NEWSLETTER

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This planner is written to assist in recognising issues and implementing strategies prior to year end to maximise profits and minimise taxes payable in the current and future years. This edition is particularly designed to be of interest to anyone who has other income, or controls assets, outside of their employment.

Increasing your personal wealth and reducing your taxes is what this is about.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation strategy and can be designed to provide substantial tax savings if correctly structured and managed. If the strategy is to work, all of the elements must be considered and kept in balance.

You need to have a wealth and tax creation strategy that deals with lowering tax rates across the income spectrum, increases the return on investment and frees up for further investments.

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NOW IS THE TIME

If you believe that you are going to be affected by the proposed superannuation changes then you should seek advice now and not wait until 1 July 2016 because it is all effective from 1 July 2017 and it is unlikely that we will see any legislation detailing the changes until sometime in December 2016.

There are vehicles and structures that can be used that are tax effective and if managed correctly can keep a family's annual tax rate below 15% which is the proposed tax rate that will be applicable to the accumulation content of superannuation funds.

We believe it is time that all taxpayers should seriously consider whether superannuation is in fact the best way to save for retirement. The government has historically changed the rules around superannuation and since 1985 has turned much of the tax free funds into a situation where the tax free element becomes taxable.

It is rarely mentioned that on your death in most cases your pension fund becomes an accumulation fund from your date of death. When you converted your accumulation fund to a pension fund (in part or in whole) a proportion of that was taxable and a proportion was tax-free.

The tax-free element will represent the un-taxed contributions made by you in your lifetime. On converting to a part or full pension the proportion of tax-free contributions made by you to the total fund (comprising compulsory superannuation, earning etc.) remains the same.

If you are in a transition to retirement then the majority of each payment is tax-free however should you die your Members Account will revert on the date of your death to an Accumulation Fund.

Any income earnt by the fund from the date of death to the date of payout becomes taxable in the hands of the fund.

When the fund is paid out to the Beneficiary, the tax-free amount that was in the fund is paid out tax-free and the balance will be subject to a further tax in the beneficiaries hands of 15% plus Medicare levy less any taxes paid between the date of death and payout. The exception to this is if at the date of payout the amounts are paid to your spouse or your children (if they are under 18 years of age), it will remain tax free in those circumstances.

If the fund was fully invested at the date of death then the realisation of those assets will give rise to a tax of 15% on the profit on realisation of the assets and on all income earnt. If a fund was carrying substantial unrealised gains and deriving substantial income and the amounts were not to be paid to your spouse or your children under 18 years of age then your death could create a substantial tax liability.

If you are divorced or if your wife is deceased and your children are grown up then the tax burden on the recipients of your fund could be substantial.

Every family that has large amounts of their investments and potential retirement savings in superannuation should consider setting up other structures that will not be subject to tax when one of the family members passes away. These structures can be just as if not more tax effective than the benefits available through superannuation.

YEAR END TAX PLANNING

Regardless of whether you are cash flow positive or just have access to funds, to do year-end tax planning efficiently and cost effectively, what needs to be in place, needs to be put in place now. If you continue to live by the mantra, "it's all done by my accountant when I give them the books", then you will be sadly mistaken, because the whole environment has changed. In approximately 2010 the tax world changed in Australia and the Australian Taxation Office broadcasted to the community at large that they would be lenient for a period of time.

It is now becoming quite clear that that time has passed and the Australian Taxation Office regularly call for documentation to support deductions and are vigorously reviewing high net wealth clients to establish whether they have put in place tax avoidance schemes that continue to be developed and sold in the market place.

This usually commences with a fairly soft letter of enquiry as to their perceived concerns as to the family corporate structure and depending on the answers, can rapidly develop into a full audit.

This message has not been received by many taxpayers and their accountants and there is still a large proportion of the tax population who believe it will all be fixed up later by the accountant or they can enter into tax avoidance schemes because the chances of being audited are in their minds, low. There are still numerous schemes being promoted by accountants and lawyers to minimise tax payable.

Good tax planning takes time to be put in place and the benefits are rarely instantaneous so if someone suggests that you need to set up a structure between now and 30 June 2016 and that the benefits will be available to you in the current year and they are large and substantial then may we suggest that it is more than likely a scheme that will be looked at by the Australian Taxation Office. The defence that "I left it to my accountant and he put it in place" will not avoid fines and penalties being levied against you. The audit may not happen next year and might still be a couple of years away so should the audit reveal that it was a tax avoidance scheme then you will have several years of tax to pay which you perceived were saved. To this will be added the fines and interest from when the tax should have been paid.

If they tell you that have Senior Counsel's advice and it is not an avoidance scheme ask them for a copy of the brief to Counsel and Counsel's response. If the adviser will not provide BOTH then you should be very concerned.

If you have access to cash, then the simple tax plan is to prepay, as much as possible, expenses that would have been payable in the foreseeable future and bring the tax deductibility forward to the current financial year. The beauty of this plan is that you obtain a tax deduction in a low interest environment without affecting profit because the prepaid expense becomes a Balance Sheet item rather than an expense item without a corresponding reduction in profit.

Most tax returns for both individuals and business are produced on a cash basis however, this is in fact incorrect. Accountants have a tendency to process bank statements or cashbooks and fail to take into account deductible expenses incurred, but not yet paid for.

These expenses often require some effort by the accountant to identify them. If you only process the current year transactions and you are a business and you are on accrual accounting you are more than likely throwing away thousands of dollars of deductions.

There is a view by many accountants, which is also incorrect, that BAS's and Tax Returns must agree. This is just plain wrong. Accrual accounting takes into account amounts earned but not banked and expenses incurred but not paid whereas cash accounting simply takes into account cash receipts and cash payments paid and received in the period. You are quite entitled to do your BAS's on a cash basic and do Financial Statements and Tax returns on an Accrual basis.

Debtors, Plant & Equipment and other Assets should be reviewed to ensure the amounts carried in the books reflect their true value. If this is not the case, the carrying value should be written down. If a Debtor is bad then a procedure needs to have been followed prior to 30 June in order to claim a tax deduction in the current year. This procedure is detailed further below. If a fixed asset is recorded at an amount which is higher than its value, it needs to be written down accordingly or, in the case where an asset is obsolete or has no value, it needs to be removed from the premises and documents put in place to reflect that.

Most of the strategies above are only a short term fix or tidying up at the edges. These types of strategies, whilst relevant and necessary, only achieve short term benefits but do save substantial tax.

Optimal tax planning with the biggest tax deductions will only be achieved through strategic tax planning. *Any individual taxpayer earning income from sources other than personal exertion, on which they pay tax at a rate greater than 15%, needs to have a strategic plan for tax and wealth creation developed and implemented, which takes time.*

RELEVANT TO THE BUDGET HANDED DOWN ON THE EVENING OF 3 MAY 2016

Whilst these measures are not yet law, here are some of the announcements from the Budget:

- *the three year temporary levy of 2% on personal income will continue until 30 June 2017 on taxable income in excess of $180,000 pa;*

- *The Government will increase the small business entity turnover threshold from $2 million to $10 million from 1 July 2016;*

- *The annual cap on concessional superannuation contributions will be reduced from $35,000 for those over 50 and $30,000 for those under 50, down to $25,000 from 1 July 2017. There will be one cap for all taxpayers irrespective of their age;*

- *From 1 July 2017, the Government will remove the existing restrictions on people aged 65 to 74 from making superannuation contributions for their retirement.* ***All individuals*** *up to age 75 will be able to claim an income tax deduction for personal superannuation contributions;*

- *The Government will introduce a $500,000 lifetime non-concessional contributions cap. This lifetime cap will be available to all Australians up to and including the age of 74;*

- *From 1 July 2017, the Government will increase access to the low income spouse superannuation tax offset by raising the income threshold for the low income spouse from $10,800 to $37,000;*

- *From 1 July 2017, the Division 293 threshold will be reduced from $300,000 to $250,000. This threshold is the point at which high income earners pay an additional 15% contributions tax on concessional contributions;*

- *The Government will introduce a $1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the retirement phase. This cap will take effect on 1 July 2017. Where an individual accumulates amounts over $1.6 million, they will be have to maintain any excess amount in an accumulation phase account which will become taxable and where earnings will be taxed at 15%;*

- *The Government will remove the tax exemption on earnings of assets supporting Transition to Retirement Income Streams (TRIS) from 1 July 2017. Currently, earnings on superannuation balances that support a TRIS pension are exempt from income tax of 15% applicable to investment earnings in the accumulation phase;*

- *From 1 July 2017, the GST will apply to low value goods imported by consumers;*

- *The Government will increase the 32.5% personal income tax threshold from $80,000 to $87,000 from 1 July 2016;*

- *The Government will provide funding to the Australian Taxation Office to establish a new Tax Avoidance Taskforce. This will enable the Australian Taxation Office to undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals; and*

- *The Government will reduce the company tax rate to 25% over 10 years. The rate will firstly be reduced to 27.5%, and then it will be reduced progressively to 25% in 2026-27. Dividends will be frankable in line with the rate of tax paid by the company.*

YEAR END TAX STRATEGIES

Deferral of income until the following year not only delays the payment of tax for one year but may also achieve a permanent tax saving:

- *Deferral of income may be achieved by delaying receipt of income by individuals who are taxed on a cash basis. Equally accelerating payments that could be paid in the following year accelerates tax deductions into the current year;*

- *Other avenues to defer income may be to defer any realisation of capital gains, (i.e. sale of assets) until after 30 June, defer the realisation of assessable exchange gains until after year end, etc. Care must be taken here as the date of sale is deemed to be the contract date and not (as generally understood) the settlement date;*

- *Deferral of income may be achieved by private company shareholders through the timing of dividend payments, i.e. payment of dividends after 30 June; and*

- *Deferring income also allows for the deferral of associated quarterly tax instalments which in turn can provide short term cash flow benefits.*

By preparing interim accounts to say 30 April or 31 May and estimating the transactions for May and / or June, you can plan the amount of income which needs to be generated between then and 30 June. By doing this you can produce the best tax outcome for the Family and because it is planned in advance the capacity for lowering the tax rate is greater.

The added benefit here is that this gives you time to consider the best beneficiaries to receive income and / or put in place prior to 30 June new entities who would become eligible beneficiaries who can take the income at a lower marginal rate.

In the case of discretionary trusts, **this enables the Trustee to determine and distribute the right type of income to the right beneficiaries and to allocate expenses against different streams of income.**

This of course is subject to the fact that the Trust Deed has the power to dissect types of income and allocate expenses against those types of income.

Certain beneficiaries should only get capital gains and certain beneficiaries should only receive fully-franked dividends. The type of income is interdependent on the tax position and cash flow requirements of both the Trust and the Beneficiary.

The expense of planning like this is usually far outweighed by the future availability of cash derived from planning, and the reduction or avoidance of tax instalments for particular family members.

This in itself can save thousands of dollars of tax that would have been otherwise payable in the following year. These funds can then be invested and provide a greater return to the Family without avoiding the tax.

Funding a superannuation contribution early in a financial year may well save tax if the contribution is used to purchase investments on which dividends are received. Any franking credits received on those dividends in that year may well offset (in part or in whole) the tax on the contribution.

Consideration should also be given to accounting for self-managed superannuation funds on an accruals basis because accounting on a cash basis can be detrimental to certain beneficiaries. Most self-managed Superannuation Funds are operated on a cash basis and we regularly see cases where this is detrimental to some members of the Fund.

OBTAINING AND ACCELERATING DEDUCTIONS

By accelerating deductions (e.g. prepayments) taxpayers reduce their tax liability in the current year and may also achieve a permanent tax saving. There are a number of avenues open to taxpayers for the acceleration of deductions. These include:

- *Prepayment of expenses over $1,000 for up to 12 months, such as interest, rent, insurance, business travel expenses, lease payments and general business expenses. It should be noted however that prepayments cannot be made to an associated party and the expense must be a deductible expense;*

- *For small businesses, a tax deduction may be claimed for prepaid expenses up to $1,000, regardless of the period they cover;*

- *A tax deduction for each item of plant and equipment including motor vehicles delivered and installed for less than $20,000 is available to each piece of plant and equipment purchased and installed prior to 30 June 2016. If you have a small fleet of motor vehicles and the cost of replacing each is less than $20,000 (including all on road costs) then it may pay you to replace them prior to 30 June 2016 and claim a deduction;*

- *Payment of annual leave, long service leave, superannuation contributions and termination payments must all be made prior to 30 June 2016 to claim deductions in the current year. With regard to annual leave and long service leave, it is not enough to simply make a provision in the accounts to claim a tax deduction;*

- *For business entities which use the accrual method of accounting, accruals should be made for expenses which relate to the year ended 30 June, but which are not likely to be paid until the following year. These amounts need to have been incurred prior to 30 June and must be able to be substantiated by way of subsequent invoices etc. Some examples of these types of expenses are: telephone expenses, electricity, and payroll tax;*

- *For small business taxpayers, assets costing less than $20,000 can be written off immediately in the current financial year as depreciation. For large business taxpayers, they can claim a deduction for 15% of the cost;*

- *Businesses should look to identify expenses that could be prepaid and gear their cash flow between now and 30 June to maximise the benefits, which could be substantial. By way of example, if the rent was say $5,000 a month, then paying the rent 12 months in advance just prior to 30 June would obtain a deduction of $60,000 against the current year's income; and*

- *If bonuses or Director's Fees are to be paid to either staff or principals (employees of the business) and it is not documented prior to 30 June 2016 and it can be shown that the documentation did occur prior to 30 June 2016 then the bonus paid in the next financial year will not be deductible. The raising of a minute after the event and backdating it to a date in June has been proven time and again to be ineffectual because the electronic trail left on documents and other third party supporting confirmations.*

BAD DEBTS AND PLANT AND EQUIPMENT WRITE-OFFS

If you are in business and you have debtors who are bad or you have plant and equipment that is obsolete or surplus then if you want to obtain a tax deduction for that debt or write-off, then you should be fully aware of what needs to be done prior to 30 June.

For a debt deduction to be claimed:

- *A conscious effort to recover the debt must have been undertaken. It must then be reasonable to conclude that the debt is bad. This does not necessarily require the debtor to be in liquidation, receivership or under a scheme of management.*

  It may be that for sound business reasons it is considered expedient to abandon the claim, such as where the debtor and their assets cannot be traced. Demonstrating reasonable action has been taken prior to 30 June will be mandatory in these cases. For example: a singular letter dated sometime in June would not demonstrate reasonable action. Therefore to protect themselves, taxpayers should document any enquiries made to establish that a debt is bad, together with details of the recovery action that was taken;

- *The debt must be physically written off from all books of account prior to 30 June. This includes writing off debts from both the general ledger and debtors subsidiary June ledgers;*

- *It is also a requirement that the debt has to have been previously brought to account as assessable income for a deduction to be claimed;*

- *In order to claim the tax deduction, a company must satisfy either the continuity of ownership and control test or the same business test; and*

- *Partial debt write-offs are now allowable deductions, i.e. where the taxpayer has made a commercial decision that they can only pursue or recover part of the debt.*

For a write off of obsolete or surplus assets to be written off and claimed:

- *They must be sold or scrapped; and*

- *They must not be on the premises on or after 30 June 2016.*

FOREIGN EMPLOYMENT AND OTHER INCOME

All Australian resident taxpayers are taxed on world-wide income in Australia. The government in 2014 introduced “Project Do It” which allowed Australian Tax Payers to voluntarily disclose all their offshore assets bank accounts etc. and on the basis they paid the last three years’ tax they were subject to minimum fines and penalties.

Since 19 December 2014 the Australian Taxation Office has vigorously been reviewing Australian Taxpayers who have not made the disclosure under “Project DO IT”. They now have international access through the Anti-Terrorism and Money Laundering Provisions to obtain information world-wide as to income earnt and assets held by companies, individuals and other entities. They also regularly get information on any income earnt from any and all Australian Taxpayers including people working part-time on holidays.

If you derive income from overseas don’t be silly enough not to disclose it and if you still have assets of any nature offshore that you haven’t disclosed then if you don’t go to the Australian Taxation Office and make that disclosure there is just no room to argue minimum fines and penalties even though you may contend you were not aware of the disclosure requirements.

The situation is that foreign income is required to be disclosed including employment income derived by all Australian residents and is now subject to tax in Australia. A tax offset for foreign tax paid is available to the taxpayer.

MOTOR VEHICLE EXPENSES

If you have a motor vehicle either personally or in a business you must keep records either in the form of a log book or a detailed record of the Kilometres travelled claimed on a statutory cents per kilometre basis. The latter requires a declaration if the vehicle is owned by a Business.

When was the last time you checked how old your log book was and due to the progression of time have you changed your circumstances through promotion or whatever where the log book produced say three or four years ago is now no longer applicable to the usage currently being consumed. You may be doing more or less kilometres and if that is the case you are obliged to complete a new logbook.

There are several methods of claiming motor vehicle expenses. Irrespective of which method you use, if you do not have a log book, keep all of your receipts and take an odometer reading each year at 30 June, you are going to have problems with this type of claim.

SUPERANNUATION

The following is relevant and applicable:

- *the maximum concessional contributions that can be made by taxpayers that are 49 years of age or over in the 2016 year is $35,000 (the concessional cap). If the taxpayer is less than 49 years of age then the maximum concessional contribution is $30,000.*

  A concessional contribution includes your superannuation guarantee made by all your employers as well as contributions made by you. To obtain a tax deduction for up to the concessional cap no more than 10% of your total taxable income with certain write backs, will be allowed;

- *retirees over 60 years of age with superannuation funds can have all or part of their superannuation fund paid to them tax-free;*

- *taxpayers can make non-deductible contributions of $180,000 per year, or $540,000 over any three year period where the taxpayer is less than 65 years of age;*

- *the Superannuation Guarantee Rate, currently 9.50%. Under the Budget announcements, the rate will then remain at this level until 30 June 2018 at which time it will increase by 0.5% each year until it reaches 12% in 2022 / 2023.*

- *As announced in the Budget on the evening of 13 May 2014, individuals will be given the option of withdrawing superannuation contributions in excess of the non-concessional contributions cap made from 1 July 2013 and any associated earnings, with these earnings to be taxed at the individual's marginal tax rate.*

MAIN RESIDENCE CGT EXEMPTION

Many taxpayers believe that their Main Residence is automatically exempt from capital gains tax however the specific circumstances of the taxpayer need to be taken into consideration when determining eligibility for this exemption.

The Laws in this regard are more complex than most people think. Advice should be sought prior to selling your Main Residence where there have been periods of time when the property in question ceased to be your Main Residence. Whether this was due to the property being rented or used in part or in whole as a place of business or even where the property has been inherited and not lived in. Not surprisingly, many inherited properties do not have a documented cost base because the Executors of the Estate do not typically advise the Beneficiary of the probated value (market value) of the property being transferred.

There may be circumstances where a taxpayer has changed their Main Residence frequently or has derived income from their Main Residence and still be eligible for the concession. In this regard, good record-keeping is crucial.

This is particularly relevant to younger couples who buy their first home, renovate it and several years later after child arrives they decide to buy a bigger home to accommodate the children and their change in lifestyle and because of the revenue now being generated by the family decide to rent their old home which now no longer remains the principal residence.

This is more common that many would perceive and if you don't have the records you are going to be subject to capital gains tax and part of the gain where the original residence is sold and you will have difficulty claiming depreciation on assets which are depreciable because you have no records. As to the latter there are solutions to the problem after the event but it is preferable to put those solutions in place prior to the acquisition of the new home.

Despite the fact that it is a legal requirement, the majority of accountants do not maintain Capital Asset Registers for their clients and where they do they rarely include the Main Residence.

These Registers should contain cost details pertinent to each asset including the purchase price, stamp duty and improvement costs. These details are also relevant when the asset is sold to determine if a capital gain or loss is made. Even if it is determined that any capital gain made is entirely exempt from capital gains tax, the detail must be maintained.

If you do have a domestic residence and you **are thinking of building a granny flat** then the issue of investment registers becomes critical because if you don't do it correctly and seek advice before you do it you may lose your Capital Gains Tax exemption on your domestic residence when it is sold.

CONSULTING AND PERSONAL SERVICES EMPLOYMENT

It continues to concern us that after so many years taxpayers continue to receive advice that they can be consultants when they are clearly employees.

- *If you go to the same premises and sit at the same desk and you are required to carry out the instructions on a daily basis as an employee of a firm you are an employee. You can have several employments such as working two days a week for one company and three days a week for another. You can even have three employments but if there is a situation of what is called master and servant that is someone can tell you what to do and you're obliged to do it then you are an employee.*

- *It also continues to surprise us that people believe they can split their income by having one partner paid a salary and another part of it paid a consulting fee to one of their corporate entities or a family member, usually a spouse*.

Personal services income is income derived by you personally resulting from your effort or skills. It can be paid to you directly or to a Company, Trust or Partnership owned and controlled by you. Where the personal services income is not paid to you directly, it is still deemed to be paid to you personally and as such, taxed in your hands.

The only exception to this is when that income is derived by an entity nominated by you and the resultant profit derived from those efforts are paid to you exclusively after deduction of very specific expenses that you might normally incur as an employee. The divestment of your consulting income or management fees being paid as salaries and superannuation or distributed to family members is completely illegal.

To suggest that a separate entity receives income, that operates from your home, employs family members, incurs expense for local or overseas travel will just end up having you issued with amended assessments with maximum fines and penalties.

