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CLIENT NEWSLETTER

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The 2008 financial year is drawing to a close. Below is some information you may like to peruse before the end of the year, regarding:

- Some of the more significant **tax changes** and issues. These include, for example, details about changes to tax rates, reportable fringe benefits, superannuation fund issues, concessions for small business and key changes from the Budget. *Page 2*
- Some **tax planning** suggestions you may wish to consider before 30 June 2008. *Page 4*

These comments are general in nature as this letter is sent to all clients who are in business. If you would like to discuss any of the issues raised in this newsletter in more detail, please feel free to contact any of our team members.

SIGNIFICANT TAX CHANGES AND ISSUES

New Tax Rates for Individual Taxpayers

Tax Rates – 2007/08

Taxable Income \$	Tax Payable \$
\$0 - \$6,000	Nil
\$6,001 - \$30,000	Nil + 15% of excess over \$6,000
\$30,001 - \$75,000	\$3,600 + 30% of excess over \$30,000
\$75,001 - \$150,000	\$17,100 + 40% of excess over \$75,000
\$150,001 +	\$47,100 + 45% of excess over \$150,000

Tax Rates – 2008/09

Taxable Income \$	Tax Payable \$
\$0 - \$6,000	Nil
\$6,001 - \$34,000	Nil + 15% of excess over \$6,000
\$34,001 - \$80,000	\$4,200 + 30% of excess over \$34,000
\$80,001 - \$180,000	\$18,000 + 40% of excess over \$80,000
\$180,001 +	\$58,000 + 45% of excess over \$180,000

This therefore means that, depending on your individual situation, it may be beneficial to defer income (eg bonuses, superannuation withdrawals (where taxable), redundancy packages etc) until the 2009 financial year so that they are possibly taxed at a lower rate.

If you use a payroll software package to calculate the amount to withhold from salary and wages, please ensure your tax rates are updated to reflect the changes.

Reportable Fringe Benefits

The FBT rate remains at 46.5%.

If the value of certain fringe benefits provided to an employee exceeds \$2,000 (including GST) in an FBT year, the employer must record the grossed-up taxable value of those benefits on the employee's PAYG Payment Summary.

This reportable fringe benefits amount needs to be reported on the employee's income tax return. Where we assist with preparing the FBT return for 2008, a schedule of the reportable benefits will be provided to you.

Annual PAYG Withholding Reconciliation

Employers need to lodge their annual PAYG Payment Summary Statement for the 2008 financial year with the Taxation Office by 14 August 2008.

PAYG Payment Summaries (formerly called "group certificates") should be provided to all employees by 14 July 2008. This includes any staff member who finished employment during the 2007/08 year.

Self Managed Superannuation Funds

For ease of accounting and audit purposes, we suggest that the expenses of a Self Managed Superannuation Fund be paid directly by the super fund. However, the rules prohibiting the payment of those expenses by an employer entity have been relaxed.

Once again we remind you that money belonging to the fund should not be used for personal or business purposes.

Concessions for Small Businesses – "Small Business Entities"

From 1 July 2007 changes were introduced that streamline how many of the tax concessions apply to businesses with an aggregate turnover below \$2 million. These changes standardise the eligibility criteria for accessing the small business concessions for GST, the Simplified Tax System (STS), Capital Gains Tax, Fringe Benefits Tax and PAYG instalments. This means that more small businesses will be able to access the concessions as the threshold has increased and some of the hurdles complicating access have been removed.

For example, more small businesses will now be able to access the CGT small business concessions which provide the opportunity to significantly reduce the CGT payable on the sale of your business or business assets.

Key Budget Changes

Immediate effect –

- The FBT exemption for certain work related items (including laptop computers, personal digital assistants and tools of trade) will be tightened so that only one item per employee per year can be provided, the item must be used primarily for work use, and depreciation can't be claimed by an employee who has been reimbursed for the cost of any such item
- FBT rules on jointly held assets tightened so that the full value of a benefit that has been provided to both an employee and an associate in relation to a jointly held asset (eg rental property) will be subject to FBT
- The FBT exemption on salary sacrificed in-house meals has been removed
- The period over which capital expenditure on in house computer software is depreciated will increase from 2.5 years to 4 years
- Superannuation lump sum benefits will be made tax free for people with a terminal medical condition

From 1 July 2008 –

- Income tax rate reduction as detailed above
- The Medicare levy surcharge thresholds will increase for singles from \$50,000 to \$100,000 and for those who are members of a family from \$100,000 to \$150,000
- The definition of family in the family trust election rules will change to limit lineal descendants to children or grandchildren
- An income test will be introduced for the entrepreneurs' tax offset
- For employee share schemes, the value of the discount (where it exceeds \$1,000) is included in assessable income if a taxpayer elects to be assessed upfront
- The luxury car tax rate will increase from 25% to 33%

- The tax deductibility of contributions and gifts made by individuals and businesses to political parties, members and candidates will be removed
- Income testing of child care/family tax benefit so that it will not be paid if family income exceeds \$150,000 (i.e. no shading out)
- Eligibility for dependency offsets tightened
- Introduction of a 50% education tax refund on eligible educational expenses up to \$375 for primary students and \$750 for secondary students (note – receipts should therefore be kept from 1 July 2008)
- The child care tax rebate for out of pocket approved child care expenses will increase from 30% to 50% (received as a direct payment from Centrelink)

From 1 July 2009 –

- Salary sacrificed contributions to super will be included in income testing for government benefits such as support programs for family assistance, child support, superannuation co-contributions and financial and retirement savings assistance

TAX PLANNING – SUGGESTIONS TO CONSIDER BEFORE 30 JUNE 2008

While taxation is a major factor affecting many decisions, it should be remembered that it is normally only one of several factors to consider. In addition, keep in mind that you may need to consider other taxes such as stamp duty, payroll tax, land tax and GST, and seek advice from licensed financial planners where appropriate.

Depreciable Assets

A review of depreciable assets should be undertaken to ensure that a deduction is claimed for items lost, stolen, destroyed or scrapped during the year.

A deduction can also be claimed for depreciable assets no longer actually used in the business. It is not necessary to physically scrap the assets.

Superannuation Guarantee Charge (SGC)

The superannuation guarantee requires employers to contribute 9% of each eligible employee's earnings base to a complying superannuation fund, and to make the superannuation contributions at least every quarter.

If employers:

- do not pay enough superannuation contributions (at least 9%) for an employee,
- do not pay superannuation contributions by the quarterly cut-off date for payment,
- do not pay superannuation to an employee's chosen fund, or
- pay a superannuation contribution to a fund after the cut-off date for payment,

then they will need to lodge a superannuation guarantee statement and pay the superannuation guarantee charge. The superannuation guarantee charge is made up of the employee's superannuation guarantee shortfall, nominal interest of 10% per annum and an administration fee of \$20 for each employee with a shortfall. Unlike superannuation contributions, there is no tax deduction available for the superannuation guarantee charge (which will include the superannuation contribution which is being paid late). Other penalties may also apply.

To avoid the charge, we suggest that employers ensure that all superannuation contributions are paid by each quarterly cut-off date. In addition, we suggest that all contributions for the 2008 year be made by 30 June 2008, in order to claim a tax deduction in the 2008 year. We note that the date payment is made is the date the payment is *received* by the superannuation fund. If payment is made by cheque, it is the date of receipt of the cheque, not the date the cheque clears the bank, nor the date it is posted. If a cheque is dishonoured, it is deemed not to have been received.

Superannuation Contributions by Employers

From 1 July 2007, you can claim a full deduction for all superannuation contributions you make to funds on behalf of employees, provided certain conditions are met (such as you must have made the contribution to a complying superannuation fund). Age-based limits on deductions will no longer apply.

Employees wishing to "top-up" their superannuation may wish to approach their employer about "salary sacrificing". Under an effective salary sacrifice arrangement, an employee sacrifices future salary or wages in return for the employer making superannuation contributions of an equivalent value for the employee. Salary or wages to which an employee is already entitled cannot be sacrificed, and there should be a pre-existing agreement between the employer and employee.

The contribution limit from 1 July 2007 is \$50,000 per person (\$100,000 pa until 30 June 2012 for those aged 50 and over), so current salary package arrangements should be reviewed to ensure that they don't breach this limit. If contributions are made above the \$50,000 limit, the excess amount of the contribution is taxed at a further 31.5% in the employee's hands, on top of the 15% tax paid on entry to the fund. In addition, the excess counts towards their undeducted contribution limit.

Undeducted Superannuation Contributions

From 1 July 2007, a limit of \$150,000 per financial year applies to undeducted contributions. For those under 65, this limit is averaged across three years allowing you to bring forward three years worth of contributions (\$450,000) into one year. For example, you might have chosen to make a \$450,000 contribution on 5 July 2007, in which case you could not make another concessional-tax contribution until the 2011/2012 financial year.

Any contributions above this non-concessional threshold are taxed at the top marginal tax rate of 46.5%.

As superannuation is not taxed when you withdraw it (assuming you are 60 or older, and the payments are from a taxed fund), superannuation is an attractive investment vehicle. By comparison, if you were to put the money into a different investment vehicle, any income you generate from the investment would be taxed as income at your marginal tax rate. In super, your investment can grow and any gain is potentially tax free. Note however that tax is only one consideration, and advice should be taken from a licensed financial planner.

Self Employed Superannuation Contributions

From 1 July 2007, self employed people are eligible to claim a full deduction for the contributions they make to superannuation until age 75.

Superannuation Contributions by Self-Employed Persons

From 1 July 2007, self-employed persons are eligible to claim a full deduction for all contributions made accumulation schemes on their own behalf up to age 75. This replaces the old rules where a full tax deduction applied to the first \$5,000 contributed and 75% thereafter.

If you are a contractor you should be aware that you may not be able to access a tax deduction for your superannuation contributions. Under the superannuation guarantee laws, if you are paid for your personal labour or skills, perform the work personally (not delegated) and you are not paid to achieve a result (for example, the contract is based on your time), you are considered to be an employee and not a business. As a result, any contributions you make are not tax deductible as the hirer should be making a superannuation guarantee contribution on your behalf (unless you meet the definition of an 'eligible person') under SIS.

To be considered 'substantially self employed' and therefore eligible to claim a tax deduction for superannuation contributions, less than 10% of your assessable income including reportable fringe benefits can be from employment. It's important to note that this rule applies on a financial year basis. So, if you were employed for any part of the year, you might fail the test.

If you are self-employed, you may be eligible to receive the government superannuation co-contribution from 1 July 2007. You are eligible for a co-contribution if:

- you make a personal superannuation contribution by 30 June to a complying fund,
- you don't claim an income tax deduction for the contribution,
- your total income (assessable income plus reportable fringe benefits minus business income deductions) is below the income threshold (\$58,980 in the 2007-08 financial year),
- 10% or more of your total income is from running a business, eligible employment, or a combination of both (this includes salary or wages, director fees, gross income as a sole trader and partnership distributions, but not distributions from a trust)
- you are less than 71 years old at the end of the income year, and
- you do not hold an eligible temporary resident visa at any time during the income year.

Superannuation – Spouse Rebate

A spouse rebate of up to \$540 applies where a taxpayer contributes to a superannuation fund for the benefit of a low income/non working spouse. The spouse must be earning less than \$10,800 (including reportable fringe benefits) to get the full rebate and no rebate is available when the spouse earns more than \$13,800.

Motor Vehicles

All individuals who claim motor vehicle expenses for income tax purposes should ensure that they record odometer readings as at 30 June. Readings are also required at the date of sale or purchase of a vehicle.

Work in Progress/Billings

Clients who are not required to pay tax on their work-in-progress at June 30 are generally those in professions where the services cannot be billed to the client and give rise to a recoverable debt because the services agreed to be provided have not been completed. (We note that construction industry businesses are not considered to be in this category.) We suggest that those clients carefully consider their Work In Progress before billings are done for 30 June.

Interest Expense

Interest is deductible to the extent it is incurred in gaining or producing assessable income or in carrying on a business for that purpose, and is not of a capital, private or domestic nature. Where a loan is taken out for two purposes, one business and one non-business, only a proportion of the interest will be deductible.

Some of the situations in which Interest may be deductible include:

- Where the money is borrowed by a partnership to repay money advanced by a partner for working capital. This rule does not extend to co-owners of income-producing assets such as rental properties.
- Where the money is borrowed to acquire shares, if it is reasonably expected that dividends will be derived from the investment. Interest will not be deductible where the shares are acquired solely for the purpose of making a capital profit on their resale.
- Where the money is borrowed by persons in business for the purpose of paying income tax, in certain circumstances.
- Where the money is borrowed to acquire units in a split property unit trust.

Note that if interest is prepaid, the prepayment rules may preclude a deduction in certain circumstances.

Interest is not deductible on borrowings to finance life premiums or personal superannuation contributions.

Bad Debts

To qualify for a deduction, the book entries to write off bad debts must actually be made by 30 June, rather than at a later time (such as when the accounts are finalised). To be a bad debt, you need to have brought the income to account as assessable income, and given up all attempts to recover the debt.

An additional advantage of writing off any bad debts if you are on the accruals method for GST is that you will be able to claim back the GST remitted on the invoice originally raised.

Trading Stock

A physical stock-take must be conducted as at the close of business on 30 June. (Businesses in the Simplified Tax System do not need to take a physical stock-take if the value of stock on hand does not fluctuate by more than \$5,000 from year to year.)

The method of valuing trading stock on hand can be changed each year, the three basic methods being cost price, market selling value or replacement price. It is normally appropriate to value the stock at cost price, however, the option of valuing certain items of stock at replacement prices to lower the overall value of stock should be considered. If this option is exercised, a specific election must be made in your income tax return in regard to those items.

Obsolete trading stock could be disposed of prior to 30 June and the resulting loss would be claimed in the current year's accounts, or alternatively an application could be made to the Commissioner for a valuation based on the "fair and reasonable" value of the trading stock.

In a manufacturing context, "cost" includes a proportion of manufacturing overheads for finished and partly manufactured goods.

Note that trading stock *does not* include stationery and other consumable stores, if the supply is "reasonable" to ensure the "normal continuity of operations". Such expenditure will still be deductible.

A ruling from the Tax Office indicates that packaging items may be classed as trading stock in certain situations.

Year end stock take records are very important, as the Taxation Office expects that all businesses with trading stock will be able to produce stock sheets and other relevant documents which would indicate that an actual stock take was undertaken at the year end, and that the level of stock has been reported accurately.

Timing of Payments and Receipts

Clients whose returns are submitted on a "cash" basis should remember that income received up to 30 June will affect your current tax liability, while income received after to 30 June will affect next year's tax liability. You may wish to delay the receipt of further income until 1 July. Generally, interest income on term deposits can be deferred if the maturity date is after 1 July.

We are aware that when the Taxation Office audits a cash basis profession, the level of banking in June and July are carefully looked at, to ensure there has been no artificial reduction in May/June.

Clients can take steps to incur expenses in this year, which might otherwise have been deductible in the following year. In each case, the work would need to be complete and an invoice received dated 30 June or earlier (and must have been paid if in the Simplified Tax System regime and on a cash basis).

Examples would include:

- repairs to plant and equipment, premises or motor vehicles
- printing and stationery expenses (and other consumables)
- advertising expenditure
- trade gifts or donations

Bonuses due to be paid to arms-length employees will be deductible this year if the decision to pay has been made and documented prior to 1 July, and the amounts to be paid are quantified. A company resolution constitutes suitable documentation.

To a large extent, deductions for the prepayment of certain expenditure are now only available to those clients in the Simplified Tax System (STS) who calculate their income on a cash basis. We suggest that you contact us prior to entering into a prepayment arrangement to ensure that you qualify for a prepayment deduction.

Examples for consideration are:

- Insurance premiums
- Interest (this can provide a substantial deduction)
- Preventative maintenance contracts
- Rent could be paid for July before 30 June.

Small businesses in the STS can also claim an immediate deduction for assets, including software, costing less than \$1,100 (GST inclusive). For all other assets, STS taxpayers are entitled to "6 months of depreciation" in the year of purchase regardless of when the item was purchased.

A possibility also exists to enter into a one-year lease before 30 June, prepaying all the lease payments (40-50% of the cost of the goods) and then financing the residual value in 12 months' time.

Wages to Children

Salary, wages and payments for services rendered by unmarried persons who are under 18 years of age on the last day of the income year are taxed at the rates applying to adult taxpayers. You should therefore consider paying wages to children who have worked in the family business, as the income will not attract tax in their hands (provided their total income is less than \$11,000 for the 2008 income year) and will be a tax deduction to the business. Care should be taken to pay normal arms-length rates and to document periods worked. PAYG Payment Summaries are required to be prepared in these circumstances and the child may need to have a tax file number.

We note also that where the above income is accumulated by the child and invested, the income earned on the investment is also subject to tax at normal rates, rather than at the higher rates applying to "unearned income" of unmarried

minors. Naturally, these funds legally belong to the child who then has complete control over them. Where the funds are invested back into a business undertaking, the Commissioner of Taxation has discretion enabling him to form an opinion on how much of the income should be taxed at normal rates. The main factors considered hinge around "real and effective conduct, and control" over the business.

Landlords Beware

Rental properties are high on the Tax Office audit radar, especially with owners looking to accelerate deductions before the end of the year by way of expenditure on repairs and maintenance. Landlords need to be aware that repairs and replacements are likely to be deductible whereas new and improved items are more likely to be capital expenditure and depreciated over time. If it's new, bigger and brighter than what was already there, it's likely to be capital expenditure and depreciated.

The question is, are you improving or repairing and maintaining? Repairs relate directly to wear and tear as a result of renting out the property. They generally involve a replacement or renewal of a worn out or broken part. Replacement of an entire structure is capital. For example, replacing an entire fence is likely to be capital as opposed to repairing a few broken palings.

Also, be wary of holiday homes that are rented out. If you or family members have used the holiday home throughout the year then you will need to apportion the expenditure on the property between private and investment.

Net Medical Expenditure Rebate

This rebate is allowable only when net medical expenditure exceeds a threshold of \$1,500. The rebate is calculated on the excess of expenditure over \$1,500.

- Consideration should be given to maximising the claim in one year, eg. by delaying payment of medical expenditure until July if it appears that the threshold of \$1,500 will not be reached this financial year. Alternatively, if the threshold will be reached, outstanding medical expenditure could be paid prior to 30 June. Expenditure for medical rebate purposes includes doctors, dentists, hospital fees, chemist prescriptions etc.
- medical expenditure incurred for cosmetic operations for which a Medicare benefit is not payable, and dental services and treatment which is solely cosmetic are no longer subject to the rebate.

Unrealised Exchange Gains/Losses

Where possible and appropriate, the realisation of exchange gains should be deferred until after June 30, and foreign exchange losses crystallised prior to June 30.

Capital Gains Tax (CGT)

If assets are likely to return a profit on sale, CGT can be deferred by delaying the sale until after June 30. Clients who have realised capital gains should ensure that expected capital losses are incurred prior to June 30.

A reminder that the normal date for both acquisition and disposal is the date of contract and not the date money is paid or received.

The capital gains tax discounting provisions (individuals, trusts and superannuation funds) will only be available where the assets are held for greater than 12 months.

We encourage you to contact us should you be considering a significant purchase or sale to ensure that the most tax advantaged position is obtained.

Gifts and Retiring Allowances

Gifts and certain retiring allowances paid to employees cannot be used to generate a loss to be carried forward into the following year. Clients who are likely to incur a trading loss this year should therefore delay making any such payments until after June 30.

Superannuation Co-Contributions

Employees who earn less than \$58,980 a year and make personal (non-deductible) superannuation contributions may be eligible for Government Superannuation Co-contributions.

Where the eligible employee's assessable income is \$28,980 or less, the government will put in \$1.50 for every dollar the employee puts into super, up to a maximum of \$1,500 a year. Where the employee's assessable income is between \$28,000 and \$58,000, reduced co-contributions are available.

There are some other conditions attaching to this, so please contact us if you are considering making a payment.

Shareholder/Beneficiary Loans

Legislation effective from 4 December 1997 has the potential for loans and other payments to shareholders and beneficiaries, to be deemed as dividends/distributions to the shareholder/beneficiary. This area is complex and advice should be sought if your company or trust has advanced loans to shareholders/beneficiaries or associates.

Deferring Termination Payment

A taxpayer who is nearing age 55 and who is about to receive a termination payment that is not to be rolled over into another approved fund can achieve a tax reduction by waiting until age 55.

There are substantial savings on tax rates and tax free amounts for 55 year olds compared to people aged under 55.

"Averaging" of Income

If taxable income this year is likely to be substantially higher or lower than next year, there may be some tax saving opportunities, such as:

- deferring retirement benefits until after 30 June
- splitting holiday pay received on a long holiday which straddles two tax years.

Transition to Retirement & Salary Sacrifice

An individual who is over age 55 can access superannuation as a non-commutable income stream. Assessable income can be salary sacrificed to a level where minimal tax is paid, while at the same time accessing a low tax (tax free if over 60) pension.

Where the assessable income is low enough and at least 10% of it is generated from employee type activities or carrying on a business, a taxpayer can also make an undeducted contribution into super and qualify for the government's co-contribution.

Executive Share Schemes

The tax paid on executive share option schemes is based on market value at the time of exercising, unless the taxpayer has elected to pay tax up front. With stock prices low, it may be a good time for executives participating in such schemes to exercise options. Any future growth will be taxed as a capital gain and could benefit from a 50% discount if held for at least 12 months.

What is "OBM"? Open Book Management

OBM means empowering team members, facilitating emotional ownership of a business by involving team members in the management of the business.

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