

YEAR END STRATEGIES

THE 2007/08 TAX GUIDE FOR YOU & YOUR BUSINESS

THE 'TAX PIE' AND HOW TO KEEP AS MUCH OF IT AS POSSIBLE FOR YOU AND YOUR FAMILY

Albert Einstein once famously said that, 'the hardest thing in the world to understand is income tax'. But don't let complexity deter you from a simple goal: keeping your taxes as low as possible. As accountants, our role includes not only preparing financial statements and tax returns, but also working with you to ensure that taxes are at the lowest possible level. Only by achieving this can you retain the biggest slice of your wealth to spend or save.

This guide is designed to highlight a range of planning opportunities, some of which may expire on 30 June 2008. In particular, do please contact us to discuss:

- keeping tax rates as low as possible across the family
- developing a plan for tax-efficient profit extraction
- keeping business taxes to a minimum
- tax efficient remuneration packages
- retirement planning strategies
- tax-efficient savings
- reducing the tax on your estate



PROTECT YOUR SUPER CONTRIBUTIONS

Changes to superannuation legislation mean that from 1 July 2007, superannuation fund members will need to provide a valid Tax File Number (TFN) to the trustee of their super fund to avoid some or all contributions being rejected and/or paying additional tax on other contributions.

From 1 July 2007, if a TFN is not provided, an individual's superannuation fund may not be able to accept any personal after-tax contributions that are made to the fund. This means that individuals that are planning to make a personal after-tax contribution to their superannuation in order to take advantage of the Government super co-contribution, may find their fund unable to accept the contribution and therefore they would not qualify for the co-contribution.

In addition, individuals planning to claim a personal tax deduction for super contributions must first complete a approved notice of intent to claim a deduction. This form must be provided to their super fund before the lodgement of the tax return for the year the contribution is made or the end of the income year following the year of the contribution, whichever comes first. Super contributions that are claimed as a deduction are not eligible for the governments co-contribution.



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IN THIS GUIDE

- Co-contribution
- Contribution caps
- The big winners
- SMSF borrowing
- Private loans update

YEAR END TIPS FOR FARM & BUSINESS OWNERS

- 1 Personal services income** - Recipients of PSI should ensure they satisfy PSI provisions and that a review of allowable deductions is carried out before year end.
- 2 Review franking account** - Consider whether there is a benefit in paying a dividend to take advantage of company tax credits.
- 3 Obsolete stock** – The year end stock-take should involve a review of all stock and a decision made in relation to its value from both a tax and commercial perspective. Obsolete stock may be scrapped or valued below cost subject to specific guidelines.
- 4 Tax file numbers** - Ensure that tax file numbers that have been provided to you by the employee are forwarded to the employee's superannuation fund.
- 5 Professional advice and planning grants** – Grants of up to \$5,500 are available to farmers in EC declared areas. The grant pays an advisor of your choice to complete a review of your farm's viability and undertake a farm recovery plan. Those who have previously received access to the grant may be eligible to receive an additional \$2,200 to re-evaluate their plan provided that at least six months has lapsed since the initial plan.
- 6 Trading stock** - Plan to physically count the stock on hand at 30 June. If it is not practical to have it completed by that date ensure that you are able to track movements in and out from sales and purchases.
- 7 Farm management deposits contributions** – Making a FMD will entitle you to an immediate deduction (subject to limits) in the current year of income.
- 8 Review private loans** – Where a private company provides loans to shareholders, a review of the loan arrangement is necessary. Specific rules apply to loans which may have the effect of the loans being deemed as unfranked dividends.
- 9 FMD withdrawals** – If you plan to make a withdrawal of a deposit made in the last 12 months, you will not be eligible for the deduction this year or may lose the deduction for last year subject to your EC status and the timing of the deposit.
- 10 Repairs and maintenance** – Review all spending during the year to determine if all items are deductible or if they are capital by nature and need to be depreciated.

INCOME AVERAGING

Primary producers are allowed to average income and spread tax obligations over a period of up to a five-year period, instead of paying tax on it in the year in which it is received.

The system is intended to provide tax relief in years when it is needed most. In reality it potentially creates cash flow issues, because it provides relief in the form of a tax offset when incomes are higher than average, and higher tax obligations when incomes are lower, for instance during period of drought or flood.

Primary producers may obtain greater benefits from the income averaging scheme when it is combined with the use of Farm Management Deposits. However, the timing of deposits and withdrawals need to be taken into consideration as it can impact the extent to which farmers are able align cash flow with tax obligations.

In addition, primary producers may be able to manage the impact of the averaging system by having the calculation of average income restarted. Provided the primary producer can establish that taxable income has been permanently reduced to two thirds of their average as a result of retirement or some other event, primary producers may elect that income averaging recommences.

If you are unsure if you are using income averaging to effectively manage your tax obligations or what elements of income need to be included in the calculation of average income please call our office before year end.

CONTRIBUTION CAPS

Contribution caps are used by the Government to regulate the amount directed towards superannuation and replace the role of the previously Reasonable Benefit Limits. There are two caps:

The **non-concessional contribution cap** (after-tax contributions for which a deduction is not claimed and spouse contributions) is \$150,000 per financial year. Taxpayers who are under 65 can bring forward two years of entitlements, which allows non-concessional contributions of up to \$450,000 to be made in one financial year.

The **concessional contribution cap** (employer contributions, individual pre-tax contributions and any contributions for which tax deduction is claimed) is now \$50,000 per financial year. A transitional concessional contributions cap of \$100,000 applies to taxpayers aged 50 or over during the transitional period.

Excess concessional and non-concessional contributions are taxed at 46.5%. As a result care needs to be taken to ensure individuals are not penalised by exceeding the new maximum contribution levels.

SMSF'S BORROWING STRATEGIES

The government recently introduced laws enabling a SMSF to borrow to purchase assets. The borrowing opportunities are wide, the rules general and with a solid asset base in a SMSF the potential for leverage can be significant.

The advantages of SMSF borrowing

There are a number of benefits that a borrowing strategy can bring to a SMSF:

1. It has a multiplier effect on the wealth of the SMSF when assets of the fund are rising in value.
2. The borrowing can be tailored to the individual circumstances of fund members.
3. Borrowing can be short term or extended to a period of up to thirty years.
4. Members and related businesses can act as lenders provided that all lending is on a commercial basis.
5. It improves the flow of funds into the SMSF without violating the excess contributions tax rules.

Some SMSF borrowing strategies

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

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

Increased contributions. Members may be able to transfer assets that they own into a fund, taking advantage of the new borrowing rules. Members are then able to act as Trustee of the borrowing trust as well

as the lender. The repayments made by the SMSF may then be contributed back into the fund by the member under the normal contribution rules.

Be aware of the cost

New financial products have already been introduced by lenders to take advantage of the new rules that allow funds to borrow for investing. These products take into account the new rules that only allow a loan to be secured against the investment it is funding, not total fund assets. As a result of the higher risk profile, loans may attract a higher interest rate and require a deposit significantly higher than usually occurs with other standard investment loans. Trustees need to factor these risks and costs into their borrowing strategy.

Look before you leap

There are a number of advantages for a SMSF using leverage in the fund. However, great care must be taken, particularly in light of the Government's commitment to ensuring compliance with SMSF activities. Mistakes or improper use may result in serious financial penalties for the Trustee of the fund, in addition to the financial consequences for the fund member.



MAXIMISE TAX CREDITS FROM PROPERTY

Many property owners are missing out on potential credits by not taking full advantage of a property's tax depreciation potential. Property tax depreciation is available to any property owner who obtains assessable income by way of rent or operates a business from a property.

Tax depreciation is a deduction from assessable income, which reduces the amount of tax that is payable. There are two different depreciation allowances for investment properties.

Depreciable Assets. This class includes plant and equipment such as carpets, ovens, air conditioners and hot water services. The Taxation Office specifies the individual effective life for each plant and equipment.

Capital Works. In general, any property built or refurbished after 17 July 1985 (for residential) and 20 July 1982 (for non-residential) is eligible for the construction write-off allowance. The maximum effective life of capital allowance is 40 years.

Time to catch up

The ATO allows investors to claim up to four years of missed depreciation. In order to take advantage of the full tax benefits associated with property ownership, depreciation schedules should be prepared. For those investors who have failed to maximise their depreciation deductions in previous years, depreciation schedules can be prepared to allow recovery of missed depreciation benefits by amending previous tax returns.

YEAR END TIPS FOR PROPERTY OWNERS

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

2 Property and SMSF - Review your property acquisition strategy and determine whether there are advantages holding property in a SMSF. Assess borrowing restrictions of a SMSF and their impact on your overall buying capacity.

3 Immediate deductions for low cost assets - Generally you will receive a deduction for assets costing \$300 or less provided that they are: used for income producing purposes other than carrying on a business; they are not part of a set of assets; or one of a number of identical items that have a combined value greater than \$300.

4 Non-commercial rental arrangements - If you rent a property to family or friends at below market rent you may not claim the total rental property expenses as a deduction.

5 Substantiate your claim - Make sure that you have the receipts to prove your deduction and show why the expense was incurred to derive assessable income.

6 Acquisition and disposal costs - You cannot claim the costs of either acquiring or disposing of your property. However, you will need details of these costs.

7 Prepare a depreciation schedule - You may consider having a depreciation schedule prepared by a qualified quantity surveyor. The costs of having one prepared are tax deductible and may add a significant tax deduction for depreciation.

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

9 Prepay property expenses - You may be able to prepay property expenses up to 12 months in advance. Prepaid expenses are not automatically deductible. A review of eligible prepayments should be carried out.

10 Travel and car expense - If you have travelled to inspect, carry out maintenance or collect rent you may be able to claim the costs of travelling as a tax deduction.

PARTY OVER FOR PRIVATE LOANS

In August 2007, the ATO announced that it will provide companies with a one-off opportunity to correct past mistakes in relation to payments and loans from companies to shareholders and their associates.

Division 7A deems that any loans or payments by private companies to shareholders or their associates are treated as assessable income unless they are repaid or placed on commercial terms set out by Division 7A.



To take advantage of this opportunity, companies and the shareholder or associate beneficiaries of the 'loan' must take 'corrective action'. This includes entering into a written agreement to document the loan and make all minimum yearly repayments and payment of interest required under Division 7A. All repayments need to be accounted for.

Directors and shareholders should bear in mind, that in order to comply with the concession, it must be clear from the circumstances that the failure to comply with the provision was a result of an honest mistake by the taxpayer, private company, or other relevant party. In addition, the company must lodge all required income tax returns for the 2001-02 to 2006-07 income years.

Whilst the concession applies to transactions made between 1 July 2001 and 30 June 2007. This opportunity comes to an end on 30 June 2008.

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.