

Welcome to the February issue of Pearce Norris Tax News. This issue focuses on:

- Simplified superannuation update
- Reforms for small business
- Time to review service entities
- Drought relief expanded to businesses
- An eye on ATO compliance hot spots

We would be pleased to discuss the tax matters set out in this issue of Tax News. Please contact Michelle Pearce or Chris Rutter on (02) 9555 1309 to discuss how Pearce Norris can assist you and your business.

SIMPLIFIED SUPER UPDATE

If the Government's proposed reforms to simplify superannuation go ahead as planned, **most of the proposed changes will be effective from 1 July 2007** – that's not that far away!

Also, there are **transitional arrangements** that apply in the period leading up to 1 July this year that **could impact on your own super arrangements right now**.

Should I be doing anything now?

Take some time to plan ahead now before 1 July this year. Get appropriate advice so you're ready for any changes when they take effect.

Although there are many aspects to the proposed changes, one area that you should look at now in particular is how the new contribution rules will impact on your super.

A NOTE OF CAUTION

Bear in mind that the proposed changes are not yet law at the time of writing. There may be some changes made by the Parliament that could impact on what we tell you here now.

A snapshot on the contribution rules

Concessional contributions

There will no longer be varying aged based limits on the amount of concessional contributions you can make. Now, your concessional contributions will simply be limited to \$50,000 (indexed) each year from 1 July 2007.

These contributions are only taxed at 15% in your super fund. However, if your concessional contributions exceed this amount, you (not your super fund) will be effectively taxed on the excess at the top marginal rate of tax plus the Medicare levy.

PLANNING AHEAD NOW...

There's a transitional period from 2007-08 to 2011-12 - for those of you who are 50 and over, the cap on concessional contributions is \$100,000 each year (but it's not indexed!).

Non-concessional contributions

From 1 July 2007, there will be a cap of \$150,000 a year on the amount of non-concessional contributions you can make.

If your non-concessional contributions exceed this amount in a financial year, you and not your super fund will be taxed on the excess at effectively the top marginal rate of tax plus the Medicare levy.

This is a significant change because it will limit your opportunities to make large contributions into your superannuation close to retirement without incurring significant penalties.

PLANNING AHEAD NOW...

There are two things you need to consider:

- special rules that will allow people under 65 to bring forward two year's worth of non-concessional contributions; and
- there will be a transitional cap of \$1 million for non-concessional contributions made between 10 May 2006 and 30 June 2007 – you need to consider the impact of this on your super contributions now!

Any concessions for small business?

The \$150,000 non-concessional cap will not include the proceeds from the disposal of any of your assets that qualify for the small business capital gains tax concessions, up to a lifetime limit of \$1 million.

Who do I talk to about my super?

It's important to get the right advice from the right person.

Your tax agent:

- can advise you on and help you with all tax matters in relation to your superannuation;
- may be able to help with some aspects of setting up your superannuation;
- can help you run your superannuation (e.g., prepare accounting records, produce financial statements and prepare and lodge returns if you have a self managed superannuation fund).

Your solicitor/legal adviser:

- can help you with any legal matters and advice (e.g., in relation to setting up and running a self managed superannuation fund, such as establishing the required trust).

Your licensed financial adviser:

- can give you advice about investment products to ensure that your investments and level of contributions meet your retirement needs;
- can help you prepare and implement an investment strategy that meets your superannuation targets; and
- can advise you whether a particular superannuation product or investment is the right financial decision for you, including advice about restructuring your superannuation needs.

REFORMS FOR SMALL BUSINESS

As this is the start of a new year, it's an opportunity to let you know about a few initiatives that are on the Government's drawing board during 2007.

These may well have a positive impact on you if you're a small business taxpayer.

Of course, the devil will be in the detail. Once these initiatives are finalised, it may be necessary to get back to you with an update on how they will impact on your business to make sure you're not missing out on any opportunities.

What's a 'small business'?

As a small business operator, you may be entitled to access a number of tax concessions targeted at small business, which we have discussed from time to time in our newsletters.

Currently, one of the first hurdles we have to get over is trying to work out whether your business is in fact a 'small business' for the purposes of a particular concession.

In this regard, each concession has different entry eligibility criteria, usually based on varying levels of turnover and/or assets.

This is confusing because what represents a 'small business' changes from concession to concession. It can be a costly and time consuming exercise working all this out. However, there is some relief on the horizon.

Late last year, the Treasurer and Minister for Small Business announced that legislation will be introduced hopefully to make access to these concessions easier and less costly for small business.

The eligibility tests that currently exist for the Simplified Tax System, capital gains tax, fringe benefits tax, goods and services tax and pay-as-you-go small business concessions will be standardised.

A WELCOME SIMPLIFICATION

It is proposed that if your business has an annual turnover of less than \$2 million, you will be able to choose to access any of these concessions that meet your business needs.

All things going to plan, this simplified entry point is expected to be operative from 1 July 2007.

Small business CGT concessions

And speaking of small business concessions, the small business capital gains tax concessions allow you to eliminate or reduce your small business's potential CGT in a number of ways by providing:

- a total exemption for a capital gain on an asset if you have continuously owned the eligible asset for at least 15 years and you're 55 or over and retiring.
- a 50% reduction of a capital gain on an active asset.
- a retirement exemption for capital gains up to a lifetime limit of \$500,000.
- a deferral of a capital gain if you acquire an appropriate replacement asset.

SOONER RATHER THAN LATER...

We raise this issue with you again because the Government is legislating proposed changes to improve the operation of these concessions. As these changes apply to eligible CGT events that happen in the 2006-2007 year, you may need to look at this area now to identify any potential tax planning opportunities.

Private company loans

Private company loans to shareholders or anyone linked with or related to a shareholder can be problematic, with nasty consequences for the unsuspecting.

A deemed dividend arises if a loan like this is not

- fully repaid in the same tax year in which it arises; or
- repaid on commercial terms where the loan is for more than a tax year.

If this happens...

- your company's franking account is debited; and
- the deemed dividend is taxable in the hands of the shareholder or associate without access to a franking credit to offset the tax paid by your company.

Ouch! This effectively amounts to a double penalty overall.

Late last year, the Government announced that it would remove the automatic debiting of a company's franking account when a deemed dividend arises in these circumstances – this at least removes the element of double penalty.

The Commissioner of Taxation will also be provided with a discretion to disregard a deemed dividend.

He will be able to do this where there is evidence that you have attempted to comply with these provisions, have made an honest mistake and efforts have been made to rectify it.

Standard business reporting

The Treasurer has announced a new initiative to reduce the amount of reporting your business currently makes to government.

The focus will be on eliminating unnecessary or duplicated reporting and improving the interface between businesses and government agencies.

Working with State and Local governments, the Federal Government aims to reduce business reporting burdens by:

- reducing the number of different agencies to which you have to report the same or similar information;
- standardising and harmonising the data you have to report; and
- providing options for increased automation of business reporting, including greater pre-population of forms.

TIME TO REVIEW SERVICE ENTITIES

Last year we alerted you to changes in the way the ATO looks at service entities.

What's a service entity?

By way of a quick recap, it's common for professionals (like lawyers, accountants, doctors and dentists) to set up a separate entity (e.g., a service trust or company) to provide the business with staff, clerical, administrative and other office services.

What's the problem?

There's generally nothing wrong with this type of service arrangement – it's not all about tax and is often used as a planning strategy to protect your assets.

However, the ATO has some particular views about how your service entity should operate for tax purposes.

The ATO is on the look out for fees and charges levied by your service entity that are:

- disproportionate or excessive;
- calculated using arbitrary or unrealistic fixed mark-ups; and/or
- charged without clear evidence that the service arrangement adds value or performs any necessary functions for your business.

What's the urgency?

If your business has a service entity, the ATO is giving you until **30 April 2007** to make sure it comes within its operational guidelines – so if you're using a service entity you need to make sure everything is in place before then.

AND A WORD TO THE WISE...

If your service entity comes within the ATO's guidelines, the ATO has indicated that there's a significantly reduced risk that the ATO will audit your service entity.

DROUGHT RELIEF EXTENDED

If you're a farmer, you're already aware that late last year the Government announced a revised drought relief package to assist you.

If you're in an area that is recognised as being severely affected by the drought (*Exceptional Circumstances* declared areas), you may be entitled to assistance that mainly comes in the form of income support and interest rate subsidies.

However, if you're not a farmer but run a business that services them, you are only too well aware that the drought also cuts deeply into your own business.

You may not be aware that the *Exceptional Circumstances* drought relief has also been recently extended to eligible small businesses.

Does my business qualify?

If your business employs up to 20 staff and derives at least 70% of its income from the provision of goods and services to farmers, you may now be eligible to access this drought relief package.

Even if your small business is not located in an Exceptional Circumstances designated area, you may still be eligible, provided you derive at least 70% of your income directly from farmers located in such areas.

A NOTE OF CAUTION

Changes to the eligibility criteria for this business support means that it's important for you not to self-assess your potential entitlement – seek advice.

You can also find out more from the Department of Agriculture and Fisheries at www.daff.gov.au/droughtassist.

And for the farmers amongst you...

Don't forget that there are also a range of tax measures available to farmers affected by drought and other hardships, including:

Farm management deposit accounts: these accounts allow you to manage fluctuations in primary producers' income by a deduction for farm management deposits made in a prosperous year. When you withdraw from this account, the amount of the deduction previously allowed is included in your assessable income in the withdrawal tax year.

Profit from forced disposal or death of livestock: you may be able to spread the profit over a number of years or elect to defer the profit to reduce the cost of replacement stock.

Double wool clips: tax relief is available if you have the proceeds from the sale of two wool clips arising in an income year because of early shearing caused by drought, fire or flood. You may be able to defer the profit on the advanced shearing to the next income year.

Insurance recoveries: you may be able to spread insurance recoveries received for the loss of your stock in equal instalments over five years.

Water facilities: check whether you're entitled to deductions for expenditure on water facilities.

Landcare operations: you may be entitled to a deduction for capital expenditure you incur on eligible Landcare operations.

AN EYE ON COMPLIANCE HOT SPOTS

If you're a retailer in a shopping centre complex, you may be interested to know that the ATO is currently matching 10,000 retailers' tax records Australia wide to information you provide to shopping centres to ensure you are correctly stating turnover levels and income tax and GST owed.

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