

TAX PLANNING & YEAR END ISSUES

With 30 June 2002 fast approaching, we have looked at aspects of tax planning and year end issues to be considered before year end.

Included with this newsletter is our desktop calendar. As mentioned on the calendar, we suggest you visit our website monthly in order to keep up to date with tax action dates.

TAX PLANNING ISSUES

Deferral of Assessable Income

Tax planning measures to defer receiving assessable income include investing funds so that interest receipts occur after the end of the financial year, delaying the disposal of assets that may result in recouped depreciation or structuring royalty payments so that they are received after the end of the year.

For those taxpayers who account for income on an accruals basis, it has been common practice to defer income by the non-issue of invoices to customers. However, if the work has been completed or the goods supplied, then the issue of an invoice may be irrelevant for tax purposes. The Commissioner may use this as an appropriate test as to whether the amount of income has matured as a recoverable debt.

Fees or income received in advance, which has not actually been derived or earned by the business, should be recognised as such so as to defer the tax liability to the next financial year.

Accordingly, measures to defer income need careful consideration. The effect on cash flow should also be considered.

Accelerating Deductions

Changes to expense prepayment rules came into effect 21 September 1999. There have been further changes to the prepayment rules resulting from the introduction of the Simplified Tax System on 1 July 2001.

Generally prepayments made by businesses will only be deductible over the service period of the prepayment. Accordingly, a prepayment made on 30 June 2002 for a period of one year will give rise only to a deduction for $\frac{1}{365}$ of the prepayment during the year ending 30 June 2002. Taxpayers who have made prepayments in previous years may still be able to take advantage of transitional phasing in rules.

However non-business taxpayers and businesses within the simplified tax system can prepay some expenses up to 12 months in advance, and obtain an immediate tax

deduction. Previously this was limited to a 13 month period.

Prepayments made after 11 November 1999 in respect of so called "tax effective" investments are subject to new rules and should be entered into only after careful consideration. From a tax view point it is important that a product ruling has been issued by the ATO relating to such investment arrangements. In respect of such investments other factors apart from tax should be examined, such as the commerciality of the investment, likely returns and overall costs.

Capital Gains Tax ("CGT")

If a large capital gain has occurred during the year significant income tax savings may be obtained by reducing other income.

Consideration should also be given to realising capital losses prior to 30 June 2002 and also to the possible deferring of disposals.

Access to the 50% discount continues for individuals who dispose of assets and trust assets that have been held for at least twelve months. This 50% discount applies to applicable gains once capital losses have been offset.

For beneficiaries with fixed interests in a trust, cost base adjustments will not be required for distributions of the 50% CGT discount.

If you have made a capital gain or loss during the year you should contact us prior to year-end to consider the implications.

Directors Fees and Staff Bonuses

In order to qualify for a tax deduction, companies should pass a properly authorised shareholder's resolution to pay Director's fees and/or bonuses prior to 30 June 2002.

However amounts should not actually be paid or credited to loan accounts until after 30 June 2002.

This will result in the Director and/or employee not being assessed for the amount until the next financial year. Note that there are associated costs, including PAYG withholding, superannuation, payroll tax and WorkCover.

Simplified Tax System ("STS")

From 1 July 2001 the optional STS for certain business came into effect. The eligibility criteria for the STS applies to small businesses with a three year annual average turnover of less than \$1 million (on a grouped basis).



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For eligible business to enter the STS, an election would need to be lodged with the 2002 income tax return.

One of the STS concessions is the immediate write off of assets costing less than \$1,000.

The STS contains a number of benefits for eligible taxpayers, however there are also some disadvantages. Please contact our office should you wish to discuss this further.

Uniform Capital Allowances (“UCA”)

Under the UCA, non-small business taxpayers will have a choice of allocating assets to a low value pool. The condition for certain assets is the asset must have cost less than \$1,000 or have declined in value under the diminishing value method to less than \$1,000.

It is crucial that businesses take time to review the effective life for new plant or consider self-assessing effective lives. Remember there is still a need to keep records of assets and regularly review business turnover thresholds in relation to small business classification.

Employee Superannuation Contributions

Contributions must be actually paid to a complying superannuation fund on or before 30 June 2002, to be deductible in the current year. Book entries alone are not sufficient.

In addition employers are reminded that the superannuation contributions for employees must be met by 28 July 2002 in order to avoid incurring a liability to the superannuation guarantee charge.

The minimum level of employer superannuation support for employees for 2001/2002 is 8%. From 1 July 2002 and subsequent years the minimum level of superannuation support will increase to 9% and remain at that level unless changes are announced.

The deduction limits set out below limit the deduction of contributions made on behalf of employees.

Superannuation for Self Employed Persons

Persons who receive only a small amount of employer sponsored superannuation support may be eligible for a tax deduction for their personal superannuation contributions.

Where assessable income, exempt income and reportable fringe benefits from employment is less than 10% of the person’s total assessable income and reportable fringe benefits for the year, that person is deemed to be self-

employed. The person's reportable fringe benefit amount appears on their group certificate for the year of income.

The maximum deductible contribution allowable to self-employed persons will be the first \$3,000 contributed plus 75% of the excess above \$3,000, subject to the taxpayer's aged based deduction limit for the year of income. The deduction limits are listed below and are based upon the taxpayer's age on the last day of the year of income in which the contribution is made.

Age in Years at 30 June	Deduction Limit	Equates to Contribution
Less than 35	\$11,913	\$14,883
35 – 49	\$33,087	\$43,116
50 and over	\$82,054	\$108,405

In some circumstances, the 10% rule can be satisfied by the receipt of further income before year-end. For example a discretionary trust distribution or the declaration and receipt of a private company dividend. However this will need to be considered together with other implications.

Excess Contributions

Care should be taken to ensure that superannuation fund balances do not exceed reasonable benefit limits.

Superannuation Contributions Tax

Where a taxpayer's adjusted taxable income exceeds \$85,242 for the year, the superannuation contributions tax applies.

Adjusted taxable income is taxable income less certain eligible termination payments plus contributions to superannuation funds subject to the surcharge.

The surcharge is charged at 15% for a person with an adjusted taxable income of \$103,507 and over and is phased in from \$85,243.

Accordingly, taxpayers with adjusted taxable income in excess of \$103,507 will have 30% tax deducted from the contributions by the superannuation fund. In addition, a further 15% may be deducted at the time of withdrawing the contributions from the fund. This has greatly reduced the incentive for superannuation for certain taxpayers. There is, however, still a slight advantage compared to having income taxed at 48.5% immediately due to the slightly lower rate (45% effectively).

NEWSLETTER

Spouse Superannuation

Superannuation funds and retirement savings accounts are able to accept "*eligible spouse contributions*" from a person for the benefit of that person's spouse. Accordingly, a spouse can benefit from superannuation whether or not in the workforce. There is no limit on the amount of eligible spouse contributions provided the recipient spouse is under age 65. The contributing spouse can be any age and the recipient spouse need never have been gainfully employed.

The contributions must be made from after tax sources and not under salary sacrifice arrangements. If both spouses are not eligible to contribute to funds for themselves, each spouse can contribute to the benefit of the other provided each is under age 65. Accordingly, a couple, say aged 60 who have retired are in a position to make contributions on behalf of each other.

The tax benefits are as follows:

Undeducted contributions

Eligible spouse contributions are classified as "*undeducted contributions*". Therefore, they are:

- not subject to income tax of 15% in the fund;
- not subject to superannuation contributions tax, the tax on superannuation contributions made on behalf of high income earners;
- not taxed on withdrawal from the fund or RSA, although earnings on these contributions will be subject to tax on withdrawal; and
- not counted against the Reasonable Benefit Limit ("RBL"). However, earnings on these contributions will be subject to the RBL.

Tax Rebate

A tax rebate is available on up to \$3,000 of superannuation contributions made by a contributing spouse on behalf of their low income or non-working spouse. The rebate rate is 18% of the spouse contributions made but subject to a maximum rebate of \$540. The rebate is available if the recipient spouse's assessable income and reportable fringe benefits is \$10,800 or less for the tax year.

The available rebate reduces if the recipient spouse earns more than this amount, down to

nil when the recipient spouse's assessable income exceeds \$13,800.

Salary Sacrifice Year –End Bonus

Before an employee is advised of the actual amount of any year-end bonus, they can elect to have the bonus paid into a complying superannuation fund. This arrangement will need to be agreed upon by the employer and employee, and be in place before the bonus amount is known. This last requirement is necessary for it to be a bona fide salary sacrifice arrangement. In addition consideration will need to be given to the employees aged based limit and superannuation surcharge position.

Non Commercial Losses

Legislation has been in place since the 2001 income tax year, relating to losses arising from non commercial business activities.

Individual taxpayers conducting a business either as a sole trader or in partnership, may not be able to offset losses from this business, against other assessable income, unless various tests as to the commerciality of the business are satisfied. If the business is deemed to be non commercial, the losses will be carried forward until they can be offset against profits from that business.

The impact of non commercial losses would be increased taxable income possibly resulting in an increased tax bill. In addition there may be adverse social security consequences.

Other Tax Planning Measures

Other tax planning measures that may be utilised include:

- Making charitable donations - however ensure such donations do not create an overall loss in the current year;
- Paying accounting and audit fees prior to year end;
- Paying accrued leave loading prior to year end regardless of whether leave has been taken, if allowable under the appropriate award;
- Not rendering accounts earlier than necessary for work in progress;
- Writing off bad debts (consideration will need to be given to GST impact for taxpayers accounting for GST on an accruals basis);
- Reviewing stock for any obsolete items that can be written off and whether an alternative stock valuation method would be appropriate;

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- Certain construction and improvement costs may be deductible either at 2.5% or 4% per year, depending on the specific circumstances. This is often overlooked in the situation where the taxpayer did not purchase the building new or did not undertake the construction;
- Ensuring tax file number information is disclosed to investment bodies, superannuation funds and employers to avoid the deduction of 48.5% withholding tax; and
- Deferral of capital gains until after the year end.

YEAR END ISSUES

Shareholder Loans

Special consideration should be given to the balance of any shareholder loans in company accounts prior to 30 June 2002. If you have either taken money out of your company or put money into your company during the current year, please contact us prior to 30 June 2002.

Motor Vehicle Log Books

Taxpayers utilising the log book method for claiming motor vehicle expenses, should check to see that the log book is still current. A new log book will need to be kept every 5 years unless business usage changes by more than 10% in a year. Should your log book be out of date or business usage has changed, a new one should be started immediately, in order to fulfil substantiation requirements for the 2002 income tax year. The log book will need to be maintained for a continuous 12 week period, which can overlap the start of an income year.

Failure To Lodge Penalties

During the implementation of the new tax system, the ATO have not applied Failure to Lodge ("FTL") penalties unless circumstances justified its imposition. However from 1 July 2002, a stricter approach will be in place whereby the FTL will automatically be applied in relation to ATO documents lodged late. FTL penalties can be as high as \$2,750.

Personal Services Income

Legislation relating to personal services income has been in operation since 1 July 2000. The main effect of this was to limit the splitting of income resulting mainly from personal efforts or skills and also the amount of deductions for certain companies, trusts or partnerships.

From 1 July 2002 these rules will also apply to taxpayers who had a Prescribed Payments System payee declaration in force before 14 April 2000. Please contact our office should you wish to discuss this further.

GST Review

Various GST related issues should also be looked at and these include the following:

- Registration Threshold is currently at \$50,000. If your turnover has increased over \$50,000 in the last financial year, you are required to be registered and apply for an Australian Business Number and enter the GST System.
- Cash vs Accruals Threshold is currently \$1 million. If your turnover has increased last financial year or you anticipate your turnover to exceed \$1 million, you may need to review whether a change in the method of accounting for GST is appropriate from the cash basis to accruals.
- Monthly vs Quarterly reporting threshold is currently \$20 million. Again, the end of the financial year is an appropriate time to review your reporting requirements.
- Cancellation of GST registration may also be appropriate at year-end if your turnover is less than \$50,000 or you originally chose to register in the system and now wish to opt out.
- GST Free contracts should be reviewed to ensure they continue to be GST Free. If necessary, accounting systems should be reviewed in case of changes to such contracts.

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