunction with the Ruling and PS LA 2010/4. This guide is available on the ATO website: www.ato.gov.au/businesses/content.aspx?doc=/content/00283451.htm.

TFN withholding rules for closely held trusts

The tax file number (TFN) withholding arrangements have been extended to closely held trusts (except were specifically excluded). However, withholding does not apply if the beneficiaries of closely held trusts quote their TFN to the trustees of such trusts: s 202DO of ITAA 1936.

The amount to be withheld is equal to the top marginal rate plus Medicare levy (ie 46.5%). There are also reporting and payment requirements for trustees of trusts subject to the rules. The purpose of the measure is to encourage beneficiaries to quote their TFN to the trustees of such trusts, which will in turn enable the ATO to use the TFN information to match amounts reported by trustees and amounts reported in beneficiaries' tax returns.

Family trust election

Trustees should consider whether a family trust election (FTE) is required to ensure any losses or bad debts incurred by the company will be deductible and to ensure that franking credits will be available to beneficiaries. Similar considerations can apply for companies owned by trusts.

If an FTE has been made, trusts should avoid distributing outside the family group in order to avoid the family trust distribution tax.

Small business entities

Under the small business entity regime, a taxpayer does not need to elect to enter into the regime. Instead, it will be apparent from a small business entity's tax return whether it has used the tax concessions.

Concessions available

The tax concessions available to small business entities (subject to any additional criteria set out in the particular concessions themselves) include:

- capital allowance concessions – an immediate deduction for depreciating assets costing less than $6,500 (up from $1,000) and one general small business depreciation pool from the 2012–13 year;
- instant tax write-off for the first $5,000 of the cost of eligible motor vehicles purchased in the 2012–13 or later income years (which effectively replaces the entrepreneurs' tax offset);
- simpler trading stock rules – being allowed to ignore the difference between the opening and closing value of trading stock (up to $5,000);
- small business CGT concessions – the CGT 15-year exemption, CGT 50% active asset reduction, CGT retirement exemption and CGT roll-over;

- the prepaid expenses rules;
- the use of the gross domestic product (GDP)-adjusted notional tax method to work out PAYG instalments;
- the FBT car parking exemption;
- GST concessions – the choice to account for GST on a cash basis, apportion GST input tax credits annually and pay GST by instalments; and
- the two-year period of review.

Definition of a small business entity

An entity will be classified as a small business entity for an income year if:

- it is carrying on a business in the current year; and
- it had an aggregated turnover for the previous year of less than $2 million or an aggregated turnover for the current year that is likely to be less than $2 million.

The aggregated turnover is the annual turnover of the entity's business plus the annual turnover of any businesses that the entity is connected to or affiliated with.

An "affiliate" is an individual or company that acts, or could reasonably be expected to act, in accordance with the directions or wishes of the taxpayer or in concert with the taxpayer in relation to the affairs of the business of the individual or company: s 328-130(1).

An entity is "connected" with another entity if: (a) one of the entities "controls" the other entity; or (b) if the two entities are "controlled" by the same third entity, in which case all three entities will be connected:
s 328-125(1).

- **STOP:** A person who is a partner in a partnership in an income year is not, in his or her capacity as a partner, a small business entity for the income year: s 328-110.
- **STOP:** The Government has released draft legislation proposing to amend the connected entity test so that it is based on ownership of interests rather than beneficial ownership of interests. If enacted, the small business concessions would apply to structures involving trusts, life insurance companies and superannuation funds in the same way as they apply to structures involving other types of entities. These changes are proposed to apply to CGT events happening after 7:30pm (AEST) on 10 May 2011. These proposed amendments have not yet been introduced into Parliament.

Personal services income

Broadly, the personal services income (PSI) rules attribute income derived by an interposed entity to the individual providing services to the entity. This is achieved by "forcing" individuals to include the income generated by their personal skill or efforts in their personal tax returns. The deductions of a taxpayer who receives PSI are, generally, limited to the amount that he or she would be entitled to deduct if they had received the income as an employee.

However, the PSI rules do not apply to individuals or interposed entities if one of the required personal services business (PSB) tests is satisfied. These are the results test, unrelated clients test, employment test and business premises test. The primary test to be applied is the results test. If this test is met, there is no further requirement to self-assess against the other tests and the PSI rules do not apply. Taxation Ruling TR 2001/8 provides the ATO's interpretation of the results test. The Ruling states that the results test is based on the traditional criteria for distinguishing independent contractors from employees.

In addition, the Commissioner has the power to grant a determination which has the effect of exempting a PSB from the PSI regime. Generally, a determination will be granted if unusual circumstances existed that prevented the business from satisfying the tests or the business would have had, but for the unusual circumstances, two or more unrelated clients in the current income year.

TIP: The ATO has released a personal services business self-assessment checklist: www.ato.gov.au/businesses/content.aspx?doc=/content/14895.htm

- **STOP:** If a taxpayer fails the results test **and** the 80% rule in an income year, the taxpayer is not permitted to self-assess against the remaining tests. The PSI rules will apply unless a PSB determination is obtained from the ATO.

General anti-avoidance and PSB

It is a common misconception that income earned by a PSB is income from a business structure. The income derived by a PSB is still categorised as PSI for income tax purposes if it is income that is mainly a reward for an individual's personal efforts or skills. Therefore, the income (as distinct from income from a business structure) that is derived by the PSB may be subject to the application of Pt IVA, if the income is:

- split with an associate;
- split with another entity associated with the individual; or
- retained in a company and taxed at the lower company tax rate.

However, remuneration paid to an associate (or service trust) for bona fide services related to the earning of PSI will not attract the application of Pt IVA if the amount is reasonable.

The ATO has stated that Pt IVA will not apply in the following situations:

The PSB is conducted through:	Situation
a company	There is no income splitting and no retention of profits in the company.
	If there is a bona fide attempt to break even, a relatively small amount of taxable income may be returned by the company, provided that income is distributed to the individual by way of a franked dividend in the following year.

a trust	If the trustee is a corporate trustee, the situations are the same as for a company.
a partnership	If a partnership's income results from the services of employees or the use of income-producing assets.

TIP: A partnership with a spouse will not attract the operation of Pt IVA if it is a genuine partnership.

Superannuation

Superannuation should not necessarily be viewed as a year end planning matter but rather as a long-term retirement savings approach. However, it is worth reflecting on the various concessions and deductions available under the superannuation system that may impact on the tax position of a taxpayer.

Excess contributions tax

The ATO has reminded taxpayers to consider the superannuation contributions caps when their planning tax affairs in order to avoid excess contributions tax. Some of the factors taxpayers should consider include:

- triggering of the "bring-forward" provisions in relation to the non-concessional contributions cap;
- any changes in personal circumstances, including pay rises that may alter the amount of concessional contributions made into superannuation;
- the amount of employer-paid costs such as administration fees and insurance premiums that may count towards the concessional contributions cap; and
- the age of the taxpayer.

➢ **STOP:** Note the bring-forward provisions do not apply to individuals over 65 years of age.

Timing

The ATO has further emphasised that the timing of when a fund actually receives a contribution is crucial in determining which year the contribution falls into for cap purposes.

TIP: Avoid transferring funds into superannuation via electronic funds transfer at the "last minute". Note for example that 30 June 2012 falls on a Saturday and funds that are transferred on this day may not be credited to the fund until the next business day, Monday 2 July 2012. In that case, the amount will count towards the next financial year. Note that the Commissioner's practice is to deem the contribution as having been made "when the funds are credited to the superannuation provider's account" (paragraph 13 of Taxation Ruling TR 2010/1). In addition, when posting cheques to a fund via mail, individuals should ensure there is enough time for the fund to receive the cheque within the relevant financial year.

TIP: Review salary sacrifice arrangements with employer(s) and identify the timing of superannuation payments relating to wages accrued for the June quarter (or June month). Note that the Administrative Appeals Tribunal has consistently held that the "timing difference" between when an employee accrues

a superannuation entitlement and when the employer is required to pay the contribution for superannuation guarantee purposes (ie within 28 days after the end of the relevant quarter) is not a “special circumstance” to enliven the Commissioner’s discretion to disregard or reallocate amounts (see below).

Commissioner's discretion

A taxpayer who has contributed above his or her concessional or non-concessional contributions cap can apply to the Commissioner to disregard or reallocate excess contributions for a financial year: s 292-465 of ITAA 1997. An application must be made in the approved form within 60 days of receiving an excess contributions tax assessment (or a longer period allowed by the Commissioner).

The Commissioner can only exercise his discretion to make a determination if “special circumstances” exist and the making of a determination is consistent with the object of the legislation: s 292-465(3). “Special circumstances” are not defined in the legislation but would generally only exist in situations that are “unusual, uncommon or exceptional”, or if the strict application of the law would give rise to an ”unjust, unreasonable or inappropriate result”.

It should be noted the discretion is not easy to obtain. Guidance on when the Commissioner may exercise the discretion is contained in Practice Statement Law Administration PS LA 2008/1.

A determination under s 292-465 is not reviewable under the *Administrative Decisions (Judicial Review) Act 1977*. Instead, a taxpayer who is dissatisfied with a determination may object against the relevant assessment: s 292-465(9).

- **STOP:** Note that the Government has proposed that eligible individuals who breach the concessional contributions cap by up to $10,000 will be allowed a once-only option for the excess contributions to be refunded without penalty. The refund option will not apply to excess non-concessional contributions above the $150,000 annual limit. Legislation has been introduced into Parliament and at the time of writing was before the House of Representatives.
- **STOP:** The Government has also introduced legislation (also before the House of Representatives at the time of writing) to temporarily pause the indexation of the superannuation concessional contributions cap so that it will remain fixed at $25,000 up to and including the 2013–14 financial year.

TIP: Some commentators have raised concerns as to how the proposed once-only option to refund excess concessional contributions up to $10,000 would interact with the freezing of the concessional contributions cap, arguing the changes may only exacerbate the number of taxpayers who inadvertently breach the $25,000 cap. Therefore, it is important to review salary sacrificing arrangements, transition to retirement pensions and deductible personal superannuation contributions, which are only tax-effective where an individual is within his or her concessional contributions cap.

Pending developments

The Government proposes that, from 1 July 2012, only those aged over 50 with superannuation balances of less than $500,000 will have a $50,000 concessional cap. Individuals with more than $500,000 in superannuation will be limited to a $25,000 concessional cap. At the time of writing, the Government’s proposal was still at the consultative stage.

Superannuation splitting

A member of an accumulation fund (or a member whose benefits include an accumulation interest in a defined benefit fund) is able to split with his or her spouse superannuation contributions made from 1

January 2006. The spouse contributions splitting regime also covers employer contributions to untaxed superannuation schemes and exempt public sector superannuation schemes.

While the relevance of spouse contributions splitting has been reduced following the abolition of reasonable benefit limits and the end of benefits tax for those aged 60 and over, splitting contributions between spouses can still be a useful strategy to effectively transfer concessional contributions to the older spouse who will reach age 60 (and therefore tax-free benefit status) first. In addition, contributions splitting may be relevant to access two low rate cap thresholds for superannuation benefits taken before age 60. However, it is not possible to split “untaxed splittable contributions” (eg non-concessional contributions) made after 5 April 2007. Contributions splitting may also enable some taxpayers to keep their total superannuation balances below $500,000 to access the proposed extension of the concessional contributions limit to $50,000 from 30 June 2012 (but take note of the comments above).

Importantly, it is not mandatory for a superannuation fund to offer a contributions splitting service for its members. However, a trustee that accepts a valid application must roll over, transfer or allot the amount of benefits in favour of the receiving spouse within 90 days after receiving the application.

Tax treatment

A member’s contribution that is split and paid to another fund is considered a “contributions splitting superannuation benefit” and is treated as a roll-over superannuation benefit for the receiving spouse. As such, the contributions splitting amount rolled over or transferred for the benefit of the member’s spouse is not subject to the 15% contributions tax in the hands of the fund.

If a contributions splitting superannuation benefit is transferred to an account within the same fund and paid to a taxpayer because his or her spouse is a member of the superannuation fund, the receiving spouse is deemed by s 307-5(6) to be the member of the fund for the purposes of the tax treatment of the superannuation benefit.

At the benefit payment stage, a contributions splitting superannuation benefit is deemed to consist entirely of a taxable component of a superannuation benefit: s 307-140.

A person who is entitled to a tax deduction for a personal superannuation contribution under Subdiv 290-C of ITAA 1997 and who wants to split personal contributions and claim a deduction must provide a notice under s 290-170 of ITAA 1997 to his or her superannuation fund before requesting the fund to split the contributions. Once a contribution has been split, a self-employed person is not able to make a new s 290-170 election to claim a deduction or amend an existing election in respect of the split amount: s 290-170(2)(d) of ITAA 1997 and reg 290-170.01 of the *Income Tax Assessment Regulations 1997*. (*See* **Valid notice to claim deduction** on page 12.)

Spouse contributions tax offset

A tax offset of up to $540 is available under s 290-230 of ITAA 1997 for a resident taxpayer in respect of eligible contributions made by the taxpayer to a complying superannuation fund or a retirement savings account for the purpose of providing superannuation benefits for the taxpayer’s low-income or non-working resident spouse (including a de facto spouse).

A taxpayer is entitled to the spouse contributions tax offset only if:

- the contribution is made on behalf of a person who was the taxpayer’s spouse when the contribution was made;

- both the taxpayer and the spouse were Australian residents and were not living separately and apart on a permanent basis when the contribution was made;
- the total of the spouse's assessable income, reportable fringe benefits and reportable employer superannuation contributions is less than $13,800;
- the taxpayer cannot and has not deducted an amount for the spouse contribution as an employer contribution under s 290-60 of ITAA 1997; and
- if the contribution is made to a superannuation fund, it must be a complying superannuation fund for the income year in which the contribution is made.

If the spouse in respect of whom the contribution is made is age 65 or over, the contribution cannot be accepted by the fund unless the spouse satisfies the requisite work test. Likewise, a regulated superannuation fund is not able to accept contributions on behalf of a spouse aged 70 to 74.

Spouse's income test and limit on amount of tax offset

The total assessable income, reportable fringe benefits and reportable employer superannuation contributions of the spouse must be less than $10,801 in order to obtain the maximum tax offset of $540 and less than $13,800 to obtain a partial tax offset.

The taxpayer's own assessable or taxable income, and whether he or she qualifies for a deduction or tax offset for any superannuation contributions made on his or her behalf, is irrelevant to determining entitlement to the rebate. Similarly, whether the spouse has any other superannuation is also irrelevant.

There is no limit on the amount of the actual contributions that can be made on behalf of the spouse, merely a $3,000 limit on the contributions for which a tax offset can be obtained. If less than $3,000 is contributed, the tax offset is 18% of the actual amount of the contributions. If the sum of assessable income, reportable fringe benefits and reportable employer superannuation contributions (if any) of the spouse is greater than $10,800, the $3,000 maximum contributions subject to the tax offset is reduced by $1 for each dollar of assessable income, reportable fringe benefits and reportable employer superannuation contributions in excess of $10,800 and an 18% tax offset applies on actual contributions up to this maximum.

Transition to retirement pensions

Broadly, a transition to retirement pension (TRP) allows a taxpayer who has reached preservation age to access his or her superannuation benefits by commencing a non-commutable pension or annuity without having to retire permanently from the workforce. At the same time, an individual can salary sacrifice employment income back into retirement savings. However, the pension cannot be cashed or commuted to a lump sum while the taxpayer is still working unless a condition of release with a "nil" cashing restriction has been satisfied (eg attaining age 65). All superannuation funds, including self-managed superannuation funds, are able to offer such a product to their members, provided the fund's deed allows it.

A TRP can take the form of a non-commutable account-based pension but has a maximum annual payment limit of 10%. Both the minimum and maximum annual payment amounts are calculated according to the "account balance" under Sch 7 of the *Superannuation Industry (Supervision)*

Regulations 1994 (SIS Regs). Further, the minimum annual payment amount is determined by the age of the taxpayer at the start of each financial year.

Therefore, it is necessary to decide how much superannuation capital needs to be set aside to guarantee a TRP within the minimum/maximum annual payment limits. Due consideration must also be given to the make-up of the taxable and/or non-taxable components of the pension because that composition will impact the tax treatment of a pension received by a taxpayer aged under 60.

- **STOP:** Note that it will not be possible to receive a pension (including a transition to retirement pension) from a MySuper product from 1 July 2013. As such, a MySuper member will need to switch to a separate choice product before commencing a transition to retirement pension.

Tax treatment

A TRP paid from a taxed source to an individual aged 60 or over is totally tax-free, ie non-assessable, non-exempt (NANE) income. As such, it is not counted in working out the tax payable on any other assessable income of the individual.

Conversely, if an individual is under age 60, the "taxable component" of a TRP paid from a taxable source is included in the individual's assessable income. Where the individual is above his or her preservation age (but below age 60) a tax offset equal to 15% of the taxable component of the pension payment is available.

The tax-free component of a TRP paid from a taxed source is tax-free, regardless of an individual's age.

Salary sacrifice and TRP

One advantage of a TRP is that, instead of employment income being taxed at an individual's marginal rate, the salary sacrifice superannuation contributions are only taxed at the rate of 15% on entry into the superannuation fund. This, generally, results in less overall tax being paid on the pension income (as compared to employment income). However, it is important to note that the amount available for salary sacrificing is effectively restricted by the annual concessional contributions cap, which is determined by reference to the individual's age. (See the discussion about the cap in **Pending developments** on page 20.)

Another advantage of a TRP is the income tax exemption available to superannuation funds in respect of income derived from assets that are segregated to support a fund's current pension liabilities.

Government co-contribution

Eligible low-income earners (including self-employed persons) may qualify for a government superannuation co-contribution payment. The amount of co-contribution is equal to 100% of the sum of eligible personal superannuation contributions up to a maximum of $1,000 per annum for a $1,000 personal contribution.

The Government proposes, from 1 July 2012, to reduce the matching rate to 100% from 50% with a maximum co-contribution of $500 (down from $1,000) for individuals with total incomes up to $31,920 in 2012–13 (and phasing down for incomes up to $46,920). Legislation to give effect to this measure has not yet been introduced.

For the 2011–12 income year, the maximum co-contribution ($1,000) is available to qualifying individuals whose total income for the year does not exceed the lower income threshold of $31,920. The maximum co-contribution is reduced by 3.333 cents for each dollar that an individual's total income exceeds $31,920 for 2011–12. The co-contribution ceases to be available once the individual's total income reaches the upper income threshold of $61,920 for 2011–12. From 2012–13, the Government has proposed to reduce the upper income threshold to $46,920. Note that the Government has announced that indexation of the co-contribution income thresholds, which have been frozen for 2010–11 and 2011–12, will also be frozen for 2012–13.

For the purposes of determining the amount of co-contribution payable, a person's total income for an income year is reduced by amounts for which the person is entitled to a deduction as a result of carrying on a business. These deductions do not include work-related employee deductions or deductions that are available to eligible individuals (including the self-employed) for their personal superannuation contributions. However, for the purposes of determining eligibility for the co-contribution and whether an individual satisfies the 10% test, total income is not reduced by the deductions that result from carrying on a business.

To qualify for a government co-contribution, a person must:

- have made one or more eligible personal superannuation contributions during the income year for which no deduction has been allowed to a complying superannuation fund or retirement savings account. The contribution must be made to obtain superannuation benefits for the person making the contribution or, in the event of the person's death, his or her dependants;

- have at least 10% of their total income for the income year from carrying on a business (ie they are self-employed) or attributable to activities that result in the person being treated as an "employee" for superannuation guarantee purposes, or a combination of both;

- have a total income for the year that does not exceed $61,920 for 2011–12. Total income is the sum of assessable income, reportable fringe benefits and reportable employer superannuation contributions;

- be aged under 71 on 30 June of the year in which the contributions are made. For persons aged 65 to 70, the additional work test rules (ie gainful employment for at least 40 hours in a period of not more than 30 consecutive days in the financial year in which the contribution is made) must also be satisfied in order for a complying superannuation fund or retirement savings account to accept contributions;

- lodge an income tax return for the year; and

- not have held a temporary resident visa (except for New Zealand citizens and other prescribed exceptions) during the income year.

TIP: From 1 July 2012, the Government will also provide a low-income superannuation contribution of up to $500 for concessional contributions made by individuals with adjusted taxable incomes of up to $37,000.

Reportable employer superannuation contributions

It should be noted that since from 1 July 2009, reportable employer superannuation contributions have been counted towards the maximum employee earnings limit for deducting personal contributions, the co-contribution income test, the low-income superannuation contribution and other income tests for various tax concessions and government assistance programs.

A reportable employer superannuation contribution is an amount contributed to a superannuation fund by an employer (or an associate of an employer) for the benefit of an employee (eg under a remuneration package), but only to the extent that the individual has or had, or might reasonably be expected to have or have had, the capacity to influence the size of the amount and/or the way the contribution is made (so that the employee's assessable income is reduced).

However, a contribution made by an employer that meets the employer's requirements under the superannuation guarantee scheme is not a reportable employer superannuation contribution, nor is a contribution made under an arm's length industrial agreement that the employee had no capacity to influence. In addition, a contribution is not a reportable employer superannuation contribution if the amount is included in the employee's assessable income (ie contributions made from "post-tax" income).

A person's reportable superannuation contributions are the sum of his or her "reportable employer superannuation contributions" and any deductible personal contributions for a financial year. Reportable superannuation contributions form part of a person's adjusted taxable income for various purposes including the Medicare levy surcharge (but not the Medicare levy), the pensioner tax offset and senior Australians tax offset, the spouse superannuation tax offset and the dependant tax offset.

Pensions – minimum annual payment amounts

Account-based pensions and annuities must meet the minimum payment rules set down in Sch 7 of the SIS Regs. The payment rules specify minimum annual limits only. The Government has extended the current drawdown relief to 2012–13. However, the minimum annual drawdown factors are expected to return to normal from 2013–14.

Minimum annual drawdown factors			
Age of beneficiary (years)	**Minimum annual drawdown for 2008–09, 2009–10 and 2010–11 (%)**	**Minimum annual drawdown for 2011–12 and 2012–13 (%)**	**Minimum annual drawdown for 2013–14+ (%)**

0 – 64	2	3	4
65 – 74	2.5	3.75	5
75 – 79	3	4.5	6
80 – 84	3.5	5.25	7
85 – 89	4.5	6.75	9
90 – 94	5.5	8.25	11
95+	7	10.5	14

FBT – car fringe benefits

The four rates used in the statutory formula method for determining the taxable value of car fringe benefits are being replaced with a single statutory rate of 20% for fringe benefits provided after 10 May 2011. Note that there is a three-year phase-in period.

TIP: For those with pre-existing commitments (ie contracts entered into prior to 10 May 2011), the old statutory rates will continue to apply. The commitments need to be financially binding on one or more of the parties. However, where there is a change to pre-existing commitments, the new rates will apply from the start of the following FBT year. Changes to pre-existing commitments include refinancing a car and altering the duration of an existing contract. Changing employers will cause the new rates to apply immediately for the new employer.

Statutory rates for "new contracts" entered into after 7:30pm AEST 10 May 2011 will be phased in as follows:

Kilometres travelled	From 10 May 2011	From 1 April 2012	From 1 April 2013	From 1 April 2014
Less than 15,000	20%	20%	20%	20%
15,000 – 24,999	20%	20%	20%	20%
25,000 – 40,000	14%	17%	20%	20%
Above 40,000	10%	13%	17%	20%

Individuals – some important tax considerations

Temporary flood levy

Individual taxpayers with a taxable income exceeding $50,000 in 2011–12 will have to pay an additional levy known as the temporary flood and cyclone reconstruction levy, unless they fall within an exempt class of individuals. The levy will be payable in 2011–12 only. Individuals with a taxable income in 2011–12 of $50,000 or less will not be liable to pay the levy. A trustee who is taxed on trust income instead of a beneficiary is liable to pay the levy.

The rate of the levy is as follows:

- if 2011–12 taxable income is between $50,001 and $100,000 – 0.5% on taxable income above $50,000; and
- if 2011–12 taxable income is $100,001 or more – 0.5% on taxable income between $50,001 and $100,000 and 1.0% on taxable income above $100,000.

Private health insurance incentive tiers

From 1 July 2012, the 30% private health insurance rebate will be means tested. Individuals earning more than $84,000, or families earning more than $168,000, will start to lose the rebate in the 2012–13 financial year. In the 2012–13 financial year, the rebate will only cut out completely for singles once they are earning more than $130,000 a year and for families once they are earning $260,000 or more.

In conjunction with this, and also from 1 July 2012, the rate of Medicare levy surcharge for individuals and families without private patient hospital cover may increase depending on their level of income.

Private health insurance incentive tiers from 1 July 2012 are as follows:

Tier	Income ($)		Private health insurance rebate			Medicare levy surcharge
	Singles	Families	Under 65 yrs old	65 – 69 yrs old	70 yrs or over	
	0–84,000	0–168,000	30%	35%	40%	nil
1	84,001–97,000	168,001–194,000	20%	25%	30%	1%
2	97,001–130,000	194,001–260,000	10%	15%	20%	1.25%
3	130,001+	260,001+	0%	0%	0%	1.5%

Note:

- For families with more than one dependent child, the relevant threshold is increased by $1,500 for each child after the first.
- In future years, the thresholds for singles will be indexed to average weekly ordinary time earnings and increased in $1,000 increments (rounding down). The thresholds for couples/families will be double the relevant thresholds for singles.

Dependent spouse tax offset

The Government is phasing out the dependent spouse tax offset. For 2011–12, the offset will only be available to those born on or before 1 July 1971. However, the provisions contain exceptions for dependent spouses who are unable to work due to invalidity or carer obligations, and for taxpayers who are eligible for the zone, overseas forces or overseas civilian tax offsets. The Government has proposed to further restrict the offset to those born on or before 1 July 1952 (with similar exceptions). The further restriction is proposed to apply to assessments for the 2012–13 income year and later income years.

FBT and living-away-from-home allowances

The Government has proposed that from 1 July 2012, living-away-from-home allowances will be taxed to the recipient as assessable income rather than to the employer under the FBT rules. It is proposed that employees who are permanent residents will be able to claim a tax deduction for the expenses

incurred for accommodation and food while living away from home, provided these can be substantiated. Temporary residents will also be able to claim a deduction for substantiated expenses, provided they maintain a home in Australia for their own use. At the time of writing, legislation had not yet been introduced into Parliament.

Paid paternity leave

The Government has introduced legislation to extend the Paid Parental Leave scheme by introducing a two-week "dad and partner pay". The proposed payment will be implemented from 1 January 2013. The payment will be available to eligible fathers and partners, including adopting parents and parents in same-sex couples, who are caring for a child born or adopted from 1 January 2013. The rate of pay will be the same weekly rate of pay as for existing parental leave pay (ie the national minimum wage, currently $590 a week before tax). At the time of writing, the legislation was before the House of Representatives.