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Client Information Newsletter - Tax & Super April 2014

Increased deductions for simply doing your tax

Most business owners know that they can claim a deduction for paying a registered tax agent to prepare and lodge their tax return. However many may not know that the regulations that provide for this deduction operate in a different way compared with other tax rules that allow expenses.

Why should taxpayers care which particular rule allows them to get a deduction for paying their accountant? Because in this case the specific regulations create unique opportunities for business owners, especially where their affairs involve multiple taxpayers.

What are the basics?

Before discussing how to use this rule to your advantage, let's look at the basics. If your tax agent issues you an invoice for a) managing a taxpayer's tax affairs, or b) complying with an obligation imposed on another taxpayer by a Commonwealth law (insofar as that obligation relates to the tax affairs of that entity), then, as long as the accountant is a registered tax or BAS agent (or legal practitioner) a deduction can generally be claimed by the person on the invoice. This rule is subject to a number of conditions (most of which are common sense, but more specific details on these conditions can be obtained from this office).

Don't I need to earn assessable income?

No — unlike most expenses that require a taxpayer to earn assessable income before they are able to make a claim, this type of expense can be claimed even where a taxpayer earns absolutely no assessable income. In other words, this type of expense can create a carried forward tax loss for an entity that can be offset against income from future financial years.

Tax affairs of another entity can be claimed?

That's right — where a taxpayer incurs an expense (that is invoiced) for the preparation and lodgement of a tax return or for managing the tax affairs of someone else, they can claim a deduction under this rule.

This might be useful where a spouse in a couple earns much more than the other spouse (and therefore is subject to a higher tax rate) because the higher income spouse can claim a deduction. This also becomes useful when an accountant invoices an individual taxpayer in relation to a business run within a company or trust. However, be wary that a super fund should not pay accounting fees for an individual because of the interaction with super regulations.

The bottom line is that a taxpayer is able to be flexible in terms of which entity in their group – be it an individual, trust, company or other taxpaying entity — is invoiced for managing the tax affairs of the group, and therefore which entity can claim a deduction for this type of expense. Talk to this office should you wish to pursue this potentially valuable strategy. ■

Contact Us

Welcome to Collison Accounting's client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us.

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Asset write-off & car depreciation reduction



Draft legislation closely tied to the repeal of the Minerals Resource Rent Tax (MRRT) has been cleared by the lower house of Parliament and if fully legislated, as is expected, it will mean the present instant tax write-off for "individual" assets costing less than $6,500 (GST exclusive) will be reduced back down to $1,000. This measure is proposed to apply retrospectively from January 1, 2014 once made law.

Plant and equipment

From July 1, 2012 small businesses (with a turnover of less than $2 million a year) that use a small business depreciation pool have been entitled to claim an immediate deduction for plant and equipment costing less than $6,500. The draft legislation that has cleared Parliament means that this immediate deduction is to reduce to $1,000 for all assets acquired after December 31, 2013.

To have been eligible for the higher $6,500 immediate deduction for the 2012-13 financial year, the asset must have been first used or installed ready for use, on or before the last day of 2013. This means you could not write off the asset if you had simply placed an order, or even if you had pre-paid expenditure to acquire the asset by the end of the year. The actual physical installation or taxable use of the asset determined whether you could write it off.

The $6,500 immediate deduction also applied to improvements that have been made to existing items of plant and equipment, but again provided that the cost of these improvements was incurred on or before the relevant year's end.

The changes to the law, if they are passed in their current form, will mean that for assets first used or installed ready for use from January 1 this year, only plant and equipment costing less than $1,000 will be able to be written off. An asset costing $1,000 (GST exclusive) or more will now need to be added to the small business depreciation pool, and depreciated at 15% in the year of acquisition, then 30% in subsequent years. So assets previously written off in full under this law will need to be depreciated over a number of years.

Motor vehicles

Also included in the legislation is the removal of the accelerated depreciation rules that apply to motor vehicles for relevant small businesses using pooling. As the rules stand now, a small business can claim up to $5,000 of the purchase price as an immediate deduction for a vehicle acquired on or after July 1, 2012. (Or, if the vehicle cost less than $6,500, the whole amount can be claimed as an immediate deduction under the above instant asset write-off provisions.) The balance of the purchase price is then added to the small business depreciation pool and depreciated at 15% in the year of acquisition, then 30% in subsequent years.

If the draft legislation is made law, the accelerated depreciation rules will only apply to motor vehicles purchased on or before the December 31, 2013. From January 1, vehicles will be treated like any other depreciable asset, meaning that if they cost $1,000 or more, the purchase price will need to be added to the small business depreciation pool and depreciated.

Cash flow

In any small business, cash flow is the number one concern. These measures essentially mean that a taxpayer must defer deductions to later income years where they wouldn't otherwise have had to do so.

Basically this means where a taxpayer has relevant capital expenditure (which is a burden on cash flow in and of itself), that taxpayer will no longer have the benefit of totally writing off the relevant assets against their income. Instead, they will have to depreciate over a number of years, which will mean more of their income will be subject to tax in the current income year (again adversely affecting cash flow). ■

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Thinking about setting up an SMSF? Read on

The superannuation and tax provisions offer incentives for Australians to save for their retirement. These savings may be handed over, typically to a public offer fund to manage on one's behalf, or they may be managed directly by you. Managing your own retirement savings however is a huge responsibility and one that should not be viewed lightly.

How you live and how comfortable your life will be when you're no longer earning an income will depend largely on your efforts of saving and the investment performance and management of your super fund. And while there is no greater way to take control of your retirement savings than setting up a self-managed superannuation fund (SMSF), this is not something that can be recommended for everyone.

The issue of SMSFs crops up fairly regularly in the media, and there are many SMSF-focused publications out there. For those who are interested in establishing an SMSF but do not currently have one, the following may provide some insight into managing such a fund.

There are strict rules and tangible risks to setting up an SMSF, but at the same time you can choose how to invest your fund's money and exercise full control while having greater flexibility over your investment choices. With an SMSF, you are responsible, you are the trustee of your own fund, you need to comply with the superannuation laws and regulations and you wear the consequences of all your investment and compliance decisions.

While SMSFs will be suited to many people, they are certainly not for everyone. The Tax Office asks all prospective SMSF trustees to consider the following aspects before deciding whether they should manage their own super:

1. Consider your options and seek professional advice

What many people do is invest their super by putting it into a large fund where it's pooled with the superannuation of other members and professionally managed by the trustees of the fund. If you set up an SMSF, you're very much in charge – you make the investment decisions for the fund and you are responsible for complying with the law. Another thing that larger APRA-regulated funds may have over SMSFs is a compensation scheme for fraud.

Deciding to take the SMSF route depends on your personal situation. Speak to this office or your professional adviser and do your due diligence before deciding.

Remember however, if you decide to establish an SMSF, you will be either an individual trustee of the fund or a director of a corporate trustee for the fund. We can provide information about the pros and cons of the different structures.

If you do decide to set up an SMSF, make sure it's for the right reason – saving for your retirement. Don't set up an SMSF to try and get early access to your super, or to buy a holiday home to use, or to acquire artworks to decorate your house. These actions do not comply with superannuation law, and the Tax Office considers them to be punishable offences.

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Changes to SMSF regime from July 1, 2014

There are some new rules being introduced after July 1 this year that will affect SMSF trustees:

- the SMSF registration and rollover process will be amended to reduce the instances of funds being illegally released from SMSFs
- proof of identity checks will be required for all people joining an SMSF, whether they are establishing a new fund or joining an existing fund – although note that identification measures will not apply retrospectively except for existing SMSFs wishing to organise rollovers from an APRA-regulated fund
- new penalties will be introduced to prevent illegal early release
- criminal and civil sanctions will be introduced for illegal early release scheme promoters, and
- amounts illegally released early will be taxed at the superannuation non-complying tax rate, with an additional penalty that takes into account the individual circumstances.

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Thinking about setting up an SMSF? (cont)



2. Make sure you have enough assets, time and skills

You will need enough assets, time and skills to:

- make investment decisions and formulate an investment strategy that you review regularly, and
- meet all your legal obligations as a trustee.

As an SMSF trustee, your main responsibility is to ensure you have invested your fund's money appropriately. You need to ask yourself:

- Am I a confident and knowledgeable investor?
- Will an SMSF do as well as or better than other super funds after I pay all the costs?

If you're not confident you can get a better result, you may be better off using other types of funds to provide for your retirement.

The cost of establishing and running an SMSF is contingent on the number of members in your fund (no more than four) and the complexity of the arrangements, the extent to which you make use of professional service firms (annual audit is compulsory), and how much of your own time you will have to spend running your fund. All SMSFs are also subject to an annual levy from the Tax Office, which is currently $259 for the 2013-14 financial year.

Time is another construct that is rarely talked about when considering SMSFs. It may take six to eight weeks or longer to set up an SMSF, depending on the institutions you are rolling your super from. Some of the steps involved in completing the setup of a new fund include applying for your fund's Australian Business Number (ABN) and tax file number (TFN), setting up a bank account for your fund, deciding on an investment strategy and keeping on top of administration.

The amount of time required to manage an SMSF differs from person to person. For instance, some trustees enjoy buying and selling shares, which requires frequent monitoring of the share market. Other trustees prefer to invest in assets that do not require such close attention, like investment properties. And remember, this office can always help you with the administrative tasks like record keeping, tax and your fund audit.

Don't forget – you will also be required to stay up-to-date with the superannuation and tax laws, as well as other issues that will affect your fund, such as changes in interest rates and market conditions.

3. Understand the risks and laws

Last but not least, think carefully about your investment options and how you plan to manage the associated risks. These include the objectives of the fund and considerations of the following:

- investment risk
- the age of members, and
- the impact of loss in the fund.

Avoid risking all your retirement savings in one or a few investments. By spreading your investments – in other words, diversifying – you can help control the total risk of your investment portfolio. But spreading your fund's risk means investing not just in different stocks or sectors but also across different asset classes. Depending on the investment strategy in place, investment options might include cash accounts, term deposits, managed funds, listed Australian and international shares, listed property and direct property. That way, if one or more investments perform poorly, others may help cover those losses.

Super funds, including SMSFs, receive significant tax concessions as an incentive for members to save for their retirement. However, you need to follow the tax and superannuation laws to receive these concessions. Effective from July 1, 2014, SMSF trustees can now be fined $1,700 for a breach of failing to keep adequate records, for instance. The penalties incurred by individual trustees for not complying with the law can be severe, refer to our article in last month's newsletter to read the lowdown.

One overriding obligation that every SMSF must meet is the "sole purpose test", which basically means that the fund is legally required to be maintained for the sole purpose of providing benefits to each member on retirement, or to their dependants upon the member's death. Buying a holiday home or yacht for use by your family is in breach of the "sole purpose test" and compliance with this provision is fundamental; straying from it can lead to severe penalties.

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Thinking about setting up an SMSF? (cont)

Another essential role of an SMSF trustee is to keep proper and accurate tax and superannuation records. It is always a good idea to take accurate minutes of all investment decisions, including why a particular investment was chosen and that all trustees agreed with the particular decision.

Additionally, you have a legal obligation to have your SMSF independently audited every year. The annual audit will require certain records to be made available, and you may also need to provide other records to the Tax Office to keep your fund compliant.

If you set up or join an SMSF, you will also need to consider having adequate insurance in case you pass away or are unable to work because of an illness or accident. As an SMSF trustee, you are required to consider insurance cover for fund members as part of the fund's investment strategy. However, it is not a requirement that such a policy be taken out. Life insurance can also be expensive compared to the large funds; they buy group policies that enable them to offer life insurance benefits for illness or accident at a relatively low cost.

If you decide to set up an SMSF, you're legally responsible for all the decisions made, even if you get professional advice. Typically, an SMSF is suited for those who want greater control, but are also able to actively manage their investments while keeping up with the mandatory regulatory and compliance obligations.

Contact this office to seek appropriate advice before taking the plunge. Being at the helm of an SMSF can be a very rewarding experience, and offers innumerable benefits – from tax savings and greater estate planning certainty to greater investment control and choices. Just be sure it is the option for you. ■

Lodgement deadline for R&D tax claim

Eligible businesses should be focusing on the preparation and registration of any research and development (R&D) tax incentive claims for the 2012-13 financial year, as the deadline for doing so (April 30, 2014) is fast approaching.

Registration of claims for the R&D tax incentive can take place up to 10 months after the financial year in which the R&D activities took place. R&D activities must meet certain criteria to be eligible for the tax incentive, and must be classified as either core R&D activities or supporting R&D activities (ask this office for more details about what these are and other eligibility criteria).

What does the tax incentive cover?

The R&D tax incentive is a government initiative that provides support via two available tax offsets to help businesses undertake R&D activities. The two components of the program are:

- a 45% refundable tax offset (equivalent to a 15c in the dollar benefit for a company) for eligible entities with an aggregated turnover of less than $20 million per annum, or
- a non-refundable 40% tax offset (equivalent to a 10c in the dollar benefit for a company) for all other eligible entities.

The R&D tax incentive has several business objectives. It aims to:

- boost competitiveness and improve productivity
- encourage the industry to conduct R&D that may not otherwise have occurred
- provide business with more predictable, less complex support, and
- improve the incentive for smaller firms to engage in R&D.

The incentive gives opportunity for businesses to develop:

- new knowledge, and/or
- new or improved products, devices, materials, services and/or processes.

Key eligible amounts that a company can take into account in calculating the offsets are referred to as "notional deductions" and a business must have notional deductions for an income year of at least $20,000 in order to make a claim.

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Lodgement deadline for R&D tax claim (cont)

Eligible costs may include:

- operating costs such as salaries, consumables and contractor costs
- plant and equipment, and the decline in value of these assets used for R&D activities
- expenditure incurred to an associate in an earlier income year, but paid in a current year (subject to some restrictions), and
- a partner's proportion of costs incurred, and relevant balancing adjustments.

The program is available across a broad range of sectors, including agriculture, biotechnology, manufacturing, mining and IT. The tax incentive can provide generous benefits for eligible R&D activities, and is jointly administered by AusIndustry (on behalf of Innovation Australia) and the Tax Office. Innovation Australia is primarily responsible for administering the technical eligibility and registration of R&D activities.

It is also possible to apply for an "advanced finding" on the work proposed. This can allow for certainty that the activity will be eligible for the offsets, and will lock the Tax Office into accepting the R&D claims for the following two income years. However businesses must lodge an application before the end of the financial year in which the R&D activity is conducted.

See this office for any assistance to make your R&D tax incentive claim. ■

Investment asset classes, sorted by tax flavour

The term "asset class" describes a set of investment options that are grouped into a similar area or type. The main asset classes are cash, fixed interest, property and shares. There is also a group of investment products that have tended to be labelled "alternative" as they don't readily fit into the parameters of the other asset classes.



The reason why it can be helpful to have an understanding of the different asset classes is that each has different levels of risk and return. Knowing what to expect can help you decide the type of investments that will suit your circumstances. You will also be able to judge your investments based on whether you prefer growth or income assets. The other thing people tend to overlook is how the different classes will be taxed, which is surprising because the after tax cash flow is perhaps a better measure for the return an investor can expect to earn.

Every investment carries an element of risk, and the main reason that people need to be confronted with risk is that it generally becomes inextricably linked to the level of return on any investment.

The trade-off between risk and return is well established – generally, the higher the risk an investor is able or willing to take, the higher the potential rewards. Put another way, if an investment offers huge returns, this can be an indication that it will come with higher risks. Conventional wisdom holds that reducing risk can be achieved through diversifying what you invest in. But where you invest will also be influenced by how long you are prepared to have your money tied up, your own view of that risk/reward trade-off, and your financial objectives.

Of the asset classes, cash and fixed interest both tend to be favoured by investors who are more risk averse, and who are willing to trade some potential earning power for increased security and more consistency of returns. Investment in the asset classes of property and shares have more scope to grow the capital base of your investments, but in doing so tend to be more variable in performance while offering greater potential returns.

Cash

Cash investments include bank deposits, bank bills and short-term government bonds. There is generally no capital growth, but regular interest payments and

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Investment asset classes, sorted by tax flavour (cont)

more stable, low-risk income. When official interest rates change, cash investment rates should move in the same direction. Your investment base (the original sum of money you invested) is also generally available at short notice.

Investors should however keep in mind that the lower rate of return will need to be above the inflation rate, otherwise the investment overall goes backwards. The interest income earned on these deposits is generally added to the assessable income of an investor when it is derived as ordinary income (that is, is received by the investor). This interest income is then taxed at the investor's tax rate.

Fixed interest

The slightly higher interest rates for such investments, which include bonds and term deposits, are due to the longer term nature of them. A bond, for example, can be viewed as a "loan" to an entity (corporate or government) that uses the money invested (for a defined period and for a fixed rate of return) to fund various projects and activities over months or even up to many years.

Fixed interest products can still be converted to cash very quickly, but the investor may forfeit some return for doing so. Unlike cash investments, official interest rate changes can have an inverse impact on the value of these investments. A rising rate for example will see bond prices move in the opposite direction (an investment offering 4% will be worth less once an alternative promising 4.5% becomes available). Also there will be no capital growth over the life of the investment. Much like cash, these type of investments are generally added to assessable income when received and subject to an investor's tax rate.

Property

This is not limited to tangible real estate such as houses or commercial buildings, but can include property trusts, which basically pool invested money together to buy into larger property assets. As a property can increase in value over the life of an investment, there is the real potential for capital growth. But equally there is no guarantee, and still the possibility that the value of properties can head south. As well, income returns may not be as predictable as cash or fixed interest, and will depend on aspects such as rental return, occupancy levels and the wider market conditions.

The rental return on these investments is generally added to assessable income much like cash and fixed interest investments. The expenses relating to the financing, maintenance and repair as well as occupancy of the property will generally be deductible and offset against the rental income to reduce it (and in some cases negate it completely, or even be deducted against other forms of income where deductible expenses exceed rental income).

The capital growth is generally subject to the CGT rules before it is added to income to be taxed. This means that generally for properties held over greater than 12 months, only 50% of the gain may be added to assessable income and taxed. Furthermore, certain costs of acquisition and disposal are taken into account to calculate a capital gain. The taxation of distributions from a trust can be complex and is best left to a qualified tax agent.

Shares

The fluctuation in the value of shares highlights the more volatile nature of this form of investment. Shares are easily traded, which makes them flexible, and this has also contributed to the historically higher returns that the sharemarket can offer – astute buying and selling can make (or break) the sharemarket investor.

International shares can offer even higher returns over time, but local shares can give additional tax benefits with regards to CGT and the dividend imputation system in effect in Australia. Investment in local shares is also free of currency fluctuation considerations.

Shares also potentially provide both income, through dividend payments, as well as capital growth (or loss) through changes in the value of the shares themselves. There is the potential to lose a great part of the initial money invested, but an equal potential to increase that underlying value several times. The share price itself will fluctuate depending on the conditions of the general economy as well as the performance of the particular company and the sector or industry it operates in.

Dividends that are unfranked are generally added to assessable income and taxed at an investor's tax rate. Franked dividends (which must come from a company that earns profit within Australia) are also added to assessable income (as are imputation credits attaching to them). However, an offset is generally available to investors equal to the franking credit received by the investor, which will reduce the tax payable for the investor. Depending upon whether an investor is in the business of share trading or simply investing passively, the CGT rules may also apply to capital gains and losses on shares.

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Investment asset classes, sorted by tax flavour (cont)

Alternative investments

There is really a fifth class of investment, but because of their nature these require a much deeper familiarity with financial tools and mechanisms. The alternative asset class includes investment in hedge funds, infrastructure bonds, fund-of-funds, commodities and futures, and derivative investments like contracts-for-difference and put and call options.

As these are very complex products that even challenge many hard-core Wall Street investors, they need to be approached with cautious enthusiasm. However used judiciously, and again because of their make-up, these alternative investments can also offer a diversification that will tend to produce lower returns in boom markets while having the potential for higher returns in down markets. As such, this is a diversification that of its nature can further even out the overall risk built in to your portfolio – which long-term can mean a smoother ride.

Alternative investments will more likely find a place in the portfolios of larger institutions or the big superannuation funds. The tax implications for these sort of investments can vary widely. ■

Did you know...

How highly taxed are Australians compared to other countries?

While many of us may feel that we're already paying enough to the taxman, recent Organisation for Economic Co-operation and Development (OECD) data reveals that Australia is in fact the fifth-lowest taxed nation of the 34 OECD member countries. (Statistics were taken from 2012 or the latest available year.)

Australian total tax revenue was measured by the OECD at 26.5% of national GDP. The USA is rated the third-lowest taxed nation at 24.3%. The lowest taxed is Mexico, at 19.6%. Higher taxed countries include Canada (30.7%) and Britain (35.2%), but the highest taxed OECD member country is Denmark, at 48.0% of that nation's GDP. The average tax take across all OECD countries is 34.6% of GDP. ■

Goods taken for private use – the latest values

The Tax Office has recently issued a tax determination to guide business owners on the value it expects will be allocated to goods taken from trading stock for private use for the 2013-14 income year. The table below should be used to work out these values.

The basis for determining values is the latest *Household Expenditure Survey* results issued by the Australian Bureau of Statistics, adjusted for CPI movements.

Note that the Tax Office recognises that greater or lesser values may be appropriate in particular cases, and you may be able to justify a lower value for goods taken from stock than that shown in the schedule. In that case the lower amount should be used.

And the Tax Office says that where the value of goods ex-stock would be significantly greater, the actual amount can be used, without sticking to the schedule. ■

Type of business	Amount (excluding GST) for adult/child over 16 years	Amount (excluding GST) for child 4-16 years
Bakery	$1,310	$655
Butcher	$780	$390
Restaurant/cafe (licensed)	$4,400	$1,705
Restaurant/cafe (unlicensed)	$3,410	$1,705
Caterer	$3,690	$1,845
Delicatessen	$3,410	$1,705
Fruiterer/greengrocer	$760	$380
Takeaway food shop	$3,300	$1,650
Mixed business (includes milk bar, general store and convenience store)	$4,070	$2,035

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