client alert | explanatory memorandum

May 2015

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 15 April 2015.

Tax planning

There are many ways in which entities can defer income, maximise deductions and take advantage of other tax planning initiatives to manage their taxable incomes. Taxpayers should be aware that in order to maximise these opportunities, they need to start the year-end tax planning process early. Of course, those undertaking tax planning should be cognisant of the potential application of Pt IVA and other anti-avoidance provisions. However, if done correctly, tax planning can provide a number of tax savings for entities.

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.

Another important consideration is the composition of the Senate, leaving the Government negotiating at times to push through legislative changes. In this regard, tax practitioners should stand ready to respond to possible (last-minute) changes to proposed measures.

Tax practitioners should also be aware of the ATO publication entitled, *Building confidence*, released in March 2015 available at https://www.ato.gov.au/General/Building-confidence. The publication provides a central location of the compliance risk areas the ATO is perceiving and what it is doing about them. It replaces the previous *Compliance Program* and *Compliance in focus* annual ATO publications.

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 any particular income – is it revenue or capital? – because the difference in tax treatment will ultimately have an impact on the taxpayer's tax position.

Business income

The question of when ordinary income of a business is derived and 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 reports 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 in order to defer the income.

Income from property

Income from property is essentially all income that is not personal exertion income. It includes interest, rent, dividends, royalties and trust distributions. The timing of 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 in which the income is derived by the trust

- **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, even though the taxpayer has not physically received the income (the principle of constructive receipt): 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 a balancing adjustment rollover 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 rollover relief

Balancing adjustment rollover relief effectively defers a balancing adjustment until the next balancing adjustment event occurs. Broadly, the rollover relief will apply automatically if the conditions listed in s 40-340(1) of ITAA 1997 are satisfied.

If the automatic rollover 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. The notice must be given to the transferee within six months after the end of the transferee's income year in which the balancing adjustment event occurred, or within such further time as allowed by the Commissioner.

TIP: Rollover relief may be available for balancing adjustments arising from an involuntary disposal of assets where replacement assets are acquired.

An optional rollover 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 rollover relief to apply. The choice must be made in writing and within six months after the end of the transferee's income year in which the balancing adjustment event occurred, or within such further time as allowed by the Commissioner.

TIP: A small business entity can access the optional rollover relief.

- **STOP:** The optional rollover 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 other sections of ITAA 1997 or the *Income Tax Assessment Act 1936 (*ITAA 1936). 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 outlines his view on the meaning of "incurred" for the purposes of s 8-1 of ITAA 1997. The following general rules assist, in most cases, in defining whether and when an outgoing has been incurred:

- 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;
- a taxpayer may have a presently existing liability notwithstanding that the liability may be defeasible by others;
- 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;
- whether there is a presently existing liability is a legal question in each case, having regard to the circumstances under which the liability is claimed to arise; and
- 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.

Bad debts

A deduction is allowable under s 25-35(1) of ITAA 1997 for a debt (or part of a debt) that is written off as a bad debt in the income year, provided:

- the amount owed, except in the case of a money-lending business, was included as assessable income of the taxpayer in the current or a former income year; or
- the debt is in respect of money lent in the ordinary course of a business of lending money by a taxpayer who carries on that business.

The other conditions that must be satisfied before a bad debt may be deducted under s 25-35(1) are as follows:

- there must be a debt in existence at the time of writing off;
- the debt must be bad; and
- the debt must be written off as bad during the income year in which the deduction is claimed.

In Taxation Ruling TR 92/18, the ATO sets out a list of circumstances in which a debt may be considered to have become bad. These circumstances may include 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 the 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, the question of whether the debt is bad is ultimately one of fact and will depend on all the facts and circumstances surrounding the debt.

TIP: Taxpayers should review all outstanding debts prior to year-end to determine if there are any potential debtors who will be unable to pay their bills. Once a taxpayer has done everything in their power to seek repayment of the debt, the taxpayer could consider writing off the balance as bad debt. Ensuring bad debts are dealt with prior to year-end is crucial, as a deduction is only allowable in the year in which the bad debt is written off.

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

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.

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 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; or

- 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, followed by a physical writing-off in the books of account subsequent to year-end.

Additional requirements for companies

A company may not be able to deduct a bad debt unless it satisfies certain continuity of ownership or same business tests (there is an alternative test for companies held by non-fixed trusts). 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.
- **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.

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 year 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.

- **STOP:** Companies and entities taxed like companies (eg corporate limited partnerships, public trading trusts and corporate unit trusts) are allowed to "carry back" losses from 1 July 2012, to be offset against past profits (and thus get a refund of tax previously paid on that profit). However, the loss carry-back has been repealed with effect from the start of the 2013–2014 income year. Consequently, the carry-back is only available for the 2012–2013 income year. See **Loss carry-back regime** *on page 14*.

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 firstly need to be offset against net exempt income before being available for deduction against assessable income.

TIP: It is prudent for a taxpayer who has incurred a tax loss or made a net capital loss for an income year to retain records relevant to the ascertainment of that loss. These records should be retained until the later of the end of the statutory record retention period (eg under s 262A of ITAA 1936) and the end of the statutory period of review for an assessment for the income year when the tax loss is fully deducted or the net capital loss is fully applied: see Taxation Determination TD 2007/2.

- **STOP:** It is net exempt income that is offset against any carried forward tax losses, 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.
- **STOP:** 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 their interest does not exceed $300 (even if the asset costs more than $300).

Small business entities

Small business entities (*see* **Small business entities** *on page 16*) that choose to apply the Subdiv 328-D capital allowance rules are entitled to an outright deduction for the "taxable purpose proportion" of the "adjustable value" of a depreciating asset if:

- the asset is a "low cost asset"; and
- the taxpayer starts to hold the asset when the taxpayer is a small business entity.
  - ➢ **STOP:** Since an outright deduction is only available for assets acquired while the entity is a small business entity, assets already pooled in the general small business pool (see **Pooling** *on page 6*) must remain in the pool after an entity becomes a small business entity.

The deduction is available in the income year in which the taxpayer starts to use the asset, or installs it ready for use, for a taxable purpose.

A depreciating asset is a "low cost asset" if its cost at the end of the income year in which the taxpayer starts to use it, or installs it ready for use, for a taxable purpose is less than the relevant threshold.

For 2014–2015 (and income years before 2012–2013), the low cost asset threshold is $1,000. For 2013–2014, the threshold was $6,500 if the asset was first used or installed ready for use (for a taxable purpose) before 1 January 2014, otherwise the threshold was $1,000.

In the normal case, the "adjustable value" of a low cost asset will be the cost of the asset. The "taxable purpose proportion" is (broadly) the proportion that relates to use of the asset "for a taxable purpose".

➢ If there is additional expenditure on a low cost asset (ie an amount is included in the second element of cost) and the additional expenditure is less than $1,000, the taxable purpose proportion of that expenditure is also deductible. However, in certain circumstances where additional expenditure is incurred, the asset is allocated to the general small business pool (*see* **Pooling** on page 6), even if the expenditure is incurred during an income year for which the taxpayer is not a small business entity or has not chosen to use the Subdiv 328-D rules:

- the additional expenditure is $1,000 or more; or
- the taxpayer has deducted (or can deduct) an amount under s 328-180(2) for an amount previously included in the second element of the asset's cost.

➢ **STOP:** The Government has removed the accelerated depreciation for motor vehicles. In most cases, a small business entity could effectively write off the first $5,000 of the cost of a motor vehicle which the entity acquired on or after 1 July 2012 and before 1 January 2014. This concession was repealed by the *Minerals Resource Rent Tax Repeal and Other Measures Act 2014*.

Business taxpayers

For business taxpayers that are not small business entities, all capital items must be written off over their effective lives 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.

➢ **STOP:** 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, 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 2012–2013 year, there is one general small business depreciation pool for a small business entity (ie the "general pool" and the "long-life pool" are consolidated). If the value of the general small business pool falls below the relevant threshold, a small business entity can claim an immediate deduction for the pool balance (provided it is greater than zero). The relevant threshold for 2014–2015 is $1,000 (it was $6,500 for the 2012–2013 income year and also for the 2013–2014 income year if the taxpayer is an early balancer whose 2013–2014 income year ended before 1 January 2014).

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 adjustable 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 must 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 2012–2013)	15%	30%
Other taxpayers – Low-value pool	18.75%	37.5%

TIP: Taxpayers should review their tax asset registers to identify any low-cost and/or low-value assets that may be pooled to access an accelerated rate of depreciation.

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 even though the asset costs more than $1,000, provided the taxpayer's interest is less than $1,000.

"Blackhole" expenses under section 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. In Taxation Ruling TR 2011/6, the ATO 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.

If capital expenditure is deductible under s 40-880, the deduction is spread over five years in equal proportions (ie 20% of the expenditure each year), commencing with the year in which the expenditure is incurred. Further, if a taxpayer is wound up, the entitlement to deduct any remaining undeducted expenditure is lost for income years after the one in which the taxpayer is wound up: see ATO ID 2009/6.

Donations

Gifts and donations valued at $2 or more (whether cash or property) are deductible under s 30-15 of ITAA 1997 if the rules in Div 30 are satisfied.

TIP: Written evidence of donations or gifts (eg receipts) are generally required; however, documentary evidence is not required if the gift does not exceed $10 (and if the total of all deductible amounts not exceeding $10 does not exceed $200 for the income year) eg a "bucket donation" to a deductible gift recipient (DGR).

A taxpayer is able to spread a deduction over five years for a gift of money or a gift of property to an eligible charity or Cultural Gifts Program valued by the Commissioner at more than $5,000.

TIP: A taxpayer must specify in a 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.

In certain circumstances, a deduction is available under s 30-15 for a gift of trading stock valued at $2 or more, subject to special conditions being met. If the trading stock was purchased during the 12 months before the gift was made, the amount deductible is the lesser of the market value (excluding GST) on the day the gift was made and the purchase price.

Legal expenses

It is difficult to formulate an all-encompassing "rule" as to the deductibility of legal expenses because each expense must be considered on its own merits. However, in accordance with general principles, legal expenses are deductible under s 8-1 if incurred in gaining or producing assessable income, or if necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. In general, the courts have established that if the advantage that is sought to be gained by incurring the legal expenses is of a revenue nature, the expenses will also be of a revenue nature, and if the advantage that is sought is of a capital nature, the expenses will be of a capital nature.

TIP: The success or failure of legal proceedings has no bearing on the deductibility of expenses incurred in those proceedings.

TIP: Certain legal (or legal-related) expenses (eg obtaining tax advice, preparing leases and discharging mortgages) are specifically deductible under various provisions of ITAA 1997.

TIP: Certain legal costs that are capital in nature (termed "blackhole expenditure") may be deductible over five years under s 40-880. (*See* **"Blackhole" expenses under section 40-880** *on page 6*.)

Non-commercial losses

An individual taxpayer should consider whether a loss from their 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, or 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.

TIP: Business activities of a similar kind may be grouped together as one activity. This is not compulsory although it is likely to benefit the taxpayer. For example, an olive grower who produces and sells olive oil may also start an olive bottling business. These are similar activities and may be treated as one activity. However, where the olive grower also produces an insecticide for olives and earns royalties from its patent, the activity is of a different kind and would be treated separately. It is a question of fact and degree whether business activities are of a similar kind. Taxation Ruling TR 2001/14 states that this involves a comparison of the relevant characteristics of each business, eg the location where they are carried on, the type of goods and/or services provided, the market conditions in which those goods and/or services are traded, the type of assets employed in each, and any other features affecting the manner in which they are conducted. The ruling also states that the broader in nature any business activities are, the more likely it is that they will have similar characteristics. However, note the Administrative Appeals Tribunal (AAT) decision in *Re Heaney and FCT [*2013] AATA 331*,* , in which it was held that the taxpayer's cattle and sheep farms constituted discrete business activities and not a single farming business.

The Commissioner has the discretion to override the provisions of Div 35. The exercise of the discretion is to be based on an assessment of the facts of each case, having regard to the language of the section and the policy and context of the non-commercial loss rules: Taxation Ruling TR 2007/6.

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.

High-income earners

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, wages or other income.

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

- taxable income;
- reportable fringe benefits total;
- reportable superannuation contributions; and
- 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 may apply to the Commissioner to exercise his discretion to not apply the non-commercial loss rules where they can satisfy the Commissioner that, based on an objective expectation, 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. Expenditure that is deductible under s 8-1 of ITAA 1997 is generally allowable in full in the income year in which it is incurred. However, Subdiv H of Div 3 in Pt III of ITAA 1936 (the “prepayment rules”) modifies the operation of s 8-1 by preventing the immediate deductibility of certain advance (“prepaid”) expenses. Where Subdiv H applies, the prepaid expenditure must be deducted on a straight-line basis over a period of time not exceeding 10 years.

> **TIP:** The deductibility of audit fees is dependent on the terms of the audit contract. Taxpayers should consider agreeing to prepay their audit fees under their audit engagement at the *start* of the audit, in order to claim a deduction for the full expense in the current year. Taxation Ruling IT 2625 considers the deductibility of audit fees.

➢ **STOP:** It is important to note that the prepayment rules merely alter the timing of certain deductible amounts. They do not affect the underlying entitlement to the deduction or the amount of the allowable deduction.

Excluded expenditure

Various expenses are specifically excluded from the prepayment rules. This means a taxpayer is able to claim an outright deduction. Excluded expenditure includes:

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

> **TIP:** If a taxpayer is entitled to an input tax credit for 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*.

➢ **STOP:** If two or more prepayments, each of less than $1,000 are made for the purpose of exploiting the $1,000 threshold for “excluded expenditure”, Pt IVA may deny the advantage: Taxation Determination TD 93/118.

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 must not exceed 12 months, and must end 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 this formula:

$$\text{Expenditure} \quad \times \quad \frac{\text{No. of days of eligible service period in the year of income}}{\text{Total no. of days of eligible service period}}$$

Speculators and losses from shares

Generally, speculators are denied a revenue deduction for any losses arising from the disposal of shares unless a speculator is carrying on a business in relation to the shares (ie a share trader). Some of the significant factors in determining whether a person is a share trader include:

- whether there is 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;
- the setting of budgets and targets and keeping of 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 a share trader, losses may be deductible against other income. If the taxpayer is not a share trader, indexation or the CGT 50% discount may apply to reduce the capital gain.

➢ **STOP:** Note that Taxpayer Alert TA 2009/12 warns against an arrangement whereby taxpayers seek to re-characterise their shareholding status from that of a long term capital investor to a trader in shares.

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 to value each item of trading stock on hand. However, this does not apply to obsolete stock or to 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.

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, a 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 used or held 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 (which is deductible) and improvement of the item (which is capital and thus not deductible). It is important to understand 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

An employer is entitled to a tax deduction under s 290-60 of ITAA 1997 for contributions made to a complying superannuation fund or a retirement savings account (RSA) for the purpose of providing superannuation benefits for an employee if certain conditions in Subdiv 290-B of ITAA 1997 are satisfied.

TIP: To maximise the deductions available, employers should ensure that the contributions are paid to their employees' superannuation funds or RSAs before 30 June. However, note that contributions are considered "paid" when they are "received" by the super fund.

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

TIP: For employees turning 75, the contribution must be made by the employer within 28 days after the end of the month in which the employee turns 75. However, the age limit does not apply in respect of a deduction for an amount that is required to be contributed under certain industrial awards, determinations or agreements: s 290-80. From 1 July 2013, an employer can 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.

- **STOP:** The mere accrual of a superannuation liability or a book entry is not sufficient to qualify for a deduction.
- **STOP:** A company can only deduct a contribution for a director if the director is entitled to payment for the performance of duties as a member of the company's executive body.

Change to the minimum level of employer support

Between 1 July 2002 and 30 June 2013, the prescribed minimum level of superannuation support was 9% of an employee's earnings. From 1 July 2013, the rate gradually increases from 9%, starting with 9.25% for 2013–2014 and 9.5% for 2014–2015, until it reaches 12% from 1 July 2025.

Employers must use ordinary time earnings to calculate the minimum superannuation guarantee contributions required for their employees. If employers provide less than the required minimum level of support, they will be liable to pay a non-deductible charge called the superannuation guarantee charge.

- **STOP:** The ATO has identified the following industries as being at higher risk of not meeting superannuation obligations for employees: child care; building and industrial cleaning; and pubs, bars and taverns. The ATO has advised that it will be undertaking audits from July 2015 of employers from these industries who continue to not meet their superannuation obligations for their employees.
- **STOP:** In certain cases, a person who describes themself as an "independent contractor" may in fact still be an "employee" for superannuation guarantee purposes (in a similar manner as for PAYG purposes and for some of the state payroll tax laws).

Superannuation guarantee charge

The SGC is imposed if an employer does not make sufficient quarterly superannuation contributions for each employee by the relevant quarter's due date. The SGC is calculated, and the SGC is payable, on a quarterly basis. If an employer has a shortfall for a quarter, the employer is required to lodge a superannuation guarantee statement by the 28th day of the second month following the end of the relevant quarter. The SGC is payable by the same date. The SGC is not deductible: s 26-95 ITAA 1997. Note that the liability to pay the SGC remains with the employer even if the employer (if a company) goes into liquidation: see ATO ID 2008/28.

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. If 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 is the only tax that the Commissioner wants employers to avoid paying.

- **STOP:** 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.
- **STOP:** Directors have been made personally liable for their company's unpaid SGC amounts following the extension of the director penalty regime. The Commissioner can make an "estimate" of the unpaid SGC for a quarter under Div 268 of Sch 1 to the Taxation Administration Act 1953 (TAA) and recover the estimated amount through a director penalty under Div 269 of Sch 1 to TAA. The extension of the director penalty regime to SGC liabilities applies in respect of superannua0tion guarantee statements due and payable from 28 August 2012.

Personal superannuation deductions

The self-employed (and other eligible persons) are entitled to a full tax deduction under s 290-150 for their personal concessional contributions until age 75, consistent with employer contributions made on behalf of employees. The contribution is only deductible for the year in which the contribution is made: s 290-150(3).

If the taxpayer engages in activities as an employee, the taxpayer must also meet the 10% work test. That is, less than 10% of the total of their assessable income, reportable fringe benefits total, and reportable employer superannuation contributions for the income year is attributable to those activities as an employee: s 290-160.

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 that is given to the trustee of the relevant superannuation fund.

- **STOP:** Income attributable to a taxpayer's employment activities also includes worker's compensation payments, unused long service leave and annual leave payments, to the extent they are assessable in the income year: Taxation Ruling TR 2010/1.
- **STOP:** From 1 July 2013, any excess concessional contributions a taxpayer has for the corresponding financial year are disregarded for the purposes of the 10% test for deducting personal contributions: s 290-160(3). This follows the introduction of new rules from 1 July 2013 whereby any excess concessional contributions are included in a taxpayer's assessable income.
- **STOP:** Note that a deduction is not available in respect of any financing costs on a loan connected with a personal superannuation contribution.

TIP: A deduction for personal superannuation contributions should only be made towards the end of the income year when it is certain that a taxpayer will satisfy the 10% rule (and other eligibility conditions).

TIP: A taxpayer who has not engaged in an employment activity in the income year in which they make a contribution is not subject to the 10% earnings test. For example, a person receiving workers' compensation payments (but who is no longer employed) is not subject to the 10% test: see Taxation Ruling TR 2010/1.

Valid notice to claim deduction

In order 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 their 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 their 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 rollover.

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 71121-06.2012) form on its website at www.ato.gov.au/uploadedFiles/Content/SPR/downloads/spr86434n71121.pdf.

- **STOP:** If a valid notice is not provided, the taxpayer will not be entitled to a deduction for the personal superannuation contributions. The Commissioner may also impose an administrative penalty for failing to provide the notice within the time limit.

- **STOP:** The ATO says it will only accept notices that include all of the mandatory information and the member declaration.

Investment schemes

Cases concerning "tax effective" investment schemes show that the deductibility of expenditure incurred in relation to such schemes depends on the particular circumstances, especially an analysis of the agreement under which the relevant fees are paid (typically the management agreement, but also the loan agreement when considering the deductibility of interest payments).

- **STOP:** It may be advisable to invest only in a "tax effective" investment scheme for which a product ruling has been issued. A product ruling is a form of binding public ruling and sets out the taxation consequences of investing in a particular scheme. However, a product ruling is only binding to the extent the arrangement is implemented as proposed in the application for the ruling. The ruling does not guarantee the viability of a project, whether charges are reasonable or represent industry norms or whether projected returns will be achieved or are reasonably based.

Companies

The tax treatment of companies will depend on their classification, ie as a private or public company. For example, only a private company is subject to the operation of Div 7A in Pt III 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.

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 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.

For loans by a private company, taxpayers should:

- repay 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;
- ensure 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; and
- ensure that the interest rate on the loan for years of income after the year in which the loan is made equals or exceeds the benchmark interest rate for the year.

For payments by a private company:

- s 109C(3) contains an extended definition of "payment", which includes the crediting of amounts to, on behalf of, or for the benefit of an entity, and the transfer of property to an entity. If property is provided, companies should consider requiring shareholders to pay market value;
- the concept of "payment" also extends to the provision of an asset for use by a shareholder or the shareholder's associate. If a company-owned asset (eg a boat, etc) is made available for use by shareholders or their associates, companies should consider requiring payment of an arm's length fee or ensuring they retain full and unfettered access to the asset; and
- s 109D(4A) allows a payment by a private company to a shareholder (or an associate) to be converted into a loan before the lodgment day for the company's tax return. The loan can be repaid (before the lodgment day) or a written loan agreement that complies with s 109N may be entered into.

For debts forgiven by a private company:

- a debt is also taken to be forgiven (even if it has not actually been forgiven) if a reasonable person would conclude (having regard to all the circumstances) that the private company will not insist on the entity paying the debt or rely on the entity's obligation to pay the debt; and
- a deemed dividend may arise if a shareholder dies and the debt is forgiven during administration of the deceased's estate (and the dividend will be taken to be paid to the legal personal representative of the shareholder).

Other considerations include that:

- payments under a guarantee can trigger a deemed dividend and must be considered carefully;
- 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; and
- the exemptions available should be considered and used if possible.

Section 109RB gives the Commissioner a discretion to disregard a dividend that would otherwise be deemed to arise under Div 7A, or to allow a 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.

TIP: Taxpayers should ensure that any loans or payments are repaid by the earlier of the due date for lodgment of the company's tax return or the actual lodgement date. If repayment is not made, taxpayers should ensure that loan repayments and applicable interest are documented through loan agreements between the taxpayer and related party.

- **STOP:** Practice Statement Law Administration 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.

Research and development

Companies should consider whether they have undertaken eligible research and development (R&D) activities that may be eligible for the R&D tax incentive. Eligible R&D activities are experimental activities that are conducted in a scientific way for the purpose of generating new knowledge or information. The R&D tax incentive provides two types of tax offsets:

- a 45% refundable offset for smaller companies; and
- a 40% non-refundable offset for larger companies and companies controlled by tax-exempt entities.

The 45% tax offset is available to R&D entities with an aggregated turnover of less than $20 million per annum (unless they are controlled by one or more tax-exempt entities). The 40% tax offset is available to R&D entities that do not qualify for the refundable 45% offset.

The company's R&D activities need to be registered with AusIndustry within 10 months of the end of the income year. For example, this means that companies with a standard year of income of 1 July 2013 to 30 June 2014 who wish to apply for the R&D tax incentive for the 2013–2014 income year must have lodged their application with AusIndustry by Wednesday, 30 April 2015. Information on registration requirements is available on the Government's business.gov.au website at www.business.gov.au/grants-and-assistance/innovation-rd/RD-TaxIncentive/Pages/default.aspx.

TIP: Companies are required to maintain records to demonstrate, not only to AusIndustry, but also to the ATO, that the activities carried out are eligible R&D activities and that they incurred expenditure related to the activities.

- **STOP:** For the year ending 30 June 2015, there will no reduction, as had been proposed by the Government, in the R&D offset rate of 1.5 percentage points to 43.5% and 38.5% for "small" and "large" companies, respectively. This means the R&D tax incentive offset will remain at 45% for "small" companies and 40% for "large" companies.
- **STOP:** A $100 million R&D annual spending limit for the R&D tax incentive has been introduced with effect from income years beginning on or after 1 July 2014, meaning the limit would only apply to taxpayers lodging their tax returns from 1 July 2015 onwards. Note the limit will apply for 10 years and will cease on 1 July 2024.

Tax consolidation

Companies may want to consider consolidating for tax purposes prior to year-end in order 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.

Carried forward losses

Companies should carefully consider whether any deductions are available for any carried forward losses, including analysing the continuity of ownership test and the same business test.

Loss carry-back regime

The loss carry-back offset rules in Div 160 of ITAA 1997 give companies (and other corporate tax entities) which have paid tax in a previous income year a limited right to, in effect, obtain a refund of tax (by way of a tax offset) where losses are incurred in a subsequent year.

Importantly, the tax offset (the loss carry-back offset) has been repealed as from the start of the 2013–2014 income year (thus the operation of the concession has been preserved for the 2012–2013 income year only). In the 2012–2013 income year, corporate tax entities can carry-back up to $1 million worth of losses to obtain a refund of tax paid in the 2011–2012 income year.

STOP: Only corporate tax entities (as defined in s 960-115) can take advantage of the loss carry-back rules.

Monthly pay-as-you-go (PAYG) instalments

A monthly instalment system is being phased in from 1 January 2014. Initially, the monthly system only applies to very large corporate tax entities (companies, corporate limited partnerships, corporate unit trusts and public trading trusts), but by 1 January 2017 the system will apply to all entities that meet or exceed a $20 million threshold. The monthly instalment system is being phased in as follows:

- from 1 January 2014 – corporate tax entities that meet or exceed the $1 billion threshold;
- from 1 January 2015 – corporate tax entities that meet or exceed the $100 million threshold;
- from 1 January 2016:
  - corporate tax entities that meet or exceed the $20 million threshold; and
  - all other entities, including superannuation funds and trusts, that meet or exceed the $1 billion threshold; and
- from 1 January 2017 – all non-corporate tax entities (including individuals) that meet or exceed the $20 million threshold.

An entity that reports and pays GST on a quarterly or annual basis will only become a monthly payer if it meets or exceeds the $100 million threshold: s 45-138. The head company of a consolidated group or the provisional head company of a multiple entry consolidated (MEC) group will be a monthly payer if it meets or exceeds the $20 million threshold.

Trusts

The provisions governing trusts, including in whose hands trust income is assessed and the amount assessed, are 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 as trust income or whether trust income is equated with taxable income. This may have an impact on the trustee's tax planning.

TIP: It is critical to check who are the trust beneficiaries and ensure that all distributions of income are valid under the deed.

Family trust election

Trustees should consider whether a family trust election (FTE) is required to ensure any losses or bad debts incurred by the trust 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 to avoid the family trust distribution tax. Family trust distribution tax is payable on the amount or value of income or capital to which a non-family member is presently entitled or that is distributed to a non-family member. The rate of tax is equal to the top personal marginal tax rate plus Medicare levy. The rate is:

- for income years before 2014–2015 – 46.5%;
- for 2014–2015, 2015–2016 and 2016–2017 – 49% (incorporating the increase in the Medicare levy to 2% and the 2% temporary budget repair levy); and
- for 2017–2018 and later years – 47%.

Trusts and Division 7A

An amount of trust income to which a private company is or has been presently entitled, but that has not been distributed to the company, may be regarded as a loan made by the company to the trust for the purposes of the deemed dividend provisions of Div 7A.

The Commissioner has indicated that he will apply Div 7A where there is an unpaid present entitlement (UPE) from a trust to an associated private company. The approach that the Commissioner will adopt in UPE cases is outlined in Taxation Ruling TR 2010/3, and guidance as to how that ruling will be applied is contained in Practice Statement Law Administration PS LA 2010/4.

In broad terms, a trust distribution to a beneficiary who is a private company that remains unpaid may be regarded by the ATO as a deemed dividend in the hands of the trustee. Such deemed dividends could be avoided if the UPE (that arises on or after 1 July 2011) is paid out, or if a complying loan agreement is entered into, by the due date for lodgment of the private company's tax return.

Note that the ATO has also issued a supplementary guide, which taxpayers should read in conjunction with the Ruling and PS LA 2010/4. This guide is available on the ATO's website at www.ato.gov.au/Business/Division-7A/In-detail/Fact-sheets/Division-7A---unpaid-present-entitlement.

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 ITAA 1936 and there remains some uncertainty as to its meaning. Note that the previous Government was 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) 75 ATR 1, the trust deed permitted the trustee to determine that a capital gain should be treated as income of the trust estate. For the 2001–2002 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) 81 ATR 772. 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 the trust estate" for the purposes of s 97: see the ATO's Decision Impact Statement on the *Bamford* case and Practice Statement Law Administration 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 2009–2010 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 Law Administration PS LA 2010/1.

The ATO has set out its preliminary views on the meaning of "income of the trust estate" as used in Div 6 in Draft Taxation Ruling TR 2012/D1. The draft ruling states 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 said 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 said the statutory context in which the expression is used may also influence its meaning. Note that the ATO has indicated that the draft ruling would not be finalised pending possible law reform. (*See* **Pending changes relating to trust income** *on page 16*.)

> **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.

- **STOP:** Note that for the 2010–2011 and subsequent years, new rules contained in Subdiv 115-C apply to capital gains made by trusts.

Pending changes relating to trust income

Following the High Court's decision in *Bamford*, the previous Government announced that it would update and rewrite Australia's trust taxation laws. The then Government said 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 would 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.

On 24 October 2012, the previous Government released a policy options paper for reforms to the taxation of trusts. The options paper considered two possible models for taxing trust income that were outlined in the initial consultation paper released in November 2011:

- an **economic benefits model (EBM)** – referred to as the "trustee assessment and deduction model" in the consultation paper, the EBM uses tax concepts to determine how different amounts should be dealt with for tax purposes. Broadly, the EBM would assess beneficiaries on taxable amounts distributed or allocated to them, with the trustee assessed on any remaining taxable income; and
- a **proportionate assessment model (PAM)** – referred to as the "proportionate within class" model in the consultation paper, the PAM uses general concepts of profit to determine tax outcomes. Broadly, the PAM assesses beneficiaries on a proportionate share of the trust's taxable income equal to their proportionate share of the "trust profit" of the relevant class. As currently occurs, present entitlement would be used as the basis for attributing the trust profit or class amounts to beneficiaries.

The previous Government did not release draft legislation for consultation. It had expected to introduce changes with effect from 1 July 2014.

On 6 November 2013, after winning the federal election, the new Coalition Government announced its formal position with respect to some 92 previously announced tax, superannuation and related changes that had not been legislated. In relation to the review of the taxation of trusts, the Assistant Treasurer at the time (Senator Arthur Sinodinos) said that work was continuing and that he would not push that review "to report prematurely" because it was a complex issue.

Trust issues on ATO radar

The ATO is leading a taskforce to combat the misuse of trust structures. The ATO said the Trust Taskforce is cracking down on those exploiting trusts to conceal their interests, mischaracterise transactions and artificially deal with trust income to avoid paying their fair share of tax. The Trust Taskforce is expected to raise $415 million in liabilities and $165 million in collections by the end of 2016.

Taxpayer Alert TA 2014/1 describes an arrangement where property developers use trusts to return the proceeds from property development as capital gains instead of income on revenue account. The alert notes the ATO has commenced a number of audits and has made adjustments to increase the net income of a number of trusts. It adds that audit activity will continue. The alert is available on the ATO Legal Database at http://law.ato.gov.au/pdf/tpa/tpa1401.pdf.

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 (*see* **Depreciation (capital allowances)** *on page 5*);
- simpler trading stock rules – being allowed to ignore the difference between the opening and closing value of trading stock (up to $5,000) (*see* **Trading stock** *on page 9*);
- small business CGT concessions – the 15-year exemption, 50% reduction, retirement exemption and rollover concession (*see* **Small business CGT concessions** *on page 17*);
- the prepaid expenses rules (*see* **Prepayments** *on page 8*);
- the use of the GDP-adjusted notional tax method for working 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 is classified as a small business entity for an income year if:

- it carries on a business in the current year; and
- it had an aggregated turnover for the previous year of less than $2 million, or is likely to have an aggregated turnover for the current year that is 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 their capacity as a partner, a small business entity for the income year: s 328-110(6).
- **STOP:** The connected entity test was amended by the *Tax Laws Amendment (2013 Measures No 1) Act 2013* to remove references to beneficial ownership of interests. As a result, the test is now based on ownership of interests rather than beneficial ownership of interests. As a result, the small business concessions in Div 328 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. In addition, companies in liquidation, bankrupts, absolutely entitled beneficiaries and security providers are treated as the owners of CGT assets for the purposes of the small business connected entity test.

Capital gains tax

A taxpayer may consider crystallising any unrealised capital gains and losses in order to improve their overall tax position for an income year. For example, if the taxpayer anticipates 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 of (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 for 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 in order 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 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, they must be at least 55 years of age and the CGT event must happen in connection with the taxpayer’s retirement, or they 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 may choose to disregard all or part of a capital gain up to a lifetime maximum of $500,000; and
4. **the asset rollover concession:** a taxpayer may disregard all or part of a capital gain if a replacement asset that 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 capital gain remaining after the 50% reduction may be further reduced by the retirement exemption and/or the asset rollover concession, if the gain qualifies for those concessions. Note that if the gain qualifies for both the retirement and rollover 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 years 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. Also, any prior year losses and the CGT discount must be applied to a gain before the retirement exemption.

TIP: A taxpayer claiming the asset rollover concession does not need to acquire a replacement asset before choosing the rollover. However, if the taxpayer does not acquire a replacement asset by the end of the “replacement asset period”, or other replacement asset conditions are not met by that time, CGT event J5 will apply to reinstate the rolled over gain.

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 their 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). **TIP:** In *Re Gutteridge and FCT* [2013] AATA 947, the AAT allowed the appeals of two taxpayers (a married couple) and held that the husband alone was the person who controlled the relevant trust within the meaning of s 328-125(3) of ITAA 1997 and that the trust was therefore entitled to certain CGT small business concessions. The Commissioner had argued that the daughter was a controller of the trust and that, therefore, the trust was connected with another entity controlled by her, with the effect that the trust was not eligible for any of the Div 152 small business concessions. However, the AAT concluded that although the daughter was the director and public face of the business carried on by the trust, the trustee was not accustomed to acting in accordance with her wishes. The AAT found the husband alone was the person who controlled the trust within the meaning of s 328-125(3). This case may provide guidance in circumstances involving "puppet directors". Note, however, that the ATO's Decision Impact Statement on this case stated that the Commissioner did not accept that the "reasonable expectation" test in s 328-125(3) can be substituted with an "accustomed to act" test in all cases. **TIP:** Good records are necessary to help substantiate claims for any of the small business CGT concessions. Records that should be kept should include the market value of relevant assets just before the CGT event, evidence of carrying on a business (including calculation of turnover) and calculations relating to carried forward losses. Other documents that should be kept include relevant trust deeds, trust minutes, company constitution, and any other relevant documents.

- **STOP:** Under the maximum net asset value test, the net value of all the CGT assets of the taxpayer, entities "connected with" the taxpayer, the taxpayer's "affiliates" and entities "connected with" the taxpayer's affiliates (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, note that 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.

Rollover relief

Rollover 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 rollover usually places the transferee under the rearrangement in the same CGT position that the transferor was in before the event occurred. Some types of rollover relief apply automatically, while some require taxpayers to elect the use of the relief, which is indicated by the way their tax returns are prepared.

Two types of rollovers are available: the replacement asset rollover and the same asset rollover. A replacement asset rollover allows the deferral of a capital gain or loss until a later CGT event happens to the replacement asset. A same asset rollover 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 rollover relief that may be considered for tax planning purposes:

Type of rollover	**Brief description**	**Election required**
Rollover from individual to company	Individual disposes of assets to a wholly owned resident company	Yes
Rollover from trust to company	Trustee of a trust disposes of assets to a wholly owned resident company	Yes
Rollover from partnership to company	Partners dispose of assets to a wholly owned resident company	Yes
Assets compulsorily acquired, lost or destroyed	Disposal of an asset by being compulsorily acquired, lost or destroyed	Yes
Fixed trust to company	Fixed trust disposes of all of its assets to a resident company	Yes
Breakdown of marriage or de facto relationship	Taxpayer disposes of assets to their spouse pursuant to an order of a court under the *Family Law Act 1975,* or a written agreement under a state, territory, or foreign law relating to relationship breakdowns	No

Type of rollover	Brief description	Election required
Small business replacement asset rollover	Taxpayer who is eligible for the small business CGT concessions acquires a replacement asset or improves an existing asset	No

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, which may impact on the tax position of a taxpayer.

- **STOP:** Although the present Government has pledged "not to make any unexpected detrimental changes to superannuation", tax advisors should stand ready to respond to any possible changes.

Some items for taxpayers to consider:

- Checking the individual's age to identify the relevant contributions caps.
- Investigating or reviewing superannuation salary sacrifice arrangements.
- Responding to changes in personal circumstances, such as pay rises or extended time off work, that would alter the amount of concessional contributions made.
- Making additional after-tax non-concessional contributions.
- Triggering the bring-forward provisions of the non-concessional contributions cap.
- Identifying concessional contributions relating to multiple jobs.
- Considering making a contribution on behalf of a spouse.
- Checking eligibility for the Government's co-contribution scheme.
- Checking the amount of employer-paid costs, such as insurance premiums etc, as they may count toward the concessional contributions cap.
- Reviewing reasons for having more than one superannuation fund (if the person has multiple funds).

Timing of contributions

A contribution is considered to be "made" by a taxpayer or an employer when a cheque, or an amount of cash, is "received" by the trustee of a superannuation fund or RSA, except in the case of a post-dated or dishonoured cheque. According to Taxation Ruling TR 2010/1, a contribution by electronic funds transfer (EFT) is not made until an amount is credited to the fund's bank account.

TIP: Individuals who wish to take advantage of the concessionally taxed superannuation environment while staying under the relevant contributions caps should consider keeping track of contributions and avoid making last-minute contributions that would be allocated to the next financial year. However, if individuals decide to make a payment before 30 June, they should allow for possible delays and ensure that the fund will receive the amounts on time. For example, funds paid by electronic funds transfer on 30 June may not be received by the fund until the next day, ie 1 July. Other payment options (eg via cheque in the mail or via a clearing house) may cause additional delays.

TIP: Individuals with salary sacrifice arrangements for superannuation may want to have early discussions with their employers to help ensure contributions are allocated to the correct financial year.

Types of contributions and annual contribution caps

Superannuation contributions are classified as either "concessional" or "non-concessional". Below is a table summarising the types of contributions and annual contribution caps.

Type of contribution	Annual contribution cap 2013–2014 ($)	Annual contribution cap 2014–2015 and 2015–2016 ($)	Excess contributions tax (%)
Concessional[1] – < age 50	$25,000[2]	$30,000[2]	31.5 (abolished from 1 July 2013)[3]
Concessional[1] – age 50-59	$25,000[4]	$35,000[4]	31.5 (abolished from 1 July 2013)[3]
Concessional[1] – age 60 +	$35,000[4]	$35,000[4]	31.5 (abolished from 1 July 2013)[3]
Non-concessional[5]	$150,000	$180,000	49 (46.5 prior to 1 July 2014)[6]
Non-concessional (3-year)[7]	$450,000	$540,000	49 (46.5 prior to 1 July 2014)
TFN not quoted[8]	N/A	N/A	49 (46.5 prior to 1 July 2014)

1 Concessional contributions are essentially contributions which are included in the assessable income of the receiving superannuation fund, eg employer contributions, salary sacrifice contributions, deductible personal contributions.

2 Cap increased to $30,000 from 2014–2015 via indexation. The cap is $30,000 for 2015–2016. For 2013–2014, a $35,000 cap applies for those who were 59 years or over on 30 June 2013: see note 4.

3 Excess concessional contributions tax of 31.5% is levied on the individual (on top of the original 15% contributions tax paid by the fund). However, an individual is able to withdraw from their superannuation fund an amount to meet the tax liability. From 1 July 2013, the Government abolished excess concessional contributions tax. Instead, excess concessional contributions is automatically included in an individual's assessable income from the 2013–2014 income year (and subject to an interest charge).

4 For 2013–2014, a $35,000 concessional contributions cap (not indexed) applies for those who were 59 years or over on 30 June 2013, instead of the general concessional cap of $25,000. The $35,000 concessional cap applies from 2014–2015 for those who are 49 years or over on 30 June for the previous income year.

5 Non-concessional contributions include contributions which are not included in the assessable income of the receiving superannuation fund, eg non-deductible personal contributions made from the member's after-tax income. Section 290-90 also provides for several specific inclusions (eg excess concessional contributions) and exclusions (eg government co-contributions and proceeds from the disposal of small business assets up to the CGT cap of $1.355 million for 2014–2015 and $1.395 million for 2015–2016).

6 Excess non-concessional contributions tax of 49% (or 46.5% prior to 1 July 2014) is levied on the individual who must withdraw an amount from their superannuation fund to meet the tax liability. Individuals can withdraw any excess non-concessional contributions made from 1 July 2013, plus 85% of the associated earnings. If an individual chooses this option, no excess contributions tax is payable but the full amount (ie 100%) of the associated earnings are included in the individual's assessable income (and subject to a 15% tax offset). Individuals who leave their excess non-concessional contributions in their superannuation fund will continue to be taxed on these contributions at the top marginal tax rate (ie 49% from 1 July 2014).

7 Individuals under 65 may bring forward the non-concessional cap for the next two years (ie $540,000 over three years from 2014–2015).

8 Where a member's TFN has not been quoted to a super fund by 30 June each year, this "no-TFN contributions income" is taxed at 49% (or 46.5% prior to 1 July 2014) in the hands of the receiving fund. A superannuation fund must return non-concessional contributions within 30 days where the member has not quoted a TFN.

Extra 15% Division 293 tax for higher income earners

From the 2012–2013 income year, individuals above a "high income threshold" of $300,000 are subject to an additional 15% "Division 293 tax" on their "low tax contributions" (essentially concessional contributions). As a result, the effective contributions tax has been doubled from 15% to 30% for certain concessional contributions (up to the concessional cap) for "very high income earners" with income (plus the relevant concessional contributions) above the $300,000 threshold.

TIP: Despite the extra 15% tax on concessional contributions for individuals with incomes above $300,000, there is still an effective tax concession of 15% (ie the top marginal rate less 30%) on their concessional contributions up to the cap of $30,000 for 2014–2015 (or $35,000 for those 50 or over). Nevertheless, taxpayers who exceed the $300,000 high income threshold should review their superannuation contributions and salary sacrificing arrangements to take into account any impact of the additional 15% Division 293 tax.

ATO administrative penalties for SMSF trustees

Trustees of self-managed superannuation funds (SMSFs) should be aware of new ATO powers to impose administrative directions and penalties for certain super law contraventions from 1 July 2014. The Tax Commissioner can give rectification directions, such as a direction that a trustee ensures that the fund begins complying with the relevant legislation, and education directions to ensure that a trustee's knowledge of the relevant legislation comes up to the requisite standard. The Tax Commissioner can also impose administrative penalties on SMSF trustees for certain contraventions of the superannuation law.

- **STOP:** Any costs imposed under the administrative penalty regime are payable personally by the person who has committed the breach (and cannot be paid or reimbursed from assets of the SMSF): s 168 of the SIS Act. The directors of a corporate trustee at the time it becomes liable to the penalty are jointly and severally liable to pay the amount of the penalty: s 169.
- **STOP:** From 18 March 2014, civil and criminal penalties apply for the promotion of illegal early release schemes involving unlawful payments from regulated superannuation funds (including SMSFs): s 68B of the SIS Act. A breach is a civil penalty contravention that may result in a fine up to $340,000 and/or 5 years imprisonment.

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 their 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 contribution splitting has been reduced following the abolition of reasonable benefit limits and end benefits tax for those aged 60 years 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 attain 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 assist taxpayers in equalising their total superannuation balances to guard against a future government possibly seeking to introduce a cap on the tax-free fund earnings for pension assets.

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 30 days (90 days prior to 1 July 2013) after receiving the application.

TIP: Note that the spouse contributions-splitting regime is separate from the tax offset up to $540 for personal superannuation contributions made by a taxpayer on behalf of their spouse. (*See* **Spouse contributions tax offset** *on page 22*.)

Low income superannuation contribution

From the 2012–2013 income year (until the 2016–2017 income year), the Government will make a low income superannuation contribution (LISC) of up to $500 for individuals with an adjusted taxable income (ATI) that does not exceed $37,000. The *Minerals Resource Rent Tax Repeal and Other Measures Act 2014* provides for the LISC to apply until 30 June 2017 and then be repealed in respect of concessional contributions made from the 2017–2018 financial year. The Government had originally proposed to repeal the LISC for contributions made after 1 July 2013. However, the Government agreed to continue the LISC until the 2016–2017 financial year pursuant to a compromise deal with the minority parties to repeal the MRRT.

Government co-contribution

Certain low-income earners (including self-employed persons) may qualify for a government superannuation co-contribution payment if the individual makes eligible personal superannuation contributions during an income year and the individual does not exceed the relevant total income thresholds. For 2014–2015, the lower income threshold is $34,488 (phasing down for incomes up to $49,488). For 2015–2016, the lower income threshold is $35,454 (phasing down for incomes up to $50,454). That is, a government co-contribution up to a maximum of $500 per annum is available for a $1,000 eligible personal superannuation contribution during an income year for those under the lower income threshold. The amount of the government co-contribution then reduces and is not available when the individual exceeds the upper income threshold.

Lost superannuation transfers to ATO

A trustee of a regulated superannuation fund is required to report details about small accounts of lost members, and inactive accounts of unidentifiable lost members, and pay these amounts to the ATO. The account balance threshold below which accounts of "lost members" must be transferred to the ATO has been increased to $2,000. In addition, the period of inactivity before "inactive accounts" of unidentifiable members must be transferred to the ATO has been decreased to 12 months.

TIP: From 1 July 2013, the Commissioner will pay CPI interest on payments of unclaimed superannuation money. Interest will accrue and be payable from 1 July 2013 at the time the money is claimed from the Commissioner. However, interest will not accrue in relation to the periods before 1 July 2013.

Spouse contributions tax offset

A tax offset is available up to $540 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 an RSA for the purpose of providing superannuation benefits for the taxpayer's low-income or non-working resident spouse (including a de facto spouse and, from 1 July 2009, a same sex partner).

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 for the income year 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 is 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 aged 65 years 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 years.

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

The assessable income, reportable fringe benefits and reportable employer superannuation contributions of the spouse must be less than $10,801 in total 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 they qualify for a deduction or tax offset for any superannuation contributions made for their own benefit, 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

A member of a regulated superannuation fund who has reached their preservation age (currently age 55 can access their superannuation benefits as a non-commutable income stream without needing to retire. As a result, workers have the option of retaining a connection with the workforce, rather than being forced to retire early simply to gain access to their superannuation.

Upon attaining preservation age, this limited condition of release (also referred to as a "transition to retirement pension" or "pre-retirement pension") allows superannuation benefits to be accessed through the existing range of non-commutable income streams. Importantly, eligibility for this condition of release is not subject to a work test (ie part-time and full-time employees qualify).

The minimum pension standards apply to transition to retirement pensions for a person who has reached their preservation age. However, transition to retirement pensions have a maximum annual payment limit of 10% of the account balance at the start of each financial year. Note that the Tax Commissioner's administrative policy to allow a superannuation income stream to continue despite a failure to meet the minimum pension standards from 1 July 2007 may apply to transition to retirement pensions in respect of breaches of the "minimum" payments (but not the maximum 10% limit). (*See* **Minimum payment rules** *on page 24*.)

The category of "transition to retirement income stream" or "non-commutable allocated pension or annuity" cannot be cashed or commuted to a lump sum while the person is still working, unless they have satisfied a condition of release with a "nil" cashing restriction (eg permanent retirement from the workforce or reaching age 65).

Note that it is not compulsory for superannuation funds to offer their members these non-commutable income streams. Furthermore, the fund's trust deed must allow benefits to be accessed when a member reaches preservation age, without needing to retire, and must allow the payment of a non-commutable complying or allocated pension.

➢ **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 of transition to retirement pensions

A pension paid from a taxed source to a person aged 60 years or over is totally tax free (ie not assessable and not exempt income). As such, it is not counted in working out the tax payable on any other assessable income of the taxpayer.

For a pension paid to a person under age 60, the "taxable component" of the pension paid from a taxed source is included in the person's assessable income. A taxpayer above his or her preservation age (but below age 60) is entitled to a 15% tax offset in respect of the taxable component of the pension. Any tax-free component of a pension paid from a taxed source is tax free, regardless of the pension recipient's age. Once the pension recipient reaches 60 years, their pension is received tax-free.

Transition to retirement pensions and salary sacrifice strategies

Transition to retirement pensions has brought to light various tax-effective strategies whereby a taxpayer who is above preservation age can draw down their superannuation via a transition to retirement pension while, at the same time, salary sacrificing employment income back into retirement savings.

Instead of being taxed as employment income at the taxpayer's marginal rate, the salary sacrificed superannuation contributions are only taxed at the rate of 15% on entry into the superannuation fund. However, the annual concessional contributions cap effectively restricts the amount available for salary sacrificing. For 2013–2014, the concessional cap was $25,000 (or $35,000 for those who were aged 59 years or over on 30 June 2013). For 2014–2015, the higher concessional cap of $35,000 (instead of the general concessional cap of $30,000 for 2014–2015) also applies for taxpayers aged 49 years or over on 30 June 2014. (*See* **Types of contributions and annual contribution caps** *on page 20*.)

Note that the effective contributions tax has been doubled from 15% to 30% for certain concessional contributions for those above the $300,000 income threshold. As such, taxpayers who exceed this income threshold should review their superannuation contributions and salary-sacrifice arrangements to take into account any impact of the additional 15% tax. (*See* **Extra 15% Division 293 tax for higher income earners** *on page 20*.)

To access income to live on, the person can access their superannuation via a non-commutable income stream (eg a transition to retirement pension). A pension paid to a person aged 60 years or over is totally tax-free. A pension paid to a person under age 60 but above preservation age is included in their assessable income, but a 15% tax offset applies in respect of the taxable component of the pension.

While this strategy results in less overall tax being paid on the pension income (compared with employment income), the greatest advantage from converting employment income to pension income comes from the income tax exemption available to the superannuation fund in respect of income derived from assets that are set aside to support the fund's current pension liabilities.

➢ **STOP:** Any salary sacrifice arrangement must strictly comply with Taxation Ruling TR 2001/10.

Simplified pension rules – minimum standards

New minimum standards apply from 1 July 2007 for private superannuation pensions and annuities under the SIS Regulations. All pensions and annuities that meet the simplified minimum standards are taxed the same on payment. Earnings on assets supporting these pensions remain tax-exempt. Existing allocated pensions and annuities are also able to operate under the new minimum payment rules.

Under the new standards set out in subregs 1.05(11A), 1.06(9A) and Sch 7 of SIS Regulations, pensions and annuities effectively fall into two classes:

- *account-based income streams* – those where there is an account balance attributable to the recipient; and
- *non-account based income streams* – those where there is no attributable balance (eg traditional lifetime and life expectancy income streams generally offered by life insurance companies). However, this category can no longer commence from a self managed superannuation fund.

Broadly, the new minimum standards for account-based pensions and annuities require:

- payments of a minimum amount to be made at least annually, allowing pensioners to take out as much as they wish above the minimum (including cashing out the whole amount): SIS reg 1.07D;
- no provision to be made for an amount to be left over when the pension ceases; and
- that the pension can be transferred only on the death of the pensioner (primary or reversionary as the case may be) to one of their dependants or cashed as a lump sum to the pensioner's estate.

Note that the deeming rules in the *Social Security Act 1991* have been extended to superannuation account-based income streams for the purposes of the pension income test to ensure that all financial investments are assessed under the same rules from 1 January 2015. Products held by pensioners before 1 January 2015 are grandfathered provided that such pre-1 January 2015 income support continues uninterrupted from that day. Similarly, another amending Act applies the deeming rules to untaxed superannuation income streams for the purposes of the income test for the Commonwealth Seniors Health Card (CSHC) from 1 January 2015. The CSHC income threshold is $51,500 for singles (and $82,400 for couples) from 20 September 2014. For people who have continuously held a CSHC from before 1 January 2015, account-based pensions and annuities in place before 1 January 2015 are grandfathered under the original rules. Therefore, advisers need to consider the implications of disrupting established pre-1 January 2015 account-based pensions after 31 December 2014 and potentially triggering the new social security deeming rules.

A Treasury discussion paper, *Review of retirement income stream regulation*, July 2014, investigates the regulatory barriers for retirement income products and considers the extension of concessional tax treatment to facilitate deferred lifetime annuities. The paper is also reviewing the minimum annual payment amounts for superannuation account-based pensions to assess how appropriate they are in light of the prevailing financial markets.

Minimum payment rules

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. From 2013–2014, the minimum draw down amounts are calculated according to the standard percentage factors in Sch 7 to the SIS Regs.

Minimum annual draw down factors			
Age of beneficiary (years)	**Minimum annual draw down for 2008–2009, 2009–2010 and 2010–2011 (%)**	**Minimum annual draw down for 2011–2012 and 2012–2013 (%)**	**Minimum annual draw down for 2013–2014 + (%)**
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

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 they 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 (results test, unrelated clients test, employment test and business premises test) is satisfied. 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 Tax Commissioner has the power to grant a determination, which has the effect of exempting an individual or a personal services entity from the PSI regime. Generally, a determination will be granted if unusual circumstances existed that prevented the business from satisfying the tests, or if 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 for taxpayers: www.ato.gov.au/Business/Personal-services-income/In-detail/Introduction/Personal-services-business-self-assessment-checklist.

- **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.

Fringe benefits tax

Car fringe benefits

The four rates used in the statutory formula method for determining the taxable value of car fringe benefits have been replaced with a single statutory rate of 20% for fringe benefits. Note that there has been a three-year phase-in period.

For those with pre-existing commitments (contracts entered into up to 10 May 2011) that are financially binding on one or more of the parties, the old statutory rates continue to apply. 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 on 10 May 2011 have been 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%

- **STOP:** From the 2014–2015 FBT year, the FBT statutory rate is 20% regardless of how far the car is driven.
- **STOP:** An employer can choose to skip the transitional arrangements and directly use the flat 20% rate, but only with the consent of any employees who would be worse off as a result of the employer making that choice. The way an employer's return for the relevant FBT year is prepared will be sufficient evidence of the making of the choice.

In-house fringe benefits

The first $1,000 of the aggregate of the taxable values of "in-house" fringe benefits (ie in-house expense payment, in-house property and in-house residual fringe benefits) provided to an employee during a year is exempt from FBT (but note the restriction below where a benefit is provided under a salary packaging arrangement).

"In-house" fringe benefits generally arise where an employee (or an associate of an employee) is provided with benefits that are similar or identical to those provided to the employer's customers or clients. The exemption applies in respect of the total benefit provided to each employee and their associates in a particular year.

The exemption applies to the taxable value of benefits, rather than the market value of the goods or services provided. For example, in the case of a retailer a fringe benefit is only provided to an employee if the goods are provided at below cost. This means that goods to a value greatly in excess of $1,000 can be provided to an employee at a discount from the retail price without the $1,000 figure being breached.

If the aggregate fringe benefit amount includes a mixture of benefits that do not all give rise to GST input tax credits, the $1,000 threshold amount should be deducted from the employer's Type 1 aggregate fringe benefits amount first. The relevant gross-up rate (2.0802) is applied to any residual Type 1 benefits.

If the $1,000 exemption is not likely to be exceeded in respect of an employee, record-keeping is not required: Miscellaneous Taxation Ruling MT 2022.

Salary packaged benefits

The $1,000 reduction does not apply to an in-house benefit provided on or after 22 October 2012 under a salary packaging arrangement. If the salary packaging arrangement was in place before 22 October 2012, the $1,000 reduction is available for benefits provided before the earlier of 1 April 2014 and the first material variation (if any) in the arrangement.

Individuals

Tax-free threshold

For the 2014–2015 income year, the general tax-free threshold available to Australian resident taxpayers is $18,200. The tax-free threshold does not apply to foreign residents. The tax-free threshold has to be apportioned if a taxpayer becomes an Australian resident, or ceases to be an Australian resident, during the income year.

Tax offsets

A "tax offset" reduces a taxpayer's basic income tax liability.

Dependent (invalid and carer) offset

The dependent (invalid and carer) tax offset in Subdiv 61-A of ITAA 1997 generally replaced the invalid spouse, carer spouse, child-housekeeper, invalid relative, parent or parent-in-law and housekeeper tax offsets. However, those offsets remain available to taxpayers eligible for the zone offset, overseas forces offset or overseas civilian offset, who will not be entitled to the dependent (invalid and carer) offset. Note the proposal to abolish those offsets from 2014–2015.

- **STOP:** The Government announced in the 2014–2015 Federal Budget that the tax offsets for dependants, with the exception of the dependent (invalid and carer) offset, will be abolished with effect from the 2014–2015 income year. The offsets that will be abolished are the spouse, invalid spouse, carer spouse, child-housekeeper, invalid relative, parent and parent-in-law offsets. The housekeeper offset will also be abolished. As noted above, access to the offsets that are to be abolished (except the spouse offset) is restricted to taxpayers who qualify for the zone, overseas civilian or overseas forces offset. The Government has proposed that those taxpayers will instead qualify for the dependent (invalid and carer) offset as from the 2014–2015 income year. Legislation to implement these measures had not been introduced as at 17 April 2015.

Low income offset

Certain low income taxpayers are entitled to an offset under s 159N of ITAA 1936. The maximum offset for 2014–2015 is $445. Note that previously legislated changes to the low income offset to apply from 2015–2016 (reduction in the maximum offset to $300, increasing the phase-out limit to $67,000 and lowering the reduction rate from 1.5% to 1%) have been repealed.

Medical expenses offset

A resident taxpayer who during the income year pays net medical expenses (as defined, see [19 360]–[19 400]) for themself or for a resident dependant is entitled to an offset under s 159P ITAA 1936 (commonly called the net medical expenses tax offset). Note the medical expenses offset is being phased out over a six-year period and will no longer be available after 2018–2019. Transitional arrangements allow taxpayers who claimed the offset in both 2012–2013 and 2013–2014 to claim it in 2014–2015 (for all qualifying expenses that meet the requisite threshold). However, from 2015–2016 to 2018–2019, those taxpayers will only be able to claim the offset for medical expenses relating to disability aids, attendant care or aged care. All other taxpayers can only claim the offset (from 2014–2015 to 2018–2019) for medical expenses relating to disability aids, attendant care or aged care.

Private health insurance offset

A tax offset is available (under Subdiv 61-G of ITAA 1997) to individual taxpayers and some trustees in respect of private health insurance premiums, including if the premiums are paid by an individual's employer as a fringe benefit. The private health insurance offset has been means tested since 1 July 2012. There are three private health insurance incentive tiers.

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