

# YEAR END STRATEGIES

THE 2010/2011 TAX GUIDE FOR YOU AND YOUR BUSINESS

## TAX PLANNING A YEAR ROUND AFFAIR

There are some moments in life when it pays to leave things to the last minute, whether it is movie tickets or a cheap holiday deal. Dealing with financial planning or tax is not one of those times. It is in your interest to think about such issues in advance, and to talk to your family, advisors and business partners to make sure that everything is in order. Don't leave it to the last minute!

Not all business strategies can be carried out late in the day. Most good operations require preparation, research and the proper drafting of documents before they can function at the optimum level. Try and make your tax and financial planning a year round activity.

The current tax year ends on 30 June 2011, and any tax planning should be completed a few days before that date, at the very latest.

This newsletter will highlight a few tax issues, relevant to the majority of our clients. Please get in contact with us so that we can tailor the financial strategy that is best for you.



## CHANGES TO SMSF

One common tip around the end of year tax time is to transfer assets from outside super into a Self-Managed Super Fund (SMSF). Those who want to grow their super funds have the option of moving Business Real Property (BRP) into a SMSF, while only attracting a small stamp duty and little or no capital gains tax.

This might be useful if cash needs to be freed up to use as consideration of a transfer. It also avoids paying a high rent on business premises by buying the premises in a SMSF, and allows members to benefit personally from the high rental yield.

Be sure to first consider what a BRP is, given the recent ATO rulings:

- The property must be individually owned, not by a company or trust.
- The business use test must be satisfied, the BRP must be used 'wholly and exclusively' in one or more businesses.
- There must be some element of physical use of the property, actions that are connected with its underlying business purpose.
- Special rules apply to farmland, where up to 2 hectares can be used for a residence without prejudicing the definition of BRP.

It is vital to get advice to maximise tax savings before the end of June.

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## YEAR END STRATEGIES FOR PROPERTY OWNERS



The end of the financial year is approaching, and it is important to be prepared. This will ensure there aren't any nasty surprises and as much cash as possible can be protected. Here are some tips to keep in mind:

### 1. Personal Expenses

Be careful and ensure that any claims or interest on borrowing for investment are separated from interest on borrowing of a personal nature.

### 2. Substantiate Your Claim

Keep all receipts to prove any deductions and be able to show why the expense was incurred to derive assessable income.

### 3. SMSFs And Property

Consider moving Business Real Property into a SMSF. This is a good way to free up some cash coming into tax time.

### 4. Renovations By Previous Owner

If the renovations are identifiable and itemized in a depreciation schedule, then it is possible to be eligible for a deduction for depreciation on the cost of improvements by a previous owner.

### 5. Capital Gains Tax

Ensure any capital gains on the sale of property are properly recorded. The ATO are keeping an eye out for any undisclosed capital gains from disposing of assets to invest in superannuation.

### 6. Fixtures And Fittings

If fixtures and fitting cost less than \$300, it may be possible to claim a tax deduction.

### 7. Self-Education Expenses

Keep all receipts and documentation relating to self-education, such as seminars and investment related books and magazines, in order to qualify for tax deduction.

### 8. Use A Quantity Surveyor

There are benefits to having a depreciation schedule prepared by a qualified quantity surveyor. They could help gain a significant tax deduction for depreciation. The cost of employing such a surveyor is tax deductible and will help back up a capital allowance claim.

### 9. Pre-Pay Interest

Depending on the lender, it is possible to pre-pay interest to defer the payment of tax. This is dependant on possible future income, interest rates and cash flow impact.

### 10. Repairs To Property

Be aware that although the cost of initial repairs at the time of purchase is not deductible, expenses for repairs further down the track are. They must relate, however, to wear and tear or other damage incurred as a result of earning rental income.

### 11. Short Term Holdings

If a property has been renovated with the aim of selling it at a profit in the short term, the ATO may tax it as if it were a 'profit making scheme'. If this occurs, it is not possible to take advantage of CGT concessions.

## TOO MUCH SUPER?

As the end of financial year approaches, superannuation issues are some of the most important considerations that tax payers should be aware of. One such issue is the danger of super contributions exceeding the contributions cap. If the contributions exceed the cap, then it is possible to pay almost 93 per cent tax on a super contribution in penalty for the breach.

To avoid being penalised, keep in mind that there are only a limited number of contributions that can be elected not to count towards the non-concessional contributions cap. These include contributions arising from personal injury payments and the proceeds from certain small business assets. There are a number of circumstances that should raise alarm bells:

- Keep track of when an employer makes a superannuation guarantee payment. If they make it in July instead of June, this could force up the contribution.
- The same applies to contributions which are made before June, but aren't processed until July or later. This can increase a contribution unbeknownst to the taxpayer.

- If a taxpayer has multiple jobs, then it is possible that the superannuation guarantees by each employer can push them over the edge and make them qualify for the excess contributions tax.

The limit for concessional tax deductible contributions is very low, and so many people are being pushed inadvertently over the limit. Make sure to consult a professional and find out whether circumstances warrant asking the Commissioner to reconsider the excess contribution assessment.



## BEWARE THE RULES OF SUPER AND PROPERTY

In the new financial year, many DIY super funds will try to expand the diversity of their investment strategies. Including a residential property in a fund's portfolio is beginning to be a popular choice. There are a number of rules and dangers, however, that potential investors should be aware of.

Most importantly, a fund cannot buy a property owned by a fund member or someone related to that member. Although a fund can acquire investments from a related party, such as shares, commercial property or units in certain managed investment trusts, it cannot purchase a residential property from a related party.

Some funds might wish to strategise and get around this prohibition by creating a unit trust. A unit trust is an arrangement whereby money from different investors is pooled to buy an investment. The value of the investment is converted into units which are issued to investors in proportion to the money they invested.

A family home, or residential property owned by a fund member, could be invested in by a unit trust. The fund will run into problems however, if it is entitled to more than half the units. Under super rules, where an asset is an in-house asset,

no more than 5% of the market value of the super fund's assets can be committed to the investment.

There are severe penalties if it is established that a unit trust was used to circumvent the prohibition on acquiring assets from related parties.

Investing in property might still be a good super fund strategy and it is worth considering the range of properties available. If a fund is going to diversify in the new financial year, be sure to get professional advice and ensure that the property investment does not break super rules.



## RECENT AMENDMENTS TO DIVISION 7A

The ATO will be paying special attention to Division 7A of the Income Tax Act 1936 this year, an integrity measure that attempts to ensure that private companies cannot make tax free distributions of profits to shareholders or their associates in the form of debts forgiven, loans or payments. Make sure not to fall afoul of these measures during the end of year tax process.

In July 2010, a new ATO tax ruling indicated that unpaid present entitlements (UPE) from trusts to corporate beneficiaries can now be treated by the ATO as Division 7A loans, broadening the range of transactions that can be taxed under the Division.

An 'unpaid present entitlement' occurs when a trustee makes a beneficiary entitled to some or all of the income of the trust for that particular income year, but also continues to hold those funds on trust for that beneficiary.

A loan by a private company will be a Division 7A loan when:

- The company has a UPE and an agreement as to a loan can be implied.
- The company has an UPE and there's an express loan agreement to the trustee.
- The company owns a UPE and there's a loan within the extended meaning, in that the company provides a loan to the trustee but does not call for payment or simply authorizes the trustee to use those funds for trust purposes.
- Instead of paying money to the company, a trustee pays or applies an amount of the UPE for the benefit of the beneficiary.

This change affects small businesses that use private companies as beneficiaries in order to limit tax on trust distributions. Be sure to review the ruling and get advice on how it will impact on trust positions before the end of the financial year.

## REMEMBER TO CLAIM PROPERTY DEPRECIATION

Many property investors are not aware of the savings that can be made from depreciation on their purchase. Almost all properties depreciate in value in some way.

A qualified quantity surveyor can inspect a property and prepare a depreciation report. The report can then be used as part of a tax return, to claim the depreciation of the investment property against taxable income.

Two types of depreciation can be claimed. Depreciation on Building Allowance refers to actual construction costs, like cement and brickwork. Depreciation on Plant and Equipment includes items inside the building, such as dishwashers, carpets and blinds.

A depreciation report prepared by a quantity surveyor can help property investors pay less tax.

## QUICK CASH & SUPER FUNDS AT YEAR END

During the lead up to the end of the financial year, many DIY super fund trustees are implementing new financial strategies. Because of this, there may be times when a super fund is short of cash. Unfortunately, there are only limited circumstances in which a fund can borrow to make up for this, whether from a trustee or a bank.

One scenario where a short-term loan may be allowed, arises when a fund is in trouble during the process of settling an investment purchase, such as shares. If some shares are sold and others bought, yet the cash for the first transaction has been slow in coming, then it is possible that a short term loan could be procured. The loan period should not exceed seven



working days and the amount should be no more than 10 per cent of the all the assets of the fund.

Another possible scenario occurs where a trustee is required by law, or by the fund's rules, to pay a benefit to a member or a tax liability for which the fund does not immediately have the cash. The fund can borrow so long as the period of the loan does not exceed 90 days and the total amount borrowed is no more than 10 per cent of the value of the total fund assets.

If any loan is made, it is essential that the fund take all means to ensure that money is freed up to pay off the loan.

It is a breach of super fund rules for the fund's account to be in deficit for longer than seven days. The rules indicate that loaning money to super funds can only occur in unexpected situations. It is important to get advice if a super fund is in the red, especially as the end of year approaches.

### *We Are Here To Help*

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

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



## END OF YEAR TAX CHECKLIST

- ✓ **SUPERANNUATION**  
If not yet retired, earnings on superannuation investments are taxed at 15%. It is worth considering saving for retirement using super funds in order to benefit from this low tax rate.
- ✓ **SALARY SACRIFICE CONTRIBUTIONS**  
If a marginal tax rate exceeds fifteen percent, consider contributing to the related superannuation fund through a salary sacrifice arrangement.
- ✓ **NEGATIVE GEARING**  
Investments that have generated a short term loss are tax deductible. As long as the investment grows at more than the rate of inflation, negative gearing can generate long term benefits for investors.
- ✓ **EDUCATION TAX REFUND**  
Remember to keep all receipts and documents related to educational expenses, such as text books and conferences. These are tax deductible.
- ✓ **PREPAY EXPENSES**  
If a business has a turn over of less than \$2 million, then it may be entitled to an immediate tax deduction for pre-payment of expenses. This only applies if the period was covered in 12 months or less.
- ✓ **BAD DEBTS**  
If there are bad debts, they can be physically written-off the books by the 30 June. Make sure that the debt qualifies as a bad debt. The amount must be previously owed to an account as assessable income and all attempts to recover it given up.
- ✓ **DEFERRAL OF INCOME**  
Income can be deferred to 2011/12 if entitlement to income can be delayed. Deferral of earnings may reduce tax obligations.
- ✓ **STAFF BONUSES & EMPLOYEE HOLIDAY PAY**  
Ensure that accrued holiday pay and bonuses are paid within 63 days of the balance date so that they are deductible.
- ✓ **REVIEW PRIVATE USE OF COMPANY ASSETS AND LOANS**  
Remember that assets owned by a company, available for use and under the control of an individual, may create benefits which will be deemed a payment to an individual just as with a private loan.
- ✓ **EMPLOYEE SUPER**  
Make sure that superannuation entitlements are paid to employees by 30 June 2011. That way they will be tax deductible.
- ✓ **DISPOSE OF NON-PERFORMING INVESTMENTS**  
Recall that losses can be offset against other capital gains. Review assets and dispose of any non-performing investments to take advantage of the capital loss.
- ✓ **OBSOLETE STOCK**  
All stock should be reviewed during the end of year stock-take and choices made in relation to its value as a tax and commercial asset. Consider the age of the items, likelihood of future sales and their scrap value. Remember to keep and file all relevant documents.