BRIEFINGS

WATERHOUSE
CHARTERED ACCOUNTANTS

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Why 90,000 more businesses can access the $20k instant asset write-off this year

The popular $20,000 instant asset write-off for small business ends on 30 June 2017. This concession enables small businesses to immediately write-off depreciable assets which cost less than $20,000.

Until recently, this instant write-off was only accessible to businesses with an aggregated turnover of less that $2 million. But, a last minute deal struck between the government and Senator Nick Xenophon to pass the enterprise tax Bill - containing amongst other things the tax cuts for business and a change in the small business threshold – will see up to 90,000 more businesses access the instant write-off.

While the Bill containing these changes is not yet law, we expect that it will be passed when Parliament next sits.

For those businesses that have not accessed this concession previously, it's important to understand how you can take advantage of it before 30 June 2017.

What is the $20,000 instant asset write-off?

A deduction is generally available for purchases your business makes. The instant asset write-off however changes the speed at which you can claim a deduction. Since 7.30pm, 12 May 2015, small businesses have been able to immediately deduct business assets costing less than $20,000. On 30 June 2017, this $20,000 deduction limit reduces back to $1,000. When we say "immediately deductible" we mean that your business can claim a tax deduction for the asset in the same income year that the asset was purchased and used (or installed ready for use). The deduction is claimed on the business's tax return.

If your business is registered for GST, the cost of the asset needs to be less than $20,000 exclusive of GST. If your business is not registered for GST, it is $20,000 including GST.

Assets costing $20,000 or more can be allocated to a pool and depreciated at a rate of 15% in the first year and 30% for each year thereafter.

The instant asset write-off only applies to certain depreciable assets. There are some assets, like horticultural plants, capital works (building construction costs etc.), assets leased to another party on a depreciating asset lease, etc., that don't qualify - check with us first if you are uncertain.

Also, you need to be sure that there is a relationship between the asset purchased by the business and how the business generates income. You can't for

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example just go and purchase multiple television sets if they have no relevance to your business.

How can you access the $20,000 instant asset write-off

There are a few issues to be aware of if you want to utilise the instant asset write-off:

Does your business qualify?

To access the instant asset write-off, your business needs to be a trading business (the entity buying the assets needs to carry on a business in its own right). It also needs to have an aggregated turnover under $10 million. Aggregated turnover is the annual turnover of the business plus the annual turnover of any "affiliates" or "connected entities". The aggregation rules are there to prevent businesses splitting their activities to access the concessions. Another entity is connected with you if:

- You control or are controlled by that entity; or
- Both you and that entity are controlled by the same third entity.

Should you spend the money now?

If there are purchases and equipment that your business needs, that equipment has an immediate benefit to the business, and your cashflow supports the purchase, then in many cases it will make sense to go ahead and spend the money – you have until 30 June 2017 before the deduction threshold drops back to $1,000.

The $20,000 immediate deduction applies as many times as you like so you can use it for multiple individual purchases. But, your business still needs to fund the purchase for a period of time until you can claim the tax deduction and then, the deduction is only a portion of the purchase price.

Assets must be ready to use

If you want to access the $20,000 immediate deduction, you have to start using the asset in the financial year you purchased it (or have it installed ready for use). This prevents business operators from stockpiling purchases and claiming tax deductions for goods they have no intention of using in the short term. So, if your business purchases an asset on 20 May 2017, it needs to be used or installed and ready to use by 30 June 2017 to qualify for the immediate deduction.

Second hand goods qualify

The instant asset write-off does not distinguish between new or second hand goods. For example, second hand machinery may qualify if it meets the other requirements.

The immediate deduction can be used more than once

Assuming all the other conditions are met, an immediate deduction should be available for each individual item costing less than $20,000. Just be careful of cashflow.

Be careful of contracts

You need to ensure that any contract you sign makes your business the owner of the asset and that the asset can be used or installed and ready to use by the business on or before 30 June. The rules require you to "acquire" the asset before 30 June so the wording of the contract will be important.

Assets for business and pleasure

Where you use an asset for mixed business and personal use, the tax deduction can only be claimed on the business percentage. If you buy an $18,000 second hand car and use it 80% for business and 20% for personal use, only $14,400 of the $18,000 is deductible.

You don't get $20,000 back on tax as a refund

The instant asset write off is a tax deduction that reduces the amount of tax your business has to pay. It enables your business to claim a deduction for depreciating assets in the year the asset was purchased and used (or installed ready to use). For example, if your business is in a company structure the most you will 'get back' is 27.5% (in 2016-17). If your business is likely to make a tax loss for the year then the bigger deduction might not provide any short-term benefit to you.

The deal to pass the enterprise tax Bill

The tax rate reductions for business and changes to the small business threshold were announced in the last Federal Budget but have been stuck in the Senate with concerns that it was merely a 'sugar hit' for the top end of town. However, a last minute deal between the government and Senator Nick Xenophon will see the Bill pass Parliament but exclude large businesses with a turnover of $50 million or more from any tax cuts or concessions.

The negotiated Bill enables:

- An increase to the aggregated turnover threshold to $10 million for access to small business tax concessions from 2016-17. This

means that any businesses with a aggregated turnover of under $10 million can now access a raft of concessions previously only accessible to small businesses under $2 million. The main concession left out is access to the small business CGT concessions, which still requires the entity to pass a $2 million turnover test or a $6m net asset value test.

- Progressive reductions in the corporate tax rate for businesses with a turnover under $50 million. Businesses with an aggregated turnover of less than $10 million will benefit from a company tax reduction to 27.5% this financial year, and
- For unincorporated businesses such as sole traders, partnerships and trusts:
    - An increase to the aggregated turnover threshold to $5 million (up from $2 million) for access to the small business income tax offset from 2016-17, and
    - An increase to the unincorporated small business tax discount to 8% from 2016-17. The offset will be capped at $1,000.

Trusts, timing and getting it right

Trustees (or directors of a trustee company) need to decide on the distributions they plan to make by 30 June 2017 at the latest. It's also important to check your trust deed – most trust deeds require resolutions to distribute trust income to be made by 30 June each year. Decisions made by the trustees should be documented in writing by 30 June 2017.

If valid resolutions are not in place by 30 June 2017, there is a risk that the taxable income of the trust will be assessed in the hands of a default beneficiary (if the trust deed provides for this) or the trustee (in which case the highest marginal rate of tax would normally apply).

It's not essential for distributions to be paid by 30 June, but the trustees need to decide on the distributions that need to be made.

Why work-related travel claims are easy pickings for the ATO

The Australian Taxation Office (ATO) is on the warpath over work related travel expenses and is prepared to test the boundaries of claims in court.

A recent case before the Administrative Appeals Tribunal (AAT) highlights many of the issues that commonly occur. In this case, a truck driver claimed large work related travel expenses over two years - $24,736 in the first year, and $17,489 in the second.

Large work-related claims often pique the interest of the ATO and in this case, the ATO audited the taxpayer's returns, then made amendments to take into account allowances the taxpayer received from his employer for travel but had not declared as income. The taxpayer responded by lodging an amended return, increasing his claim to $33,503 in the first year (later reducing it back to $26,235). The ATO responded by initiating a specific audit of his work-related expenses across both years. The result was that the taxpayer's claims for work-related travel were reduced to $0 for both years and he was slapped with shortfall penalties totalling just under $8,000.

At this stage you are probably wondering why you would bait the ATO, particularly when the documentation supporting your claims was inconsistent. But, the taxpayer objected to the ATO's decision, which launched a further investigation. This time the ATO conceded on some claims. Despite this, the taxpayer brought his case before the AAT.

The AAT found that the taxpayer did not prove that the ATO's amended returns were excessive, primarily because he did not keep records for work-related travel expenditure when away from home overnight driving trucks. The penalties applied by the Commissioner were also found to be reasonable. The issue in this case appears to be that the truck driver just didn't believe that he needed to keep records under the substantiation exemption and that he was entitled to claim the full amount of the Commissioner's reasonable rates each day he travelled.

While this case appears excessive, the main parameters highlight common issues that arise for work related travel claims.

What paperwork do you need to claim travel expenses?

Every year, the Commissioner publishes the reasonable rates for travel expenses – accommodation, food and drink, and incidental expenses. If claims fall within these reasonable amounts, you can deduct travel allowance expenses within Australia without being required to keep full written evidence of all the expenses. But, even if

you can rely on the substantiation exception, you may still be required to show the basis for determining the amount of your claim - that is, you still might need to prove that you actually incurred the expenses, and the expenses were work related.

An area of concern is where these reasonable rates are applied carte blanche. For example, you might be travelling overnight but don't leave until the afternoon. You have breakfast and lunch as usual before travelling, sleep away from home, then return home the next night. In this circumstance you could not claim breakfast and lunch on the first day because these meals would have been consumed before the travel began.

Also, the ATO's reasonable rates for accommodation expenses are only applicable if you are staying in commercial accommodation such as a hotel, motel or serviced apartment. If you choose to stay with family or friends while you are travelling then you can't claim the ATO's reasonable amount.

If you choose to claim amounts above the Commissioner's reasonable amounts, you need to keep records substantiating all of your claim (not just the amount in excess of the Commissioner's rates).

Just because you receive a travel allowance does not mean you have a legitimate claim

One of the issues highlighted in this case was the misconception that because someone receives a travel allowance or overtime meal allowance, this automatically entitles them to a deduction. The expenses still need to be incurred in the course of work-related travel in order to be deductible. Also, the ATO's reasonable rates don't apply unless the allowance itself is 'bona fide' – that is, the amount must reasonably be expected to cover accommodation or meal expenses that will be incurred while travelling for work.

To qualify as a travel expense you need to sleep away from your home

To qualify as a travel expense, you need to travel away from your ordinary residence. The ATO takes that to mean that you're sleeping away from home – not just travelling for the day.

The difference between travelling in the course of your work, living away from home, or relocating is important. The tax treatment between these is quite different.

Are you paying more tax than you need to?

What can you do to reduce your tax and the tax paid by your business? The answer is quite a bit but it takes planning pre 30 June. Here are our top tips:

Timing is everything

Accelerate deductions

For businesses, if your cashflow is good, make the purchases you need before the end of the financial year to claim the deduction, particularly those with turnover under $10 million. The $20,000 immediate deduction reduces back to $1,000 on 30 June (see Why 90,000 more businesses can access the $20k instant asset write-off this year).

For individuals, it's a good time for charitable giving.

Delay income - One off opportunity for high-income earners

Taxpayers with assessable income above $180,000 face an additional 2% tax on every dollar above this level. The 2% 'debt tax' is scheduled to end on 30 June. The difference in timing between the reduction in the FBT rate that occurred on 1 April 2017 and the removal of the 2% tax on 1 July offers a one-off opportunity to reduce your taxable income through salary packaging and other planning initiatives.

If you are likely to have a one off spike in income, for example from the sale of a business or other significant assets, it's worth seeing if you can delay the sale until 1 July 2017 to avoid paying an additional 2% tax. Just be aware of how the arrangement is structured. In many cases the sale is treated as having taken place for tax purposes when the parties enter into the contract, even if settlement occurs at a later point in time.

Money or debts owed to private companies

It's common for business owners to take cash out of their business or for the business to fund some personal expenses through the year – these appear in the shareholder loan account. If this has occurred, it is important that these debts are either repaid by 30 June (you can declare dividends to pay any outstanding shareholder loan accounts) or a formal loan agreement (with specific conditions) is put in place. Without taking action, the ATO will treat any outstanding amount as a deemed dividend taxable in the hands of the shareholder at their marginal tax rate.

House-keeping for business

- For companies, directors' fees and employee bonuses may be deductible for the 2016-17 financial year if the directors pass a properly authorised resolution to make the payment by year-end (payment should be made as soon as practicable). Just be aware of the 2% debt tax for high income earners (see Delay income - One off opportunity for high-income earners)
- For Trusts, it is essential that decisions to distribute pre 30 June income are documented in writing.
- Write-off bad debts
- Review your asset register and scrap any obsolete plant
- Bring forward repairs, consumables, trade gifts or donations
- Pay June quarter employee super contributions now if cashflow allows
- Realise any capital losses and reduce gains
- Raise inter-entity management fees by June 30.

Super Reform: What SMSFs Absolutely Need To Consider Before 30 June

The wide-ranging superannuation reforms come into effect on 1 July 2017. With the changes come a series of issues that Trustees need to be across, even if they don't immediately affect you or your fund:

Understand the value of assets at 30 June

At 30 June 2017, SMSF Trustees will need to know the total superannuation balance held by members. If you have assets such as real estate in your SMSF, and to an extent other assets such as collectables, and artwork, you will need to have a current valuation of those assets. Real estate property values in particular may have varied dramatically over the last few years and should be reviewed. The value of the asset needs to be arrived at using a fair and reasonable process. Because of the extent of the changes, it is worth considering the use of an independent and qualified valuer for some assets.

Your total superannuation balance is the total value of your accumulation and retirement phase interests and any rollover amounts not included in those interests. The balance is valued at 30 June each year and it is this value that may determine what you can and can't do during the following year. For example, if your total super balance is $1.6m or more at 30 June, you are restricted from making further non-concessional contributions in the next year as these contributions may create an excess contribution. And, if your balance is close to the $1.6m cap, then the fund can only accept limited non-concessional contributions.

Self funded retirees – avoiding adverse tax outcomes

If you are receiving a pension or annuity, a $1.6m "transfer balance cap" applies to amounts in your tax-free pension accounts. The cap is essentially a limit on how much money a member can transfer into or hold in a tax-free account. If you have $1.6m or more in a pension phase account, you will need to reduce the pension value level back below the cap before 30 June 2017. If the excess amount is not removed from the pension phase account the amount will be subject to a transfer balance tax.

If you opt to sell fund assets to manage the cap, transitional capital gains tax relief may be available to manage any adverse tax outcomes.

How do you value SMSF assets?

One of the emerging problems for many superannuation fund members is understanding whether they are close to or are likely to exceed the $1.6m cap at 30 June 2017. For those with assets such as real estate, collectables or art, a current valuation that meets the ATO's guidelines will be essential. Real estate in particular has substantially risen in value in some areas creating uncertainty about the real value.

Fund assets need to be valued at market value. While these assets do not have to be valued every year by an independent valuer, it will be important to have documentation validating the value

assigned to the asset. A qualified and independent valuer is recommended if the asset is a significant part of the value of the fund - if the asset is real property, this could be as simple as an online real estate agent.

Should you update your SMSF trust deed?

Over the years there have been continuous changes in superannuation legislation. While many of these changes do not require you to update your SMSF deed, where a deed has not been updated in at least the last 5 years, we suggest that the deed is updated to ensure it is compatible with current law.

If we have not already contacted you about your fund's deed, we will be in contact shortly to discuss if an update is required.

As always, before buying, selling, transferring assets, or making any payments, make sure your trust deed allows you to complete the transactions in the way you intended.

Salary sacrificing concessional super contributions

If you have entered into a salary sacrifice agreement to make concessional super contributions, you will need to review these agreements to ensure your concessional contributions do not exceed the new $25,000 from 1 July 2017.

Investment Property: Pre And Post 30 June

Anyone with investment property in Australia is probably feeling a little edgy with all the recent media attention on deductions, affordable housing, and negative gearing. We take a look at some of the key tax issues for investors pre and post 30 June:

No more deductions for travelling to and from your investment property

The days of writing-off the costs of travel to and from your residential investment property are about to end. From 1 July 2017, the Government intends to abolish deductions for travel expenses related to inspecting, maintaining, or collecting rent for a residential rental property.

Depreciation changes and how to maximise your deductions now

Investors who purchase residential rental property from Budget night (9 May 2017, 7:30pm) may not be able to claim the same tax deductions as investors who purchased property prior to this date.

In the recent Federal Budget, the Government announced its intention to limit the depreciation deductions available.

Investors who directly purchase plant and equipment - such as ovens, air conditioning units, swimming pools, carpets etc., - for their residential investment property after 9 May 2017 will be able to claim depreciation deductions over the effective life of the asset. However, subsequent owners of a property will be unable to claim deductions for plant and equipment purchased by a previous owner of that property. If you are not the original purchaser of the item, you will not be able to use the depreciation rules to your advantage. This is very different to how the rules work now with successive owners being able to claim depreciation deductions.

Investors will still be able to claim capital works deductions including any additional capital works carried out by a previous owner. This is based on the original cost of the construction work rather than what a subsequent owner paid to purchase the property.

There are very limited details about how this Budget announcement will work but we will bring you more as soon as we know.

Business as usual for pre 9 May investment property owners

If you bought an investment property recently, are about to renovate, or have not had a depreciation schedule completed previously, you should consider having one completed.

As a property gets older the building and items within it wear out. Property owners of income producing buildings are able to claim a deduction for this wear and tear. Depreciation schedules are completed by quantity surveyors and itemise the depreciation deductions you can claim.

Higher immediate deductions for co-owners

It's not uncommon to have multiple owners of an investment property. Co-ownership can, in some circumstances, quicken the rate depreciation deductions can be claimed for the same asset. This is because depreciation is claimed on each owner's interest. If an owner's interest in an asset is less than $300, they can claim an immediate deduction. In a situation where there are two owners split 50:50, both owners could potentially claim the immediate deduction, bringing the total immediate deduction available up to $600 for a single asset.

The same method can be used when applying low-value pooling. Where an owner's interest in an asset is less than $1,000, these items will qualify to be placed in a low-value pool. This means they can be claimed at an increased rate of 18.75% in the first year regardless of the number of days owned and 37.5% from the second year onwards.

In a situation where ownership is split 50:50, by calculating an owner's interest in each asset first, the owners will qualify to pool assets which cost less than $2,000 in total to the low-value pool.

The value of renovations

It's best to get a depreciation schedule completed before you start renovations so the scrap value of any items you remove can be recognised and written-off as a 100% tax deduction in the year of removal. This is available for both plant and equipment depreciation and capital works deductions. When new work is completed as part of the renovations (i.e., a new roof, walls, or ceiling), this can also be depreciated going forward.

In some circumstances, there may be depreciation deductions available for renovations completed by a previous owner.

Deductions for older properties

Investors in older properties may still be able to claim depreciation costs. This is because a lot of the items in the house will not be the same age as the house or apartment. Hot water systems, ovens, carpets, curtains etc., have probably all been replaced over time. Additional works, extensions or internal refurbishments may also be deductible.

Further restrictions on foreign property investors

We have seen a number of measures over the years restricting access to tax concessions for foreign investors, particularly for residential property investments. The recent Federal Budget goes one step further, restricting access to tax concessions, increasing taxes, and penalising investors who leave property vacant. Measures include:

- Charge for leaving properties vacant - Foreign owners of residential Australian property will incur a charge if their property is not occupied or genuinely available on the rental market for at least 6 months each year. The charge, which is expected to be at least $5,000, does not appear to apply to existing investments but those made on or after Budget night, 7:30pm on 9 May 2017.
- Excluded from main residence exemption - Foreign and temporary residents will be excluded from the main residence exemption. The main residence exemption excludes private homes from capital gains tax (CGT). Existing properties held prior to 9 May will be grandfathered until 30 June 2019. However, it remains to be seen whether partial relief will be available to those who have been residents of Australia for part of the period they owned the property and whether this change will apply to Australian residents who were classified as a foreign resident for part of the ownership period.
- Increase in CGT withholding tax - When someone buys Australian real property (i.e., land and buildings) they are currently required to remit 10% of the purchase price directly to the ATO as part of the settlement process unless the vendor provides a certificate from the ATO indicating that they are an Australian resident. These rules do not currently apply if the property is worth less than $2 million. From 1 July 2017, the CGT withholding rate under these rules will increase by 2.5% to 12.5%. Also, the CGT withholding threshold for foreign tax residents will reduce from $2 million to $750,000, capturing a much wider pool of taxpayers and property transactions.
- Rules tighten for property purchased through companies or trusts - Australian property held through companies or trusts by non-residents or temporary residents is also being targeted by expanding the principal assets test to include associates. The move is to prevent foreign residents avoiding Australian CGT liability by splitting indirect interests in Australian real property.
- Level of foreign investment in developments capped - a 50% cap is being placed on foreign ownership in new developments.

The push for affordable housing

The Government is very keen to ensure that investment is directed into 'affordable housing.'

The 2017-18 Budget announced an increase in the CGT discount for individuals who choose to invest in affordable housing. The current 50% discount will increase by 10% to 60% for Australian resident individuals who elect to invest in qualifying affordable housing.

In addition, the Government is creating investment opportunities for Managed Investment Trusts (MIT) to set up to acquire, construct or redevelop property to hold as affordable housing. In order for

investors to receive concessional taxation treatment through an MIT, the affordable housing must be available for rent for at least 10 years. For foreign investors, MITs are one area where the Government is actively encouraging participation rather than restricting it.

ATO Issues Notices To Outlaw Motor Cycle Gang Members

Two hundred Outlaw Motor Cycle Gang members have been served notices by the Australian Taxation Office (ATO) for failing to comply with their tax obligations. We hope for the sake of the ATO staff the notices were delivered by mail!

There are not a lot of details about exactly what type of income the ATO is targeting but tax law does not differentiate between legally and illegally earned income: If you earn income, you pay tax. Simple. An English tax law case back in 1886 set the precedent with Justice Denman stating, "In my opinion if a man were to make a systematic business of receiving stolen goods, and to do nothing else, and he thereby systematically carried on a business and made a profit of 2000 per year, the Income Tax Commissioners would be quite right in assessing him if it were in fact his vocation."

The difference between legally and illegally derived income is that you can't claim losses or expenses if you have been convicted of an indictable offence related to that business activity.

The operation targeting the bikers is part of a joint taskforce with the Australian Federal Police. Data matching technology in recent years has helped identify movements of cash and income from undeclared and often illegal activities. The 'follow the cash' philosophy works well and often results in frozen bank accounts, disrupted cash flows and supply chains, which impacts on the overall viability of illegal activities.

Staff Changes at Waterhouse Chartered Accountants

There has been several changes at Waterhouse over the last month or so. Please join us in welcoming Lisa Marie Bryant as our new reception and admin support person. Lisa will be the face of Waterhouse Chartered Accountants whilst Kirsty moves to focus more on the Wealth Management Side of the business. Waterhouse Wealth Management has its first full time employee, please join us in welcoming Samantha Lecky on board as our Client Service Manager/Paraplanner. With Samantha and Kirsty assisting Mark in the Wealth Management business we will easily be able to service any of your investment and wealth management needs.

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