YEAR END STRATEGIES

The 2012/2013 Tax Guide for You and Your Business

How to reduce the taxman's share of the pie...

And how to keep as much as possible for you and your family

Albert Einstein once famously said that, 'the hardest thing in the world to understand is income tax'. But don't let complexity deter you from a simple goal: keeping your taxes as low as possible.

As accountants, our role includes not only preparing financial statements and tax returns, but also working with you to ensure that taxes are at the lowest possible level. Only by achieving this can you retain the biggest slice of your wealth to spend or save.

In particular, do please contact us to discuss:

- reducing the tax on your estate
- tax-efficient savings
- salary sacrificing strategies
- tax efficient remuneration packages
- keeping business taxes to a minimum
- developing a plan for tax-efficient profit extraction

ATO increase penalty units

There are now greater penalties in place for breaches of most Australian tax laws. The ATO has increased the value of a penalty unit from $110 to $170, the first such increase since 1997.

A maximum of 5 penalty units for a very late tax return increases $300 to $850 ($170 x 5) from the previous $550 ($110 x 5).The new rate applies to offences that occurred after 28 December 2012, with breaches occurring before this date incurring the previous penalty rate of $110. Furthermore, under the new legislation, the penalty unit will be up for review every three years.

Individuals and businesses who fail to lodge returns on time will have to pay $170 for each 28 days that the return is overdue, up to a maximum of 5 penalty units.

For businesses, penalties can apply for each late tax return including PAYG withholding annual reports, FBT returns and activity statements such as BAS, IAS and GST.

Medium sized businesses with a turnover of between $1 million and $20 million face a penalty of 2 times, so that a 5 penalty unit for an individual or small business, becomes a 10 penalty unit with a fine of $1,700. Businesses should remember that the Failure to Lodge (FTL) penalty cannot be claimed as a tax deduction. This can result in significant financial consequences for multiple breaches.

In This Guide:

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Personal super strategies for year end

With the end of financial year fast approaching, starting to prepare now will save time and headaches when the June 30 deadline arrives.

There are a few common financial planning strategies that may be appropriate for businesses and individuals looking to take control of their finances and plan for the future.

Concessional contributions. The contributions cap for concessional contributions for those aged over and under 50 is $25,000 for the 2012/2013 financial year. Those which have exceeded this limit will face a penalty tax of 31.5%, in addition to the 15% tax payable on contribution. The excess concessional contributions also count towards the non-concessional cap. For those aged 65 or over, they must first satisfy a work test in order to make super contributions.

Government co-contributions. There are government incentives in place for making after-tax contributions to super, with the government co-contribution scheme designed for low to middle income earners earning up to $46,920 (2012/2013). For those who have made an after-tax contribution and are earning up to $31,920, the government will contribute up to a maximum of $500 tax-free into the super fund. For example if the non-concessional contribution is $800 for someone earning up to $31,920, then the Government will contribute $400, representing an instant return of up to 50% on contributions.

The amount the government contributes decreases by 3.33c for every dollar above the $31,920 and cuts out at $46,920. It is exempt from being included as income in tax returns.

Spousal contributions. Making an after-tax contribution to a dependant spouses' superannuation account can result in a tax offset, provided that the spouse is under 65, or up to 70, provided they are still working.

Those who contribute at least $3,000 to the spouses' account are eligible for the full tax rebate of $540, as long as their spouses' assessable income is less than $10,800 for the year. If less than $3,000 is contributed then the rebate will be equivalent to 18% of the contributions.

If the spouses' income is higher than $10,800, the rebate decreases until it is capped if the income exceeds $13,800 a year.

Home business tax deductions

With so many businesses now being run from home, the ATO is eager to ensure that those claiming tax deductions do so correctly.

Understanding the rules. A home-based business may use the home as the principal place of business (such as a hairdresser), with clients coming to the home. Alternatively, the business can comprise of a home work area, such as a study or lounge which is set aside exclusively for business activities. If neither applies, a home based business can still claim some deductions if there is at least some business activity conducted at home.

The responsibility for keeping invoices and records for a home office is the same as that for any other business expenses you are claiming. Invoices for these expenses must be retained.

Occupancy expenses. Business owners that are conducting their business at home may be entitled to claim a portion of their rates, house insurance and mortgage interest for income tax purposes.

The amount of these deductions is generally based upon the percentage of the home area that is used for business purposes, but there are some special circumstances.

Interest costs can generally be deducted for income tax purposes where the interest costs are directly attributed to a place of business. Whilst this may depend on particular circumstances, specific indicators include that the place is clearly identifiable as a place of business; it is unsuitable for private purposes; it is used exclusively or almost exclusively as a place of business and is used regularly by clients.

Taxpayers who satisfy the interest deductibility test may have to pay capital gains tax on part of any capital gain that is made when the house is sold.

Running expenses. Running expenses are the increased costs of running facilities within a home as a result of running a business. These expenses include electricity, cooling, telephone and cleaning costs.

Taxpayers may claim the additional expenses incurred from running a business from home, however the method to work out these additional expenses must be able to prove that the claim is reasonable and not of a personal or private nature.

Business owners of home based businesses may claim depreciation for the decline in value of depreciating assets. These include items such as computers, photocopiers, furnishings and tools. Assets used for both business and personal activities must have the deduction reduced for non-business purposes.

Borrowing strategies for a SMSF

SMSF members wanting to expand their investment portfolio are able to borrow money through their SMSF to purchase these assets.

Assets available to an SMSF include property, as well as shares and managed funds – however the usual superannuation rules continue to apply where the fund is purchasing an asset from a related party.

Some SMSF borrowing strategies

There are a number of strategies that enable individuals to take advantage of the rules.

Increasing the asset base. Contributions rules place a limit on the amount of contributions that may be contributed to a fund. In addition, an investment in the SMSF borrowing arrangement is generally accounted for as net of liabilities. Where members are in a position to contribute assets such as property or shares this has the effect of enhancing SMSF borrowing.

Increased contributions. Members may be able to transfer assets that they own into a fund, taking advantage of the borrowing rules. Members are then able to act as Trustee of the borrowing trust as well as the lender. The repayments made by the SMSF may then be contributed back into the fund by the member under the normal contribution rules.

Costs of finance

Financial products are readily available by lenders to take advantage of the rules allowing funds to borrow for investing.These products take into account the rules that only allow a loan to be secured against the investment it is funding, not total fund assets.

As a result of the higher risk profile, loans may attract a higher interest rate and require a deposit significantly higher than usually occurs with other standard investment loans. Trustees need to factor these risks and costs into their borrowing strategy.

The loan and the lender

SMSFs are able to use anybody as a lender, that is, they are able to obtain the loan from a bank, or other lending institutions, a member themselves, their business, a family member, company or trust. However while the law does not prevent the lender from being a related party, SMSFs must satisfy the sole purpose test and comply with existing investment restrictions such as those applying to in-house assets and prohibitions on acquiring certain assets from a related party of the fund.

Year End Tips For Business Owners

Fixed assets

Review fixed assets useful life and determine if there are any benefits in scrapping or trading in assets.

Write off obsolete inventory

The year end stock-take should involve a review of all inventory. Obsolete stock may be scrapped or valued below cost subject to specific guidelines.

Small business CGT concessions

Individuals operating a small business may be eligible for CGT concessions on the sale of business assets.

Capital expenditure vs repairs

Review all spending during the year to determine if all items are deductible or if they are capital by nature and need to be depreciated.

ATO benchmarking

Benchmarks for specific industries have been developed by the ATO to identify taxpayers who report income or expenses different to similar businesses.

Super guarantee changes

From 1 July 2013 the super guarantee rate is going up to 9.25 per cent, and the upper age limit of 70 years has been removed.

Instant asset write-off

Small businesses can claim an instant asset-write-off for a depreciating asset that cost up to $6,500.

Bad debts

Write off bad debts before year end. It must be bad, not merely doubtful and must have been previously included as assessable income.

Review unpaid expenses

Businesses who are falling behind in their rent and other expenses that work on an accruals basis may claim the arrears amount as a tax deduction.

SMSF member insurance

Following changes to the SMSF sector as part of the government's Stronger Super review measures, SMSF trustees are now required by law to consider the need for insurance cover for members, such as life or disability insurance.

Considering insurance for one or more of its members will come under the SMSFs broader investment strategy, which trustees will need to 'regularly review', taking into account the changes in circumstances of the fund and its members. The new legislation does not require an SMSF to obtain an insurance policy on the behalf of its members, but rather demonstrate that the fund has considered insurance as part of its investment strategy.

It is critically important that trustees review their fund's investment strategy and that all appropriate documentation is maintained to prove that regulations have been complied with. Compliance may be shown either through decisions taken in regards to the fund's investment strategy, or if there has been no change, then the trustee minutes will show that the required actions have been taken.

Year End Tips For Property Owners

Renovations by previous owner

You may be eligible for a deduction for depreciation on the cost of improvement by a previous owner, provided items are identifiable and itemised in a depreciation schedule.

Correctly disclose capital gains

The ATO is closely monitoring undisclosed capital gains including gains from disposing of assets to invest in superannuation. Ensure any capital gains on the sale of property are correctly recorded.

Prepare an accurate depreciation schedule

Having a depreciation schedule prepared by a qualified quantity surveyor may help add a significant tax deduction for depreciation. The cost is also tax deductible and helps substantiate any capital allowance claim you may have.

Property data matching

The ATO is using new data matching techniques, including monitoring property transaction details to target property investors ensuring the correct amount of tax is paid.

Interest prepayments

If allowed by your lender, this is a strategy to defer the payment of tax. Factors such as anticipated future income, interest rates and cash flow impact should be considered fully beforehand.

Repairs at time of purchase

Expenses for repairs to property are generally deductible provided that they relate to wear and tear or other damage as a result of earning rental income. The cost of initial repairs at the time of purchase are not deductible.

Capital gains tax concessions

If you have renovated a property with the view to selling it at a profit in the short term, you may find yourself taxed as a 'profit making scheme'. This means you will not be able to take advantage of CGT concessions.

Personal expenses

Ensure that any claims or interest on borrowings for investments can be clearly separated from interest on borrowings of a personal nature.

New super changes

The government recently proposed significant changes to superannuation which are far reaching and intended to make the superannuation system more sustainable, efficient and equitable.

Although the new changes may not be passed until the next parliamentary sitting, it is worth being prepared if they do come into effect later this year. The changes include:

Limiting tax exemption on super income streams

The government proposes to limit earnings that support a pension, such as dividends and interest to $100,000 from 1 July 2014. This means that the first $100,000 earned will be tax free, and the subsequent amount over this limit be taxed at 15%.

These changes will only apply to earnings that support a person's superannuation pension account and be taxed within the super fund, with pension payments and lump sum withdrawals remaining tax free.

Higher concessional contributions cap

The concessional contributions cap will be simplified, with those over 60 able to contribute $35,000 from 1 July 2013, and those over 50 able to contribute up to $35,000 from 1 July 2014.

Previously both age brackets were able to contribute up to $25,000. The cap changes will also now apply to everyone, regardless of their bank balance, with the government scrapping plans to restrict the cap to those with balances under $500,000.

Excessional contributions tax rules

Currently, excess concessional contributions which include employer contributions and salary sacrifice member contributions in excess of the cap are taxed at 46.5% instead of the marginal tax rate of 15%.

The new changes state that members who have made excess contributions from 1 July 2013 are able to withdraw the excess from their super fund and have the amount taxed at the marginal rate plus an interest charge.

Effectively members will be taxed on excess contribution amounts as though they had received an income, with there being no limit on the concessional contribution amount that can be withdrawn.

We are here to help

Make good use of us! This guide is merely a startig point, designed to help you identify areas that might have a significant impact on your tax planning.

Please keep us informed of your plans and consult us for help in taking advantage of tax-saving opportunities and tax efficient investments.