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Client Information Newsletter - Tax & Super August 2016



Gumboots? check. Akubra? check. Tax status?....

Hobby farming is a lifestyle choice that has been around for years and looks like an option that, if anything, is on the increase.

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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It can be easy to poke fun at the typical hobby farmer (like the old joke about their skills at growing blackberries and rabbits). For many the choice to embrace the rural idyll leads to a thirst for information about the taxation realities of owning a small country property.

It is true that small rural landholders may be pursuing "lifestyle" dividends rather than a genuine livelihood, but the option to claim the tax concessions for bona fide primary producers is still available, if eligible.

These extra tax concessions make securing "primary producer" status tempting — such as the three-year write-off for water facilities, deferral of profits in certain

Gumboots? Check. Akubra? Check. Tax status? ... *cont*

> Agistment is not considered by the ATO to be a business activity as the taxpayer is deriving passive income.

circumstances, and the ability to average income (ask us for more information).

Hobby farms can range from a modest block with a few cows and chooks to quite substantial small working farms capable of generating income for the erstwhile tree-changers. But owners require more than a ute with a kelpie in the back to be able to turn their small farm into a source of tax breaks.

In business or not?

The vital question to be settled is whether the small farm is indeed a "hobby", and therefore operates with no expectation of making a profit, or if it is run like a business.

If the latter, the land owner will be looking to make money from the farming operations, and needs to show they are carrying on a productive business, with sound business principles and commercial intention.

This is not to say they need to be making a lot of money, but to qualify as a business, certain factors need to be satisfied. There is a substantial body of case law that has considered whether a taxpayer is conducting a farming business, with some factors established that contribute to forming a conclusion. None of these factors are decisive on their own, and the ATO considers all of them in combination to determine an overall impression of the activity. The indicators the ATO considers relevant are listed in the table below.

Examining the factors

The "prospect of profit" is something that the ATO considers to be an important indicator when determining the status of whether the activities relate to a hobby farm or a genuine primary producing business.

For example, if it could be shown that a business plan has been drawn up, or that expert advice was sought from relevant authorities or experienced farmers or consultants in an area of primary production, then this may lead to the conclusion that the taxpayer has the intent of conducting a farming business.

Soil and water analysis could be undertaken to determine suitability for a particular agricultural use, which can be viewed as further evidence of commercial intent, as well as investigation of potential markets.

INDICATORS A BUSINESS IS BEING CARRIED ON	INDICATORS A BUSINESS IS NOT BEING CARRIED ON
Significant commercial activity	Not a significant commercial activity
Purpose and intention of the activity	No purpose or intention
Intention to make a profit	No intention to make a profit
The activity is or will be profitable	The activity is inherently unprofitable
Repetition and regularity of activity	Little repetition or regularity of activity
Activity is carried on in a similar manner to ordinary trade	Activity carried on in an ad-hoc manner
Activity organised and carried on in a business-like manner and records kept systematically	Activity not organised or carried on in a business-like manner - no records kept
Size and scale of the activity	Small size and scale
Not a hobby, recreation or sport	A hobby, recreation or sporting activity
A business plan exists	No business plan
Commercial sales of product	Sale of products to relatives and friends
Tax knowledge or skill	Lack of such knowledge

Gumboots? Check. Akubra? Check. Tax status? ... *cont*

Note however that agistment is not considered by the ATO to be a business activity as the taxpayer, in such cases, is deriving passive income from such activities. Contact this office if you need help with establishing whether your activities constitute a business.

Non-commercial losses

Typically these farming activities give rise to losses in the early stages before the business turns over a profit.

However under the tax law, losses from non-commercial business activities conducted by an individual can only be deductible against other income (such as salary and wages) in the same income year if the activity meets certain criteria, and the taxpayer has an "adjusted taxable income" of less than $250,000.

The activity must meet at least one of four criteria:

1. produce assessable income of at least $20,000 during the year
2. make a profit in three of the past five years (including the current year)
3. use land and buildings ("real" property) valued at $500,000 or more, or
4. use other assets (tractor, machinery, but not cars) valued at $100,000 or more.

Losses can be quarantined where none of the above criteria are met and used in a later year, with no time limit. Note however that the non-commercial loss rules do not extend to companies or trusts.

It's worth noting that primary production businesses, even if they don't meet the above criteria, can still offset losses if other taxable income is less than $40,000.

The ATO however maintains discretionary powers over these tax laws, so a small rural landholder can always apply for discretion if circumstances beyond their control unduly influence the financial outcomes in any income year. Contact our office if you believe you have a case. ■

ⓘ ATO'S KEY RESULTS IN 2014-15

- 17.7 million income tax returns lodged
- 89.2% of tax liabilities were paid on time
- 1,400 taxpayers (individuals and companies) were prosecuted for income tax matters
- 96 million transactions were available for pre-filling
- More than 650 million transactions were reported by third parties for data matching purposes
- 450,000 reviews and audits resulted in over $1.1 billion additional income tax
- More than 26,000 small businesses were reviewed, raising $910 million
- More than 9,400 compliance activities on privately owned and wealthy groups, raising over $2.1 billion in tax liabilities



Renting out part or all of your home

Generally, if you rent out part or all of your home, the rent money you receive is assessable. This means that you must declare your rental income in your income tax return, but you can also claim deductions for any associated expenses.

However, be warned. If you rent out part of your home, such as one room, you also may not be entitled to the full main residence exemption from capital gains tax (CGT). This means you will be required to pay CGT on part of any capital gain made when you sell your house.

Goods and services tax (GST) typically doesn't apply to residential rents, so you're not liable for GST on the rent you charge. However, you also can't claim GST credits for associated costs.

Income and expenses

If you rent out your home at normal commercial rates you will generally be able to claim tax deductions for associated expenses, such as the interest on your home loan. But if only part of your home is used to earn rent, the ATO generally only allows deductions for the part of your expenses that relate to the rental income. As a general guide, you should apportion expenses on a floor-area basis – that is, based on the area solely occupied by the tenant, together with a reasonable figure for their access to the other general living areas.

If you rent out part or all of your home at less than normal commercial rates – for example, to a relative – this may limit the deductions that will be allowed by the ATO. In fact, the deductions are capped at the amount of rental income returned.

Note that payments from a family member for board or lodging are considered to be domestic arrangements and are not considered to be rental income. In these situations, you also can't claim income tax deductions.

For situations involving non-commercial rental and renting to related parties, ask us for more information.

Capital gains and the main residence exemption

Generally, you don't pay CGT if you sell the home you live in (under the main residence exemption). However, if you have used any part of your home to produce income – for example, by renting out part or all of it – you are generally not entitled to the full CGT exemption.

To work out the capital gain that is not exempt, you need to take into account a number of factors, including:

- proportion of the floor area that is set aside to produce income
- period you use it for this purpose
- whether you're eligible for the "absence rule" where you treat a dwelling as your main residence after you move out (ask us for more information if this is the case), and
- whether it was first used to produce income after 20 August 1996 – there is a special market value rule which could impact on the cost of the dwelling for CGT purposes.

Ask us if you need assistance to work out the proportion of your capital gain that is exempt from CGT. ■

Information provided is of a general nature only, is not personal financial or investment advice, and we accept no responsibility for persons acting on information contained herein. Clients should not act solely on the basis of material contained in this document. We recommend that our formal advice be obtained before acting on the basis of the topics presented here. Liability limited by a scheme approved under professional standards legislation.



SMSF trustee with the travel bug? How to keep your fund compliant

Are you the trustee of an SMSF but also a travel aficionado? Nothing wrong with that; however trustees need to be aware that there can be negative consequences if you are out of the country for too long.

If a trustee relocates overseas for an extended period, the residency status of the SMSF, its compliance status and its ability to receive tax concessions may be affected. Trustees will need to put strategies in place to avoid their SMSF becoming non-compliant and losing their concessional tax rates (non-compliant funds are taxed at the highest marginal rate).

There are three practical considerations to take care of to retain compliance with regard to these circumstances, however the first of these is relatively easy to satisfy. The fund must be deemed to be an "Australian" fund, which for most (if not every) SMSF will be satisfied as the initial contributions are likely to have been made and accepted by the trustee/s in Australia.

The other two main issues that often arise when a trustee of an SMSF relocates overseas for an extended period of time are as follows.

CENTRAL MANAGEMENT AND CONTROL OF AN SMSF IS REQUIRED TO BE IN AUSTRALIA

If high-level decisions – such as the formulation of an investment strategy or how assets are used to fund member benefits – are made outside of Australia, trustees need to show that "central management and control" of their SMSF is "ordinarily" in Australia and only temporarily conducted from overseas.

In general, an SMSF will still meet the "ordinarily" definition if its central management and control is temporarily done from offshore for up to two years.

A point to note however is that if the absence is not of a temporary nature, it may be concluded that the fund's central management and control is not "ordinarily in Australia" prior to the elapse of the two year period.

In the event that the "ordinarily" requirement cannot be satisfied, consider the following options:

- appoint a legal personal representative with an enduring power of attorney (your adult child for instance) to be trustee in place of you. They will have the same power as a trustee, make key decisions and take responsibility as you cannot be seen to be making high-level decisions. If you are involved in high-level decision-making from overseas, central management and control has remained with you and will constitute a breach of the rules. (Be aware that the ATO can monitor emails to ascertain if this has happened.)
- wind up the fund and roll benefits over into a retail/industry fund, or
- convert the SMSF into a small APRA fund.

Administrative duties imposed on trustees may mean you find yourself needing to sign financial statements while overseas. An SMSF with up to two members must get all trustees to sign documents, and one with more than two members must have at least two signatures.

Problems emerge if you are overseas and unreachable, as documents may need to be signed by you. A possible solution to this is to receive all communications through email but be sure to check that digital signatures can legitimately be used. Or perhaps use an administrator for the fund as they can be responsible for receiving and processing all your paperwork.

If the central management and control of an SMSF is permanently outside Australia, you will not meet the "ordinarily" requirement and your fund may be deemed non-compliant with significant tax consequences.

SMSF trustee with the travel bug? How to keep your fund compliant ... *cont*

ACTIVE MEMBER TEST MUST BE FULFILLED

A member is classified as active if they are a financial contributor to the fund or if financial contributions to the fund have been made on their behalf. One way to satisfy the "active member test" is to ensure that no contributions are made to the SMSF by a non-resident member.

Alternatively, the "active member test" requires that at least 50% of all the fund's assets (either based on market value or the value payable to the fund's members) are attributable to active members who are Australian residents. It would be pointless to appoint a legal representative to stand in your place if you breach the active member test.

All in all, the two issues above must be addressed if you are planning to relocate overseas. Be sure to seek professional advice to maintain the residency status of your SMSF. ■

5 smart things to do with your tax refund

For many people, their tax refund is treated like a mini lottery win. This tax time, consider putting your "gift" from the ATO to good use and silencing the part of you that wants to fritter it away on things that expire.

1. Put it into your super

Remember the 70-year-old you gets better tax treatment. Unless you're already contributing the maximum to your super through a salary sacrifice arrangement, there won't be many other opportunities for tomorrow-proofing.

2. Reduce or pay off HELP debt

The ATO keeps track of your HELP debt balance and allows you to pay it off as you go. If your salary is over the HELP repayment threshold (currently $54,868) repayments are levied from your before-tax income automatically, starting at 4% and rising as your pay increases. For now, if you pay your HELP debt upfront, the government reduces your debt by a further 10%, with a 5% reduction on offer for repayment contributions that are extra to the compulsory amounts. But this generosity runs out on January 1, 2017 — so this is the last tax refund that you can use to get this "free money".

3. Pre-pay recurring obligations

It's a rare luxury to be able to pay any insurances, registrations and re-payment obligations before they roll around. Car registration payments commonly catch people off-guard, and paying extra off your mortgage will save interest on daily compounding rates. The other big one could be your credit card bill, which can have high interest rates. These don't have to be left until last. Bite the bullet – defer those Manolos for now and buy them next quarter when your bills are fully taken care of.

4. Put it in a term deposit

This could be your chance to put money away in a "just-in-case" account. Most Australian banks offer higher-interest savings accounts for term deposits, with some requiring minimum monthly deposits. While interest rates are not great at the moment, you can't go wrong letting your tax refund earn extra returns for a short stretch.

5. If you've got a small business or side venture, invest in it

Business tools and resources inevitably age. Why not use your tax refund to update old equipment or replace not-so-good assets with good ones? If you're a small business, anything you buy for business use will likely be able to be written off, so you've got an extra incentive to use your tax refund this way.

Having a better financial destiny is an age-old fight with discipline, but a tax refund is a chance to take some steps in the right direction. ■



I'm a volunteer. Any **taxing issues?**

From sporting clubs or environmental groups to many charity associations, volunteers are an indispensible workforce and support network for many organisations. For most, if not all, having volunteers ready to lend a hand is pivotal in them being able to function or survive.

Given that there are many hundreds of volunteers propping up all sorts of good works throughout the nation, and in the spirit of thorough tax planning, an important practical consideration for many may be if payments to volunteers constitute assessable income and are their expenses tax deductible?

WHAT'S A VOLUNTEER?

There is no common law definition of "volunteer" for tax purposes, although it typically means someone who enters into any service of their own free will, or who offers to perform a service or undertaking. A genuine volunteer does not work under a contractual obligation for remuneration, and would not be an employee or an independent contractor.

Volunteers can be paid in cash, given non-cash benefits or a combination of both – payments include honorariums, reimbursements and allowances. Generally, receipts which are earned, expected, relied upon and have an element of periodicity, recurrence or regularity are treated as assessable income.

Conversely, where a person's activities are a pastime or hobby (rather than income producing) money and other benefits received from those activities are not assessable income.

The examples below shed light on whether typical payments such as honorariums, reimbursements and allowances constitute assessable income.

IS AN HONORARIUM ASSESSABLE INCOME?

An honorarium is an honorary reward for voluntary services, or a fee for professional services voluntarily rendered, and can be paid in money or property.

Example 1

Q. *Alex works as a computer programmer at the local city council and volunteers as a referee for the local rugby union. This year he organised an accreditation course for new referees. He applied for a grant, arranged advertising, assembled course materials, and booked venues. Michael is awarded an honorarium of $100 for his efforts.*

A. *No, honorary rewards for voluntary services are not assessable as income and related expenses are not deductible.*

Example 2

Q. *Mindy has a graphic design business and volunteers at the local art gallery. Mindy prepares the gallery's annual report using her business's software and equipment. At the gallery's annual general meeting, Mindy is awarded an honorarium of $800 in appreciation of her services.*

A. *Yes, this honorarium constitutes assessable income because it is a reward for services connected to her income-producing activities.*

SMSF trustee with the travel bug? How to keep your fund compliant.... *cont*

IS A REIMBURSEMENT ASSESSABLE INCOME?

A reimbursement is precise compensation, in part or full, for an expense already incurred, even if the expense has not yet been paid. A payment is more likely to be a reimbursement where the recipient is required to substantiate expenses and/or refund unspent amounts.

Example 3

Q. *Matthew is an electrical contractor. He volunteers to mow the yard of a local not-for-profit childcare centre. Matthew purchases a $15 spare part for the centre's mower. The childcare centre reimburses Matthew for the cost of the spare part.*

A. *No, the $15 reimbursement is not assessable income because Matthew has not made the payment in the course of his enterprise as an electrician.*

Example 4

Q. *Rose is a gardener. She volunteers to prune the shrubs of a local nursing home and uses materials from her business's trading stock.*

A. *Yes, any reimbursement she receives for the cost of the materials is assessable income because the supplies were made in the course of her enterprise.*

IS AN ALLOWANCE ASSESSABLE INCOME?

An allowance is a definite predetermined amount to cover an estimated expense. It is paid even if the recipient does not spend the full amount.

Example 5

Q. *Andy volunteers as a telephone counsellor for a crisis centre. He is rostered on night shifts during the week and is occasionally called in on weekends. When Andy works weekends, the centre pays him an allowance of $150. The allowance is paid to acknowledge Andy's extra efforts and to compensate him for additional costs incurred.*

A. *Yes, these payments to Andy are considered assessable income because he received the allowance with no regard to actual expenses and there is no requirement to repay unspent money.*

EXPENSES INCURRED BY VOLUNTEERS

On the tax deductibility of volunteer expenses, a volunteer may be entitled to claim expenses incurred in gaining or producing assessable income – except where the expenses are of a capital, private or domestic nature, or specifically non-deductible.

For instance, expenditure on items such as travel, uniforms or safety equipment could be deductible, but expenses incurred between private and income-producing purposes must be apportioned – with only the income-producing portion of the expense being tax deductible.

Example 6

Q. *Robert operates a commercial fishing trawler for which he uses navigational charts. He is also an unpaid training officer at the volunteer coastguard. Robert purchases two identical sets of navigational charts – one for his business, the other as a training aid in coastguard courses.*

A. *Yes, Robert can claim the part incurred in gaining or producing assessable income – in this case, half the total cost.*

WHAT ABOUT DONATIONS? ARE THESE DEDUCTIBLE?

It is also common for volunteers to donate money, goods and time to not-for-profit organisations. To be tax deductible, a gift must comply with relevant gift conditions, and:

- be made voluntarily
- be made to a deductible gift recipient, and
- be in the form of money ($2 or more) or certain types of property.

Donors can claim deductions for most, but not all, gifts they make to registered deductible gift recipients. For instance, a gift of a service, including a volunteer's time, is not deductible as no money or property is transferred to the deductible gift recipient. However individuals may be entitled to a tax deduction for contributions made at fundraising events, including dinners and charity auctions.

Example 7

Mila buys a clock at a charity auction for $200. This is not a gift even if Mila has paid a lot more than the value of the clock. Payments that are not gifts include those to school building funds as an alternative to an increase in school fees and purchases of raffle tickets, chocolates and pens.

Example 8

Clive receives a lapel badge for his donation to a deductible gift recipient. As the lapel badge is not a material benefit or an advantage, the donation is a gift.

These situations are not always clear. Consult this office for more information on which volunteer payments are considered assessable income and which expenses are typically tax deductible. ■