

Abbreviated Tax Tips

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1. ACCOUNTING METHOD CHANGE

If business expansion or business systems require you to move from a cash or receipts accounting basis to an accruals basis, there could be a substantial tax windfall if the change is carried out at the end of the financial year.

Your book debts at the time of change may become tax free, because they are not taxable when you are on a cash basis. You then change to the accruals basis and the amounts, when received, are not taxed because they were not earned in that year.

Refer: *Henderson v. FCT* (70 ATC 4016).

Due to transitional rules you cannot obtain this benefit if you are an STS taxpayer or at a time when you change from a small business taxpayer to an STS taxpayer. If this is intended, you should first change your accounting method and leave your election to become to an STS taxpayer until the next year.

2. ACQUIRING A CAR AND GST

The total cost of a new car is usually comprised of a number of different components including stamp duty and statutory charges. Looking at the break-down of these costs, consider whether the entity has claimed the correct amount of input tax credit. For example, stamp duty and registration costs are not subject to GST.

3. ACQUISITION OF SHARES

If you are buying shares in a company, you can achieve a similar result to a direct asset purchase by forming a tax consolidated group (i.e. which must include at least 2 wholly owned group companies) before you make the purchase.

If the shares in a company are purchased by a tax consolidated group of companies, the purchase price for the shares will be “pushed down” to the assets so that, for the purchaser, it will be equivalent to the purchase of assets.

4. ACQUISITIONS

If you are buying a business, depreciation of the plant and equipment included in the purchase is based on the amount paid for these items. You can also get an immediate tax deduction for any stock in trade acquired.

If you are buying, it is wise to pay full value for depreciable assets and stock in trade purchased and minimise the value of any non-deductible goodwill paid for the business.

It may be advisable to ensure that the contract for the purchase of the business specifically sets out the allocation of consideration across the assets.

If such information is not documented, there

may be time-consuming administration costs in determining appropriate values for the purchaser. Of course, this may be in the purchaser’s interest, depending upon the values of the various components bought.

5. ALLOCATED PENSIONS

When a self managed superannuation fund converts to becoming a fund paying an allocated pension, investment income earned by the fund becomes tax free.

If within the reasonable benefit limit (RBL) pension recipients are eligible for a 15% tax rebate. Additionally, the proportion of pension applicable to undeducted contributions is completely tax free.

Making deductible contributions and undeducted contributions to superannuation funds with a view to collecting an allocated pension on retirement produces excellent tax savings and is encouraged by government.

Note the 2006 budget changes for tax-free payments from superannuation funds after 1 July 2007 for those aged 60 or more. Factor this into planning.

6. APPORTIONMENT OF DEDUCTIONS

You may incur an expense which is partially non-deductible capital or private and partly for business. Examples could be employing a contractor to do some repairs and capital improvements at the same time, or you might use a computer partially for business and partially for private purposes.

Make sure invoices and receipts show the exact nature of work performed and that there is a reasonable method of apportioning the expenses between the deductible and non-deductible purposes.

When using computers, vehicles and the like, the keeping of a logbook will verify your claim.

7. ASSIGNMENT OF PROFITS

The Court has confirmed that an interest in a partnership can be assigned directly to another person such as a wife, or to a discretionary trust. Thus, the income from the partnership can be distributed in a tax effective manner (*FCT v. Everett* 80 ATC 4076).

The assignment must be formally documented. Either the whole or a stated percentage of the partnership interest can be assigned. It is essential that the documentation is correctly drafted by a solicitor.

If drafted correctly, not only future income, but also the earnings of the partnership for the current year, can be diverted provided the assignment takes place before the accounts are struck (usually 30 June).

Any such assignment will be treated as a disposal (or CGT event) for capital gains tax

purposes and be subject to capital gains tax.

If the assignment is not at arm’s length, the proceeds of the disposal will be taken as equal to the market value of the interest assigned.

8. AUSTRALIAN BUSINESS REGISTER

Are you unsure whether the business which is charging you GST is actually GST registered?

You can check this by visiting the Australian Business Register website and running a search. The web address is www.abr.business.gov.au. This site contains details of all businesses that are either ABN registered or both ABN and GST registered.

You simply need to type in the supplier’s name or ABN and you then can check the registration details.

The important thing is to check that the particular supplier is registered for GST not just with an ABN.

9. BAD DEBTS - PARTIAL WRITE OFF

Sub-section 25-35(1) of the ITAA 1997 allows a deduction for even a partial write off of bad debts. Review your debtors and write off that part of any debt you know will never be paid.

10. BAD DEBTS - WRITE OFF BEFORE END OF YEAR

Don’t miss out on your tax deductions! To be deductible, bad debts must be actually written off during the tax year - a physical entry must be made in the books of the business not later than 30 June.

Have a realistic look at your debtors during the months before the end of the year and make an effort to collect the old and doubtful debts.

Sort out the ones you cannot realistically collect and write these off not later than 30 June to at least avoid paying tax on income you are not going to receive.

If you are using the cash method of tax accounting, you would not write off bad debts for tax purposes as no income has been taken into account.

11. BAD DEBTS & GST

If you are paying GST on an accruals basis you have to pay GST on all income whether or not it has actually been received. If your outstanding debtors are more than 12 months old, you can claim a decreasing adjustment resulting in a reduction of GST. In other words, you can treat that debt as a bad debt.

12. BLACK HOLE EXPENSES

In the past, expenses relating to the establish-

ment of a company, partnership or trust, business restructuring costs, equity raising costs, costs of defending or attempting a takeover and costs of liquidations or ceasing to carry on a business have not been deductible.

Certain “black hole” costs are now deductible as follows:

COST	DEDUCTIBLE OVER
Establishing your business structure, eg. Setting up companies, trusts, partnerships	5 years
Converting from one structure to another, eg. Partnership to company	5 years
Raising equity	5 years
Liquidating a company	5 years
Ending a business	5 years
Discharging a mortgage	Outright
Preparing, registering or stamping lease documents	Outright
Borrowing costs	Lesser of loan term or 5 years

13. BORROWING EXPENSES & FID

Financial institutions duty paid on investment accounts is deductible. If you are negatively gearing, don't forget to deduct any borrowing costs. These include legal costs, stamp duty, preparing mortgages, valuation fees, etc. These costs are generally deductible over the period of the loan. If the loan is for more than five years they can be pro rated over a five year period.

14. BUDGET CHANGES 2006 - SUPERANNUATION

Many of the proposed changes from 1 July 2007 will not apply to retirees under 60, giving people a clear incentive to keep working. The proposed changes are:

- No tax payable on the majority of superannuation payouts whether pension or lump sum.
- Those in public sector funds will still pay tax but at a lower rate than today.
- Retirees will be allowed to delay drawing their superannuation once they reach 65.
- Retirees will be able to make pre-tax superannuation contributions until they reach the age of 75.
- Age based limits abolished and pre-tax

contributions now to be subject to a uniform cap of \$50,000. Note that there will be a “phase in”, so that those who are aged 50 or more at 1 July 2007 will not be disadvantaged.

- Self-employed workers will be able to claim the superannuation co-contribution for low to middle income earners and claim full contributions made up to the new \$50,000 limit. This is a huge incentive.

15. BUILDING COSTS

Capital expenditure incurred in constructing buildings and structural improvements will give rise to an annual deduction at the rate of either 2.5% or 4% of the construction expenditure depending on when construction started and how the capital works are used.

The deduction is generally available from the time the works are used to produce income. It is generally the “owner” of the capital works that will be entitled to claim the deduction.

Note that if you have purchased a property and you do not have the construction expenditure costing, you can obtain a report prepared by a quantity surveyor which you can use to determine the amount of your claim. Any costs paid to the quantity surveyor relating to preparation of such a report will be tax deductible.

16. BUSINESS INCORPORATION

Incorporation and flowing business or investment income through a company is beneficial when:

- the owner is taxed at a marginal rate above 30% and
- a significant part of the profits is surplus to the owner's needs and can be saved or reinvested in the company.

Importantly, CGT discounts and other benefits will be lost in a company, so the benefit of these concessions must be weighed against the above advantages.

17. CAPITAL LOSSES

Capital losses can be offset against any capital gain made by a taxpayer in the same or future years.

Consider a situation where a taxpayer incurs a taxable capital gain on the sale of an asset or assets, while holding another asset that has a lower value than its original cost.

It may be advantageous to sell the loss making asset, thereby creating a capital loss to be offset against the gain. The latter asset can be replaced at the same market price if required although this would, of course, incur transaction costs.

Losses are deducted from gains first. The CGT discount is calculated on the net gain after deducting losses, so losses will reduce

the amount of the discount.

18. CAPITAL WORKS EXPENDITURE

You can claim a deduction for capital expenditure incurred in constructing income producing buildings and structural improvements such as roads, driveways, car parks, bridges, retaining walls, fences, etc. Extensions and alterations also qualify.

The claim is a percentage of the cost of construction, including building costs, architect's and engineer's fees.

The rates vary from 2.5% pa to 4% pa depending on the type of building and date of construction. If you are having any construction work done you should ensure you get a detailed invoice from your builder itemising the costs.

Full details are available in The Taxation Examiner Ready Reference.

19. CARPET TO FLOOR BOARDS

If you would prefer to have floor boards in your rental property instead of carpet, you will be happy to learn that the cost of ripping up the carpet and polishing the floor boards should be tax deductible.

According to ATO Interpretative Decision ID 2002/330, a taxpayer is entitled to a deduction under s25-10 of the ITAA 1997 for expenditure incurred in removing worn carpets and polishing existing floorboards in a rental property. Section 25-10 provides a deduction for expenditure incurred for repairs to premises used solely for the purpose of producing assessable income.

Taxation Ruling TR 97/23 provides that a repair involves restoring something to its original state. ID 2002/330 states that polished floor boards perform the same function as carpet, and the materials and process used in the repair do no more than restore the floor to its original state

20. CASH BASIS ACCOUNTING METHOD

The cash basis of taxing income can be used by most individuals. Under this method income is not taxed until it is actually received, e.g. fees earned and invoiced in June but not received until July, are taxed in the later year.

This can be very beneficial for tax planning purposes, as you don't have to pay tax on the earned income until it is actually received, but you can still claim expenses incurred which have not been paid.

Note that under the Simplified Tax System you can now choose to use either the accruals or cash basis of accounting.

21. CGT & COLLECTABLES

These are such things as jewellery, artwork, antiques, postage stamps, rare books, etc.

If acquired for \$500 or less (excluding GST) a collectable will be exempt from CGT (note that it is the value of the asset and not the interest you acquired in that asset which must be \$500 or less for the exemption to apply).

22. CGT & COMPANIES

If operating your business through a company you are not eligible for the CGT discount on company assets, however you can claim the active asset exemption and the retirement exemption.

The retirement exemption claim is not limited to 50% of the gain.

It is better to claim the retirement exemption than the active asset exemption as these funds can be taken from the company without further tax cost.

While not taxed to the company, the active asset exemption would be taxed in the hands of shareholders as an unfranked dividend when withdrawn from the company, unless withdrawn on the company's liquidation.

23. CGT & INSURANCE CLAIMS

The insurance payout for the destruction of an asset is treated as the disposal price. If the payout is greater than the cost base, CGT (less the 50% discount) is payable on the difference.

Where there is an involuntary disposal, the replacement asset will be deemed to have the same status as the original asset. If the original asset is exempt from CGT (it was acquired before 20 September 1985) the replacement asset will also be CGT exempt.

If the insurance proceeds exceed the cost of the replacement asset, CGT will be payable on the difference.

24. CGT & PERSONAL USE ASSETS

These are assets (other than collectables) kept primarily for your personal use or enjoyment.

If acquired for \$10,000 (excluding GST) or less, any capital gain is exempt. Capital losses from disposal of personal use assets cannot be claimed regardless of their cost

25. CGT & WORTHLESS SHARES

If you own a worthless CGT asset, get rid of it and crystallise a capital loss!

You may not have to sell or get rid of worthless shares to claim a capital loss. Where the relevant entity is in liquidation or administration, there is provision for unrealised losses on shares that become worthless to be treated as realised capital losses based on a declaration from the liquidator or administrator.

26. CGT DISCOUNT

You have the choice of claiming a CGT reduction due to the indexation of your cost base or the 50% CGT discount in respect of all assets sold after 21 September 1999 if the relevant asset has been held for more than 12 months.

The asset must be owned by an individual or, if owned by a trust, the discount can flow through to the beneficiaries hence the taxable amount of the capital gain distributed to individual beneficiaries will only be 50%.

If the asset was acquired after 21 September 1999 you cannot use the indexation method.

If the asset is acquired by a superannuation fund, the discount is one third, making the tax rate on capital gains of superannuation funds 10% for assets held longer than 12 months.

27. CGT RETIREMENT EXEMPTION

You can obtain a total exemption from CGT up to a maximum of \$500,000 (per individual) on the disposal of business assets if the proceeds received are used for retirement.

This relief can be obtained by individuals and private companies or trusts with up to two controlling individuals.

The active asset CGT exemption eligibility criteria apply here.

The proceeds exempted from CGT become an Eligible Termination Payment (ETP) and may be paid direct to the recipient if he or she is aged 55 or older. If not, the amount must be rolled over to a superannuation fund or an approved deposit fund.

The exempt amount will not be treated as taxable contributions to a superannuation fund, or be subject to the superannuation surcharge.

Additionally, they will not be subject to tax on withdrawal on retirement; however they will count towards the recipient's Reasonable Benefits Limit (RBL) and may be caught for tax if that is exceeded. Note that RBLs will be abolished from 1 July 2007.

28. CGT DISCOUNT & COMPANIES

Assets owned by companies are not eligible for the 50% CGT discount. However, intending sellers could negotiate with purchasers and instead of selling the asset out of the company, sell the shares in the company. This effectively transfers ownership of the asset but entitles the individuals owning the shares to claim the 50% discount on the shares.

29. CGT ROLLOVERS

It is important not to forget about the many other CGT rollovers which are available and

which may be relevant to a particular transaction or reorganisation you are considering. These include:

1. Transfer of an asset from an individual, partnership or trust to a wholly-owned company. This rollover is useful if you are reorganising your investment structures.
2. Purchase of a replacement asset from moneys received as a result of the loss, destruction or compulsory acquisition of an asset.
3. The renewal or extension of a statutory license, including licenses granted for broadcasting, taxis, import and export quotas, fishing permits or quotas, oyster farming licenses, milk quotas, wool quotas and liquor licenses.
4. Conversion of ownership of a home unit or apartment into strata title ownership.
5. Exchange of shares in the same company. Allows you to change the share capital structure of your company, perhaps in preparation for introducing a new investor.
6. Interposing a new company. Allows you to interpose a new company between the shareholders and an existing company. This is also useful if you are contemplating introducing a new investor into the existing company.
7. Scrip-for-scrip takeovers. Take-overs of a company can be tax free to the shareholders to the extent the consideration received is shares in the purchaser company.
8. Transfer of all assets from a fixed trust to a company. This is not available for discretionary trusts.
9. Transfer of assets under a marriage breakdown settlement. This must be approved by a court. Although the Government has announced changes to extend this rollover relief.

30. CGT ROLLOVERS - PRE-CGT ASSETS

If all the assets of a business that are being rolled over are pre-CGT assets (i.e. purchased before 20 September 1985) and you want to transfer them to a new company you will own, you can make an election upon incorporation so that the assets are treated as pre-CGT assets of the company. Your shares will also be treated as pre-CGT shares (provided the assets transferred are not precluded assets such as trading stock).

31. CHANGE OF RESIDENCY

If you hold shares or similar assets which are likely to substantially increase in value and are contemplating an extended trip overseas (and become a non-resident for tax purposes), you can elect to pay CGT on a deemed disposal of these assets at the time of your

departure.

When you later return and take up Australian residency again, you will be deemed to have reacquired the shares at the market value then applicable. If the shares have increased in value substantially during your absence, that increase will be exempt from Australian tax and you will have a substantially higher cost base to reduce CGT payable on any subsequent actual disposal.

32. CHILDREN'S EXCEPTED INCOME

Children are taxed on income which they did not earn themselves at the highest marginal rate. These rules have been put in place to stop parents or other relatives passing their income to the children to get the benefits of low tax rates.

Some income earned by children is taxed at normal rates and enjoys the tax-free threshold. Normal or excepted income includes income from deceased estates, Family Court settlements or compensation claims, death benefits (such as life assurance or superannuation), lottery winnings, income from wages earned personally by the children and business income subject to the following qualifications.

If it is clear that there is a business carried on by the child alone, or with other children and the income represents a reasonable return for their efforts and from an investment of their own capital, that income will be regarded as wholly excepted.

However, if the business has plant or other assets, capital or services provided by parents or relatives on a non arm's length basis, the profits will be taxed at the highest marginal rate. These provisions catch children under 18 years of age, referred to in the Act as minors.

33. CHILDREN'S TAX-FREE THRESHOLD

Children under 18 years can receive \$416 as unearned income or trust distributions without being subject to penalty tax. They will also be eligible for the low income offset which effectively increases the \$416 tax-free threshold to \$1,325. Minors are defined as unmarried persons under 18 years of age at the end of the year of income. Income from full-time occupation is not caught by these rules.

34. CLOTHING

You can claim a deduction for the cost of buying, renting, replacing and maintaining clothing, uniforms and footwear if it is:

- protective in nature,
- occupation specific, but not conventional,
- a compulsory uniform (refer IT 2641), or
- a non-compulsory uniform or wardrobe

that has been entered on the Register of Approved Occupation Clothing.

Protective Clothing: This is clothing which protects against personal injury or damage to other clothes. Examples include protective work boots, helmets, safety glasses, overalls, etc.

Occupation Specific: This clothing must distinctly identify that the employee belongs to a particular trade, profession or occupation. Examples are a female nurses' traditional uniform, religious clerics' ceremonial robes and chefs' checked pants.

Compulsory Uniforms: The requirement must be an express policy of the employer. It must be consistently enforced and all employees of the same class must be compelled to wear the uniform in its entirety.

Non-compulsory Uniforms: If the design of the uniform has been entered on the Register of Approved Occupational Clothing and is suitable for the operations of the employer with identifiers shown on each item of clothing, it will comply under this heading.

The maintenance costs of clothing falling within the above headings are deductible and up to \$150 of laundry expenses need not be substantiated.

35. COMPANY ASSESSMENTS

The Federal Court has held that a company that is in loss or has no tax to pay, does not trigger an assessment on lodgement of its income tax return. Therefore, the four year limit on the ATO making adjustments to the company's taxable income does not apply.

If you wish to trigger the four year limitation, make sure your company pays at least a few dollars of income tax. You may be able to achieve this result by revaluing trading stock or choosing not to offset losses against dividends received.

36. COMPANY LIQUIDATION

Pre-CGT capital profits of a company may be distributed to a shareholder tax-free when the company is liquidated, if certain conditions are met. If the profits are paid as dividends before liquidation, tax would have to be paid.

The CGT effect on the cancellation of the shares must also be considered. If they are pre-CGT shares, those company profits can be distributed completely tax-free.

37. COMPANY TAX IMPUTATION

Australia has adopted an imputation system for the taxation of companies and shareholders.

The company tax rate is 30% and dividends paid to shareholders will attract a franking rebate at the same rate.

This would make a fully franked dividend tax-free if the shareholder is on a marginal

rate of 30% or less. As a shareholder you include the dividend imputation in taxable income, pay tax at your marginal rate on the grossed up dividend and then claim a credit at the company tax rate.

Franking credits flow through trusts, so it can be helpful to have your trust own the shares, in which case the dividends can be diverted among family members.

Note that where the trust is a discretionary trust you may need to make a family trust election in order to ensure that the franking credits are able to pass through to the beneficiaries (due to the 45 day holding rule).

38. COMPUTER SOFTWARE

Computer software which does not form an integral part of any computer hardware is depreciable at the prime cost rate of 40%. If software is no longer being used and installed, any undeducted expenditure can be deducted in full in that year.

The depreciation rate will be different if the cost of the software is such that it would form part of a low value pool, or can be entirely written off in the year of acquisition.

39. COMPUTER SYSTEMS

When a computer system is purchased for use in a business, software and contract services purchased as part of the system are often included in the total cost.

If the software costs can be apportioned, they can be depreciated at the prime cost rate of 40%. Service contracts taken on a yearly basis can be fully deducted by STS taxpayers in the year in which the expense is incurred.

Items of computer hardware are depreciating assets and subject to the ordinary capital allowance rules. Hardware includes computers, peripheral equipment (e.g. screens, backup drives etc) routers (for connection to the internet).

Note that any items may form part of low value pools or be 100% deductible depending upon the item's cost and whether you are an STS taxpayer.

40. CONSOLIDATED GROUP

If you own a number of companies and trusts, there are benefits to forming a tax consolidated group. These benefits include:

- the requirement to lodge only one group income tax return;
- improved access to franking credits;
- ease of restructuring assets within the group;
- "push-down" of the purchase price of a company to the underlying assets.

41. CONTRIBUTIONS TO SUPERANNUATION

You don't need to make cash contributions to

a superannuation fund to claim a tax deduction. Assets such as shares or business real property may be transferred to a superannuation fund by an employer and a deduction claimed for their value. Watch the possible stamp duty and CGT costs and make sure the contributions are actually made before the year end to claim a deduction.

42. CORPORATE BENEFICIARIES OF TRUSTS

It has been advantageous to have a corporate beneficiary of a discretionary trading trust. This means that trust income can be distributed to the corporate beneficiary and thereby enjoy the lower corporate tax rates.

Distribution of income to your spouse and children (especially those over 18 years of age) will also provide income splitting advantages. They will receive fully franked distributions which could, in some cases, entitle them to receive tax refunds. Take care with loans from private companies and trusts as there is a danger that these could be treated as taxable distributions.

43. COST OF ITEMS FOR DEPRECIATION

The cost of items of plant used in calculating depreciation is the full purchase price plus any costs of transporting, installing, relocating or re-erecting.

44. COSTS PRIOR TO USE OF AN ASSET

Expenses incurred in establishing an asset to earn income are generally not deductible (the noted exceptions being in the Black Hole Expenses - see above). Once the asset is available to earn income, expenses incurred in the upkeep of that asset are deductible. Establishment expenses are part of the capital costs for CGT purposes.

An AAT decision allowed losses from rental properties unoccupied for 18 months before being leased. This was because the asset had been established and was available, but simply not producing income because there were no tenants.

45. DEDUCTIONS VS. TAX OFFSETS (REBATES)

A tax offset (or rebate) is not the same as a deduction. A deduction is subtracted from assessable income to calculate the taxable income while offsets are deducted from gross tax payable.

A one dollar offset is of more value than a one dollar deduction.

Usually offsets cannot exceed the amount of tax payable.

Offsets usually cannot be carried forward and usually are not refundable. In a year where

losses are brought forward, you may find there is insufficient tax payable to fully use the offsets.

It may be possible in these circumstances to delay incurring some costs or to arrange to bring forward some income.

46. DEFER SUPERANNUATION BENEFITS

Due to the generous changes in the 2006 budget, as a general rule you should defer taking benefits until after 1 July 2007 and only then if you have reached 60 years of age. No tax will be payable on the majority of superannuation payouts whether pension or lump sum.

47. DEFERRED COMPENSATION

Typical Deferred Compensation Plans turn upon either:

- a salary sacrifice arrangement to defer salary to a later date, or
- a discretionary bonus plan.

Both types of Plans turn upon either a choice being given to the employee to defer receipt of the compensation or, where the deferral of compensation is part of a "golden handcuff" arrangement and the employer decides unilaterally to defer the compensation to some pre-determined point in time and subject to continuity of employment with forfeiture conditions for premature termination of that employment.

Both salary sacrifice and discretionary bonus arrangements deal with the notion of "constructive receipt" by virtue of the decision to defer being made before "an amount of ordinary income" can be said to exist. This is the key.

48. DEPRECIATION FOR NON-STB BUSINESSES

Medium and large businesses can utilise a low value pool for plant items acquired from 1 July 2000 at a cost of less than \$1,000 and existing items with an opening depreciated value of less than \$1,000.

An election under Section 42-450 of ITAA 1997 must be made and plant items allocated to the pool must remain there until sold. Depreciation rates are 18.75% in the year of acquisition and 37.5% annually thereafter. On disposal, the sale proceeds are simply credited to the low value pool, thereby reducing the balance for future depreciation claims.

49. DEPRECIATION FOR STB TAXPAYERS

Items of plant and equipment costing up to \$1,000 purchased by STB taxpayers may be claimed in full in the year of purchase.

STB businesses can also make use of the

pooling arrangements. Depreciated assets (other than buildings) costing \$1,000 or more are automatically pooled. Assets with an effective life of less than 25 years are depreciated in a general pool using a diminishing value rate of 30% per year (15% in the year of acquisition). Assets with an effective life of 25 years or more are depreciated in a separate pool using a diminishing value rate of 5% per year (2.5% in the year of acquisition).

50. DEPRECIATION RATES

Taxpayers may themselves estimate the effective life of the assets being depreciated. The depreciation rate is based on the effective life.

You should make an objective assessment based on things such as potential life, the type of use, whether obsolescence is likely, your own and other users' experience with similar assets and information from engineers and manufacturers about the product. Provided the estimate made is reasonable and is supported by documentary evidence, the ATO cannot vary the estimate to reflect information gained with the benefit of hindsight.

Once the effective life has been determined the depreciation rate is calculated as follows:

- Prime Cost: 100% divided by the effective life.
- Diminishing Value: 200% (formerly 150%) divided by the effective life.

If you do not wish to determine the effective life yourself, you may adopt effective lives as determined by the ATO. These rates are based on estimates of the average effective life of classes of assets in common use, and are contained in tables published in The Taxation Examiner Ready Reference.

You should work out whether you will be better off making your own assessments or adopting the ATO rates.

51. DEPRECIATION WRITE-OFFS

In addition to the \$1,000 write-off deduction allowed for STB taxpayers, other business taxpayers are entitled to an outright deduction for all equipment purchases less than \$100. For non-business taxpayers, the level is \$300.

52. DIRECTORS' FEES

Reasonable directors' fees are deductible when the company has incurred them, even if not yet paid. If a resolution authorised at a shareholders' meeting is passed prior to the end of the financial year to pay directors' fees and bonuses, the amounts shown in the resolution would be deductible in that year, even though not paid.

Later, when the directors' fees and bonuses are actually paid, PAYG tax should be deducted. They are assessable to the director at the time they are paid or credited to the

person. The advantage is that the company is able to claim a deduction in the year before the amount is assessable to the director (provided they are not related parties), in effect producing a timing benefit for both company and director.

53. DISCRETIONARY TRUST DISTRIBUTIONS

Income splitting through trusts is still possible. You can distribute trust income to any beneficiary eligible in terms of the trust deed.

Provided attribution is allowed in your trust deed, you may distribute different types of trust income (eg primary production income, capital gains, and franked dividends) to different beneficiaries in the most efficient method.

54. DISCRETIONARY TRUSTS & CGT

You can minimise taxes on capital gains made by trusts. Distribute the capital gains to family members with the lowest marginal tax rates. The trust can also pass on the CGT discount to individual taxpayers.

55. DIVORCE

There is a legitimate way of tax planning for divorce settlements that can save large amounts of tax each year where child maintenance payments are involved. Maintenance payments paid by separated or divorced parents to their children are not tax deductible and so must be paid for out of after tax income.

However, Section 102 AGA of ITAA 1936 does provide some tax relief. This is done by establishing a child maintenance trust.

Where the trust derives income from the investment of a property transferred to the trust for the benefit of the beneficiaries pursuant to an Order made under the Family Law Act that income is called excepted trust income.

This means that, when the trustee is assessed on the child's behalf, it will be taxed at general individual rates rather than at the normal penalty rates which apply to the taxable income of minors earning more than \$416 per annum.

As a result each Australian child is eligible for the tax-free threshold of \$6,000 per annum (plus a further low income rebate of \$600 for income up to \$25,000).

56. DOCUMENTING ALL CGT COSTS

When purchasing any items of a capital nature, make sure you retain documents and receipts for all costs. These include such items as legal fees, stamp duty, agent's fees or commission, valuation fees and adver-

tising. The cost of any capital improvement and any selling cost should also be listed. Any non-capital costs of ownership, such as interest, repairs, insurance, rates and land tax which are not deductible can also be included in the cost base if the asset was acquired after 20 August 1991.

Capital expenditure incurred to establish, preserve or defend title to an asset can also form part of the cost base (generally this applies to assets acquired on or after 1 July 1997).

All cost base expenses must be substantiated. Keeping a capital gains tax asset register is an effective way of reducing the amount of substantiation documents you are required to keep (Refer to the Taxation Examiner Ready Reference for further details).

57. DOGS

If working dogs or guard dogs are used in a non-primary production business, they would come under the definition of plant and would normally be depreciated. However, if the cost of each dog is less than \$1,000, STS businesses can claim the amount in full in the year of purchase. Food and any associated costs are also deductible.

58. EMPLOYEE SHARE SCHEMES

Benefits under employee share acquisition schemes are subject to tax in the hands of the employee. Employees will, however, be able to defer taxation for up to ten years on qualifying shares or rights.

In addition, there will be an income tax exemption available for qualifying shares or rights up to a value of \$1,000 per employee each year, subject to certain special requirements, including a requirement that the same level of benefits must be offered to all permanent employees.

If you decide to defer the tax payable on your qualifying shares then the amount of tax you ultimately pay will vary depending on the value of the shares at the taxing point. Where you expect that the value of the shares will rise significantly prior to that time you should pay less overall tax by electing to pay your tax upfront. This is because any increase after electing to pay your tax will be treated as a capital gain rather than ordinary income and, provided you hold the shares for at least 12 months, you will be entitled to the CGT 50% discount on ultimate disposal.

59. EMPLOYEES VS CONTRACTORS

PAYG requirements mean that an employer has to deduct and remit tax instalments to the ATO. If ABNs are supplied, payments to contractors require no withholding tax. By employing contractors it may be possible to escape additional bookwork, insurance,

payroll tax, superannuation charges, etc. and this tends to often make the engagement of contractors more attractive to business.

There are numerous categories of payments requiring PAYG tax to be withheld. These include payments to employees, directors, payments under voluntary agreements or under labour hire arrangements and where no ABN is supplied.

If an individual establishes a partnership, trust or company which contracts with the principal for the provision of services, the principal is not required to deduct PAYG tax, but must ensure that an ABN is supplied.

Where individuals contract their personal services through entities such as companies and trusts they need to be aware of the personal services income regime which was introduced with effect from 1 July 2000. This regime effectively stops individuals from utilising the benefits of various structures to obtain tax benefits they would not otherwise have access to in an employment relationship.

60. ENERGY GRANTS (CREDITS) SCHEME

This scheme is being replaced by a new system from 1 July 2006, with transitional arrangements which will apply until 30 June 2008.

Under the existing Energy Grants Credits Scheme, eligible applicants receive a 100% rebate of the customs or excise duty paid on diesel used for off-road purposes.

Eligible users include those engaged in agriculture, fishing and mining activities and also for rail transport and marine use.

The scheme also applies in respect of on-road use of diesel and similar fuels in vehicles with a GVM of 4.5 tonnes or more which are registered for use on public roads, where the fuel is used in carrying on a business and the claimant is registered for fuel grants.

Vehicles between 4.5 and 20 tonnes are subject to further restrictions; the vehicle must be used for transporting passengers or goods, and the fuel must not be used solely within specified metropolitan areas.

Significant changes to the scheme from 1 July 2006 are:

- Fuel tax credits will now be claimed via the Business Activity Statement (BAS)
- Fuel tax credits will be available for petrol as well as diesel for both on-road and off-road schemes.
- Fuel tax credits will now be available for fuel consumed in metropolitan areas.
- Businesses will be able to claim a fuel tax credit for fuel used for power generation, heating, as a solvent or in the manufacture of products.