YEAR-END TAX PLANNER

2021 TAX HIGHLIGHTS

June 2021

With the end of financial year just around the corner, BDO Automotive take this opportunity to remind you about a number of tax matters that you should consider before 30 June.

INTRODUCTION

The tax year-end is an important time to ensure your tax affairs are in order. It is important to ensure all appropriate elections and choices have been made and the correct documentation is in place for transactions that have or are to be finalised before 30 June 2021.

This is even more essential this year, with the massive disruption businesses have experienced through the pandemic.

This document is not exhaustive and your individual circumstances must be considered.

2021 TAX HIGHLIGHTS

Federal Budget Announcements

The 2021 Federal Budget was handed down on 11 May 2021. The Budget was predominantly a spending Budget to maintain the momentum of the recovery of the Australian economy following the pandemic.

The main revenue initiatives that impact immediately are:

- An extension of the Capital Asset Immediate Deduction provisions for another year, now ending 30 June 2023
- An extension of the Loss Carry Back provisions for another year, now ending 30 June 2023
- An extension of the Low and Middle Income Earners Tax Offset for another year, now ending 30 June 2022.

Tax incentives for business investment – A reminder

Backing business investment incentive

The Government introduced a time limited 15 month investment incentive (through to 30 June 2021) to support business investment and economic growth over the short term, by accelerating depreciation deductions.

Businesses with aggregated annual turnover of less than $500 million per annum will be able to deduct 50 per cent of the cost of an eligible asset upon installation, provided it was acquired after 12 March 2020 and first used or installed by 30 June 2021.

There is no asset value threshold for this 50% investment incentive. The existing depreciation rules will continue to apply to the remaining balance of the asset's cost over its effective life.

Therefore, an asset will generate the immediate deduction of 50%, plus in the same year will generate a Division 40 depreciation deduction calculated in accordance with the normal depreciation rules.

The measure results in businesses bringing forward depreciation deductions from future years to the current period resulting in a reduced tax liability in the current period. A rise in tax liability due to reduced depreciation in subsequent years will offset this reduction.

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Capital asset immediate deduction

One of the initiatives from the 2020 Budget was the introduction of the capital asset immediate deduction. Under this scheme, entities that are carrying on a business with an aggregated turnover of less than $5 billion (there is an alternative test for companies that do not satisfy this threshold) are entitled to claim an immediate deduction for the purchase and installation of new qualifying assets, and an immediate deduction for capital improvements to older assets (ie many amounts that are not deductible repairs).

The assets must be depreciable under Division 40 (general depreciation rules) and are subject to various exclusions.

The assets must be first held by the entity between 6 October 2020 and 30 June 2022, and be used or installed ready for use on or before 30 June 2022 (note that the Government has proposed to extend this to 30 June 2023, although at the time of publication, legislation has not yet been released). The deduction is allowable in the year in which the asset is used or installed ready for use.

For assets purchased between 6 October 2020 and 30 June 2021, the immediate deduction is allowable only where the asset is used or ready for use by the entity no later than 30 June 2021.

Superannuation

The rate for superannuation contributions by employers on behalf of their employees under the SGC for the year ended 30 June 2021 is 9.5%.

The rates are scheduled to increase over the next few years. For the year ended 30 June 2022, the rate increases to 10%, meaning that contributions made in relation to salary and wages paid on or after 1 July 2021 will be subject to the higher 10% rate.

The contributions rate is scheduled to increase by 0.5% per year until it reaches 12% from 1 July 2025. This may be subject to change.

Employers must make superannuation guarantee contributions for their employees on a quarterly basis within 28 days after the end of each quarter (September, December, March and June)

Tax Planning Tip

Although the June 2021 quarter SGC does not have to be paid until 28 July 2021, tax deductions for the superannuation contributions will only be available in the 30 June 2021 tax year if the contribution is received by the superannuation fund by 30 June 2021. A recent release from the Tax Office reminded all employers that deductions are not allowed when contributions are made via a clearing house until the payment has actually been paid by the clearing house to the trustee of the fund, and that this may take several days upon receipt by the clearing house.

INDIVIDUAL TAX RATES

At the time of publication, there have been no changes to the individual income tax rates for 30 June 2021.

INDIVIDUAL TAX RATES		
	Threshold	**Rate**
1st rate	$0 - $18,200	0%
2nd rate	$18,201 - $45,000	19.0%
3rd rate	$45,001 - $120,000	32.5%
4th rate	$120,001 - $180,000	37.0%
5th rate	$180,001 +	45.0%

In addition, the Medicare levy is 2% of taxable income. Therefore, the top marginal tax rate for resident individuals will be 47% (including Medicare levy).

The Low and Middle Income Tax Offset and the Low Income Tax Offset will also be available.

Small and Medium Businesses

From 1 July 2020, the small business turnover threshold has increased from $10 million to $50 million.

This means from 1 July 2020, small and medium businesses can access the concessional prepayment rules and the immediate deduction for start up costs. From 1 April 2021, the FBT exemptions for car parking benefits and for the provision of multiple work related electronic devices extends to entities with a $50 million turnover. From 1 July 2021, the balance of the small business entity (SBE) concessions extend to medium enterprises, including concessional GST and PAYG instalments, small business trading stock, 2 year amendment period and concessions for customs and excise reporting.

However, thresholds for the small business CGT concessions remains at $2 million turnover or $6 million net asset test and small business tax discount has a $5 million turnover threshold.

IMPORTANT YEAR END PLANNING ISSUES

Base Rate Entity Company Tax Rate

The base rate entity company tax rate applies where companies satisfy the base rate entity passive income test and they have an aggregated turnover less than the following:

YEAR ENDED 30 JUNE	TURNOVER
2018	$25 million
2019	$50 million
2020	$50 million
2021	$50 million

The base rate entity passive income test requires companies to derive no more than 80% passive income in a relevant year. Passive income includes items such as rent, interest, capital gains, and distributions from trusts and partnerships.

The base rate entity company tax rate for each of the relevant years is:

YEAR ENDED 30 JUNE	RATE
2018	27.5%
2019	27.5%
2020	27.5%
2021	26.0%
2022	25.0%

The base rate is also relevant in determining the maximum franking amount a company can apply to franked dividends it pays to its shareholders.

For companies that are not base rate entities, the standard 30% company tax rate applies.

Tax Planning Tip

Companies need to monitor their income tax rates as these may change from year to year. In particular, where rates are changing across years, companies may seek to time the derivation of income and/or the incurring of deductible expenses to take advantage of the changing rates (subject to prepayment rules and general anti avoidance rules).

Companies need to pay particular attention to the impacts of the business shutdown due to the pandemic. The changes in turnover may cause the company to move between thresholds in 2020 and 2021. This may result in a change of company tax rate, and more importantly, a change in the franking rate. It is the change in franking rate that companies should monitor carefully. The effects of this are illustrated below.

Trapped Franking credits

As can be seen from the above tables, the company tax rate for base rate entities has reduced for the 30 June 2021 year to 26% and it will further reduce for the 30 June 2022 year to 25%. Similarly, the franking rate will reduce in both 2021 and 2022.

If the company pays a franked dividend based on profits of a previous year where the company's tax rate was higher than the franking rate for the current year, there may be trapped franking credits e.g. previous year rate 30% and current year franking rate 27.5% then 2.5% franking credits trapped in company.

Tax Planning Tip

Companies need to consider which franking rate they are subject to in the 30 June 2021 year, and which rate they will be subject to next year. Where the company may move from a higher franking rate to a lower franking rate in the following year, there may be advantages in paying franked dividends prior to 30 June 2021 (subject to the position of the shareholders).

Higher Top-up Tax

Shareholders in companies that pay 26.0% franked dividends will have to pay higher top-up tax because the franking offset they receive will be lower than if the dividend was franked at 30%. Generally, this means the company tax cut is clawed back by the government when dividends are paid to resident shareholders.

For example, a company has $100 profit and pays 30% tax, and pays the $70 balance as a franked dividend to the shareholder. If the shareholder's marginal tax rate in 47%, they will pay tax on the $70 franked dividend of $17 (after franking offset) leaving the shareholder with $53 after tax.

However, if the company pays tax at 27.5% tax on the $100 income it can pay a $72.5 franked divided franked at 27.5%, in which case the shareholder pays $19.50 on the $72.50 franked dividend leaving the shareholder with the same $53 after tax.

Small business restructure rollover relief

From 1 July 2016 small businesses (<$10m turnover threshold) can use the small business restructure relief, which allows eligible taxpayers to transfer assets between related entities, including companies, trusts and individuals, without any income tax or CGT consequences. While this rollover can be very beneficial to a small business, care needs to be taken as the eligibility rules can be complex in some cases.

LOSS CARRY BACK RULES

Legislation has been passed allowing companies with an aggregated turnover of less than $5 billion to make an election to carry back income tax losses in 30 June 2020, 30 June 2021 and 30 June 2022. The Government has proposed extending these rules to 30 June 2023, although at the time of publication, legislation has not been introduced.

Where an election is made to carry back a loss, the company receives a refundable income tax offset equivalent to the amount of the tax loss multiplied by the relevant income tax rate.

The election allows income tax losses from 30 June 2020 to 30 June 2022 to be carried back for a refund of income tax paid in the 30 June 2019 to 30 June 2022 income tax years.

The amount of the losses able to be carried back is capped at the lesser of:

- The tax effected tax losses
- The income tax paid
- The franking account balance for the year of the election.

If you would like to consider these rules, you should discuss with your BDO adviser.

Note however that by making the election and receiving a refund of income tax paid in an earlier year, the company will receive a debit in its franking account equivalent to the amount of the refund. This may restrict the company's ability to pay franked dividends to its shareholders.

Loans from Private Companies - Division 7A

Private company directors are reminded to ensure they comply with Division 7A where they provide loans or other financial assistance to shareholders and associates or allow them to use company property.

Loans made by private companies to their shareholders or associates will be treated as deemed dividends under Division 7A unless the loan is repaid by the earlier of the date of lodgement or due date for lodgement for company's tax return for the year, or the loan is converted to a formal loan with the following features:

- Is under a Division 7A complying written agreement and on commercial terms by the earlier of the company's lodgement day or due date;
- Has a minimum benchmark interest rate; and
- Has a term of no more than seven years, or 25 years for registered mortgages over real estate

Other Important Division 7A issues:

- Ensure minimum loan repayment amounts are paid in years after the loan is made; any shortfall will be a deemed dividend in that year;
- A Division 7A deemed dividend is generally unfranked;
- Payments and debt forgiveness to a shareholder or associate can also be a deemed dividend;
- The private use of company owned assets for less than market value consideration can be a deemed dividend under Division 7A;
- These rules apply to shareholders and associates, which includes relatives of shareholders and trusts, companies and partnerships of the shareholders or their associates;
- There is a Commissioner's discretion for non-complying loans not to be treated as a deemed dividend or to be treated as a franked dividend if it resulted from an honest mistake or inadvertent omission.
- Loans for income producing purposes can be caught as a deemed dividend under Division 7A – there is no otherwise deductible rule.
- Make sure all Division 7A loans made in the 30 June 2020 tax year were either repaid or put under a complying Division 7A loan agreement by the earlier of the lodgement date or due date of the company's 2020 tax return.
- If the company has an unpaid present entitlement from a trust, it may be a deemed dividend to the trust and/or the shareholder or their associate in some circumstances (see comments under 'Trusts' below).

Tax Planning Tip

To ensure all future Division 7A loans are covered by a qualifying loan agreement, consider entering into a Division 7A complying facility loan agreement that will be able to cover all future loans to shareholders or their associates. If such a facility loan agreement is already, in place review it regularly to ensure it complies with current law and covers all relevant shareholders and associates.

Trusts

Unpaid Trust Distributions

Distributions made by trusts to associated private companies that remain unpaid at the end of the following year may be deemed to be a loan to the trust and become subject to Division 7A.

For the 2021 tax year, unpaid distributions to a private company that arose in the 2020 tax year may be a deemed dividend to the trust for the 2021 tax year unless the trustee:

- Has put the amount in a sub-trust for exclusive benefit of the private company by the earlier of the lodgement date or due date for lodgement of the trust's 2020 tax return (usually 15 May 2021);
- Converts the amount to a Division 7A complying loan by the earlier of the lodgement date or the due date for lodgement for the 2021 company tax return; or
- Pays the amount to the company by the earlier of the lodgement date or due date for lodgement for the company's 2021 tax return.

For unpaid distributions that have been placed into a sub-trust, the annual return on the sub-trust investment must be paid to the private company by 30 June 2021.

Reimbursement agreements

Trustees are also reminded of the application of Section 100A of the 1936 Act, especially where a trust has made a distribution of income to a private company.

Where the Tax Office determines that Section 100A applies to an arrangement, the net income that would otherwise have been distributed by the trustee is instead assessed to the trustee at the highest marginal rate.

Section 100A will not apply to ordinary commercial or family dealings.

- In a recent publication, the Tax Office indicated the following arrangement, referred to as the washing machine, would attract Section 100A:
- The trustee owns all the shares in a private company.
- The company is also a beneficiary of the trust and undertakes no activity but derives a small amount of bank interest on its own account
- The directors of the private company and the trustee company are the same individuals or related individuals
- The trustee resolves to make the company presently entitled to some or all of the trust income in year 1 and distributes that to the company prior to the lodgement of the trust's tax return in year 2.
- The company includes the distribution in its assessable income for year 1.
- Division 7A does not apply to the arrangement because the company's entitlement is paid before the lodgement of the income tax return
- The company pays a fully franked dividend in year 2 to the trustee. This forms part of the trust's income in year 2.
- The trustee makes the company presently entitled to all o r some of the trust income at the end of year 2.
- The arrangement is repeated.

The reimbursement agreement results in the distribution benefitting a party other than the beneficiary (it instead benefits the trustee). The reimbursement agreement provides for the payment of income from the trustee to the company on the understanding (implied from the repetition in each income year and their common control) that the company would pay a dividend to the trustee of a corresponding amount (less the tax paid).

The agreement is designed to achieve a reduction in tax that would otherwise be payable had the trustee simply accumulated the income.

This agreement is not an ordinary commercial dealing because the ownership structure and, particularly, the perpetual circulation of funds, serve no commercial purpose.

There are hybrids of this scheme that involve money flowing from the company via interposed entities, ultimately ending up back in the trust. These have also been identified by the Tax Office as possibly giving rise to a Section 100A determination.

Loans from Trusts

Where there are unpaid distributions to a private company (including those under sub-trust) that have not been converted into a Division 7A loan, and the trustee has made loans or payments to shareholders of the private company (or their associates), these loans or payments may also be subject to Division 7A.

- A loan from a trust will be a deemed a dividend where:
  - The trust has made a distribution to a company;
  - The trustee has not paid the distribution to the company that is presently entitled to the distribution; and
  - The trust makes a loan to company's shareholder or associate;
- The loan is deemed to have been made by the company to the company's shareholder or associate and will be subject to the Division 7A rules as discussed above;
- Loans will not be deemed dividends if they are repaid or put on a commercial footing before the lodgement day for the trust tax return.

Trust Distributions and Resolutions

Most trust deeds for discretionary trusts require trustees to make their distribution determination for the year ended 30 June on or before 30 June, or sometimes earlier. It is essential that trustees make these determinations prior to 30 June or earlier date if required in the trust deed (notwithstanding the requirements of the trust streaming rules discussed below).

The Tax Office stated they expect there to be evidence of the trustees making determinations in accordance with their trust deeds by the date as stated in the trust deed.

We suggest that written evidence of the 2020/21 trustee determination of income of the trust (preferably in the form of a trustee resolution) be prepared by 30 June 2021 (or whatever earlier date is required by the trust deed).

Trust Streaming

Under the trust streaming provisions, trustees are able to stream franked dividends and capital gains to specific beneficiaries, rather than distributing these amounts as part of the general distribution to beneficiaries.

To stream franked dividends and capital gains, the trust deed must not prevent the trustee from streaming these amounts to specific beneficiaries. The trust accounts must also separately account for the streaming of the capital gains and franked dividends to the specific beneficiaries.

In addition, the beneficiaries who are to receive these amounts must be specifically entitled to them, and the trustee must record the streamed distributions in the accounts or records of the trust.

The trustees' distribution resolution in favour of the specifically entitled beneficiary would generally be sufficient for this purpose.

Where beneficiaries are streamed franked dividends, this must be recorded by 30 June 2021. Where beneficiaries are streamed capital gains, this must be recorded by 31 August 2021. However, where capital gains are included in the 'income of the trust' (accounting / trust law income) the trust deed will usually require the trustee's distribution determination to be made by 30 June 2021 (or earlier).

Where the definition of income ihe trust deed includes capital gains and franked dividends, the determination to stream these amounts must be done prior to making the determination to distribute the balance of the trust income. For example, where the distribution of streamed franked dividends and/or capital gains is in the same resolution as the distribution of the balance of the income of the trust, make sure the distribution of the streamed franked dividends and capital gains is mentioned before the distribution of the other income of the trust.

In 2 recent Court decisions, distributions of capital gains to non resident beneficiaries were found to be assessable in the hands of the non resident beneficiaries, notwithstanding that the relevant CGT assets were not taxable Australian property. This is due to the operation of Division 855 of the 1997 Act. This provision does not have the same effect for fixed trusts. Where you have a discretionary trust, you need to exercise caution when making distributions of Australian capital gains to non resident beneficiaries.

Tax Planning Tip

You and/or your tax adviser, should regularly review your trust's deed to ensure you understand how it interacts with the various tax requirements, some of which are mentioned above.

TFN Trust Reporting

Trustees of resident discretionary trusts, family trusts and other closely held trusts are reminded that they are required to report new beneficiaries' tax file number (TFN) and certain personal information to the Tax Office. For 30 June 2021 the TFN report of new beneficiaries must generally be made to the Tax Office by 21 July 2021.

If the beneficiary has not provided their TFN to the trustee, the trustee will have to withhold tax from the distribution. The beneficiary will be entitled to claim a credit of the tax when they lodge their income tax return.

The report of the new beneficiaries' tax file numbers to the Tax Office must be made by no later than the end of the month after the end of the quarter in which the trustee received the TFN.

The trustee only has to report each TFN once. You only have to report the TFN for beneficiaries you have not previously reported to the Tax Office.

Affected beneficiaries include individuals, companies, partnerships and other trusts, except for non-residents and beneficiaries under a legal disability, such as minors (The trustee is generally assessed on distributions to non-residents and beneficiaries under a legal disability).

Tax Planning Tip

To ensure you don't miss the reporting of beneficiaries TFN's we suggest you report to the ATO the TFN's of all likely beneficiaries of the trust now, even though they may not be receiving a distribution until a future year.

Third party reporting

The Government has introduced a system of reporting for third parties in addition to the existing income tax, BAS and PAYG withholding reporting systems and Annual Investment income reports by investment bodies.

The system requires reports be provided to the Tax Office for:

- State and Territory revenue and Land Titles Offices to report all land or leasehold transfers (from 1 July 2016)
- ASIC, market participants and trustees of trusts with an absolutely entitled beneficiary must report on transactions relating to shares and units of unit trusts (from 1 July 2016);
- Government Grant Payments (from 1 July 2017)
- Administrators of payment systems must report on electronic business transactions (from 1 July 2017).

Automatic Exchange of Information

Since 1 July 2014, Australian financial institutions had to report to the ATO details of the accounts and other investments held by US Citizens. The ATO then reports that information to the U.S. Internal Revenue under the Foreign Account Compliance Act (FATCA).

From 1 July 2017, this has been extended to all non-resident account holders and investors in Australian financial institutions under the Common Reporting Standard developed by the OECD. Therefore, from 1 July 2017 financial institutions must report these details to the ATO, which will on report to the relevant foreign country. The ATO will also receive such reports of Australian citizens with accounts and investments with foreign financial institutions.

The Definition of financial institutions for this purpose is very wide and, in addition to Banks, it can include: managed funds, private equity groups, investment advisers, brokers, spread-betters, custodians, certain insurance entities, personal investment companies and certain trusts.

Single Touch Payroll

From 1 July 2018, employers with more than 20 employees are required to provide real time reports to the Tax Office of salary and wage payments, SGC contributions, ordinary time earnings of employees and PAYG withholding amounts.

From 1 July 2019, this system has extended to all employers.

There will be no change to the due dates for payments of SGC contributions and PAYG withholding remittances, although employers may elect to pay (early) using the new software when they report to the Tax Office.

Superannuation

Super Guarantee Changes

The rate for superannuation contributions by employers on behalf of their employees under the SGC for the year ended 30 June 2021 is 9.5%.

The rates are scheduled to increase over the next few years. For the year ended 30 June 2022, the rate increases to 10%, meaning that contributions made in relation to salary and wages paid on or after 1 July 2021 will be subject to the higher 10% rate.

The contributions rate is scheduled to increase by 0.5% per year until it reaches 12% from 1 July 2025. This may be subject to change.

Employers must make superannuation guarantee contributions for their employees on a quarterly basis within 28 days after the end of each quarter (September, December, March and June).

Tax Planning Tip

Although the June 2021 quarter SGC does not have to be paid until 28 July 2021, tax deductions for the superannuation contributions will only be available in the 30 June 2021 tax year if the contribution is received by the superannuation fund by 30 June 2021. A recent release from the Tax Office reminded all employers that deductions are not allowed when contributions are made via a clearing house until the payment has actually been paid by the clearing house to the trustee of the fund, and that this may take several days upon receipt by the clearing house.

ONGOING YEAR END ISSUES

Timing of Income Derivation

- Consider whether the amount is income or capital - Income and capital gains have different tax timing rules.
- What is the appropriate method of income recognition for each type of income: cash or accruals?
  - Cash generally for income from personal services, rent, interest, dividends and other income from non- business investments;
  - Accruals generally for trading income or other business income that relies on circulating capital, or staff or equipment to produce income.
- Consider specific rules to determine when income derived.
- Consider whether income can be deferred until after 30 June 2021.
- Alternatively, if you are in a tax loss consider whether you accelerate income receipt prior to 30 June to recoup losses that may not be available in future years.

Income Received in Advance

- Income received in advance may not be derived (and taxed) until the services are provided.
- Income received in advance should be credited to an unearned income account.
- This rule will generally not apply if payment is not refundable if services are not provided.
- Income received in advance must be released to profit when services are provided, or if services are not provided, when it is determined the services will not be provided and no refund is claimed by customer.

Timing of Expenses

- Expenses are generally deductible if incurred by 30 June 2021. This requires a presently existing liability.
- Provisions are generally not deductible.
- Some accruals are not deductible.
- There are specific rules that determine when some expenses are deductible (in particular, see prepayment rules below).
- Interest paid after business ceases may be deductible.

Repairs

Incur repairs on or before 30 June 2021 to obtain the deduction in the 2021 income year, but they must not be:

- Initial repairs;
- Substantial replacement of an asset;
- Improving an asset.

Gifts

- Donate to deductible charities before 30 June 2021.
- Ensure the payment is to an endorsed deductible gift recipient (DGR).
- Donations are not deductible if a benefit is received by the donor, unless the contribution was made at eligible fundraising event for a DGR and contribution is more than $150:
  - Deduction will be reduced by value of any benefits received at the event
  - GST inclusive value of benefits received must not exceed lesser of 20% of contribution and $150.

Bad Debts

- Review bad debts before 30 June 2021.
- Remember the rules for deducting bad debts
- Write-off bad debts before year end to get deduction in that year (provision for doubtful debts not deductible).
- Bad debts may not be deductible if there has been a change in ownership or control of a company or trust (unless company passes the same business test).

Trading Stock

The tax legislation provides that closing trading stock can be valued at the end of every year using one of the following three methods:

- Cost
- Market selling value
- Replacement value.

Usually, the most tax effective outcome is that which provides the lowest value.

For used and demonstrator vehicles the most tax effective method is usually replacement value which is ascertained by way of an independent valuation using either a:

'Suitably qualified arms length' (TR93/209), 'truly independent' (IT2648) valuer.

Recognised industry guide, for example Red Book (not permitted for Demonstrators).

Care should be taken to ensure that the valuations meet the strict requirements of the tax legislation outlined above, as the deduction derived from this valuation normally represents the largest single tax adjustment.

Note that it is not necessary to 'book' the adjustment through the accounting records, and in fact we recommend that you don't. Your accountant can include the deduction for tax purposes only.

For parts and accessories, the most tax effective method is again achieved through valuation at replacement value. Our view is that replacement value equates to cost, for parts less than 12 months old, and nil for parts with no movement greater than 12 months.

Remember to have your Parts Manager print the aged stock report on 30 June, normally in conjunction with the physical stocktake, as many DMS's cannot subsequently produce an accurate report to reflect the aged stock as at 30 June.

Defer sales/revenue

Industry practice is to bring forward the sale of vehicles to an earlier month, at least in an accounting sense, despite not having delivered the vehicle by the end of the month. Motivations include the manufacturer incentives for achieving targets and/or the Sales Managers' motivation to increase their bonus. Recognise that this practice also 'brings forward' the income tax, GST and LCT liabilities to the earlier year where it occurs in June.

Non-Commercial Losses

- Losses from businesses carried on by individuals (or partnerships which have individuals as partners) are quarantined and deductible only against income from that business, or a related business unless the tests below are met.
- For individuals with adjusted taxable income less than $250,000, at least one of these tests must be met:
  - Assessable income from the business of $20,000 or more;
  - Profit from the business in three out of the five previous years, including the current year;
  - Real property of $500,000 or more, or other assets of $100,000 or more used in the business; or
  - The Commissioner exercises his discretion.
- For individuals with adjusted taxable income in excess of $250,000, they must rely on the Commissioner's discretion (they will have losses quarantined unless they can satisfy the Commissioner the loss was the result of unusual circumstances beyond the control of the taxpayer or because of the nature of the business).

Home Office Expenses

- Home office expenses may be deductible where you carry on business or employment activities at home.
- Portion of interest, rent and insurance are not deductible unless you are carrying on business from home and the area is separate and distinguished from private living areas.
- If carrying on business from home, deductibility of interest, rent etc. may be determined by the space occupied by the home office, as well as extent the space is used for income producing purposes.
- Converting the spare room is not sufficient to be classified as a home office.
- Power, heating and depreciation can be claimed at a flat rate established by the Tax Office even if the room is not exclusively set aside for a home office.
- If an office is provided by the employer, working from home as a convenient place to do part of the work may not be sufficient to claim home office expenses.
- There have been a number of recent Tribunal cases looking at the deductibility of home office costs. This issue has been identified by the Tax Office as a risk area that may be subject to increased audit activity.

Car Expenses for Individuals

- If claiming actual expenses, check the logbook is current and that logbook details are correct.
- Ensure year-end odometer readings are taken.
- Ensure all relevant receipts have been kept.

Personal deductions

Individuals who are seeking to claim deductions for employment related expenditure should be aware of an increase in audit activity by the Tax Office in relation to personal employment related deductions.

When you are claiming these deductions, you should ensure:

- You are actually entitled to claim the deduction (is the amount deductible?)
- You can substantiate the expenditure you are seeking to deduct (do you have the appropriate receipts, tax invoices, diaries etc.)
- Have you restricted your deduction to the business/ employment related portion of the deduction (have you excluded the private/non-deductible amounts and can you substantiate business/employment use)?

Prepayments

- If expenses are not subject to the prepayment rules, prepay deductible expenditure by 30 June 2021.
- The prepayment rules spread a pro-rated deduction over more than one year, where the expenditure provides benefits after end of the current income year.
- The prepayment rules do not apply to excluded expenditure, which includes:
  - Salary;
  - Amounts required to be paid by law or a court; and
  - Expenditure under $1,000
- Small business entity taxpayers and non-business individuals are allowed prepayments in the year incurred if the benefit does not extend beyond 12 months.

Audit Fees

Audit accruals are not deductible unless the audit contract creates a presently existing liability before 30 June 2021 (subject to the prepayment rules discussed above).

Taxable Payments Reporting System

Businesses in building and construction are required to record payments to contractors and report these payments to the Tax Office. From 1 July 2018, businesses engaged in the courier or cleaning industries were also required to make these reports. From 1 July 2019, the rules will extend to businesses engaged in IT, road (freight) transport, and security industries.

The annual report due to be lodged by 21 July 2021.

Superannuation

Some of the following super fund issues require advice from a qualified financial adviser:

- Employee superannuation guarantee quarterly contributions are required by 28 July 2021;
- Ensure at least the minimum pension payments have been made for those in pension phase;
- Before making any contributions prior to year-end, ensure you are aware of your contribution caps;
- Make sure you take into account contributions already made and ensure contributions made for the year do not exceed the concessional and non-concessional contribution limits.
- Ensure that contributions made near the end of the year are actually received by the fund by 30 June to ensure deductibility.
- Review salary sacrifice arrangements, especially if you have more than one employer, to ensure you do not breach your concessional cap in total.

Super Guarantee and Contractors

Employers need to ensure they make super contributions for all eligible employees, including certain independent contractors for Superannuation Guarantee Charge ('SGC') purposes.

Under SGC, '*employee*' includes individuals who are employees in the ordinary sense (PAYG) and independent contractors engaged under a contract primarily for the provision of labour.

Where you engage contractors, you should review the contracts to determine whether the individuals are treated as employees for SGC purposes.

Director and Employee Entitlements

- Conduct shareholders' meetings before 30 June 2021 to approve directors' fees and bonuses to receive deductions for the 2020/2021 year.
- Ensure arrangements for employee bonuses based on 2021 results are in place before 30 June 2021 to receive the deduction for the 2020/2021 year.
- Ensure employee salary packages that include fringe benefits and/or additional employer super contributions are reviewed and in place before the sacrificed salary is earned by the employee.

Payment Summaries – Salary Sacrifice

- Employers are required to report (on PAYG payment summaries) reportable super contributions.
- These are contributions in excess of the amount required under the SGC (industrial award or law where the amount exceeds the SGC amount) where employee influenced the additional contribution (salary sacrifice).
- Contributions out of post-tax salary are not included.

Losses

- Check to ensure companies and trusts seeking to claim a deduction for current year or prior year losses satisfy the company loss and trust loss rules by 30 June.

Debt Forgiveness

- Where a debt owed by the taxpayer is released prior to 30 June, ensure there are no adverse consequences from the application of the commercial debt forgiveness rules.
- These rules operate where a debt is released and interest on the debt is deductible, or if the debt is interest free, interest would have been deductible if interest was charged.
- The beneficiary of the release may forfeit tax losses, future deductible amounts and/or CGT cost bases.
- In certain circumstances, there may be advantages in deferring the forgiveness until the following tax year. Where you are considering releasing debts, you should consider the optimal timing of the release.

Year End Tax Effective Investments

- Ensure the promoter has obtained a product ruling and operated scheme in accordance with product ruling.
- Consider if investment is the subject of a Tax Office Taxpayer Alert.
- Consider impact of the general anti-avoidance rules and integrity rules.
- The Tax Office has stated schemes should be considered in the light of these warning signs:
  - Arrangement contrived or artificial;
  - Limited or non-recourse funding;
  - Minimal cash outlay;
  - In-built exit strategies;
  - High management fees or promoters' commission;
  - Arrangement not economically viable without tax benefit;
  - The arrangement has not been independently assessed for economic viability; and
  - There are prepayments involved (these may not be fully deductible in current year).

Sale of Investments – CGT Issues

- Where CGT assets will be realised for a gain, consider delaying making the contract for sale until after 30 June unless you have losses that may be lost because of the loss integrity measures.
- Caution is required if you crystallise capital losses to offset against capital gains just before 30 June 2021 as this may result in the loss being denied if the taxpayer does not lose effective control of the loss assets, or they are replaced with substantially identical assets (wash sales).
- Timing of disposal under a contract for CGT purposes is generally the date of making the contract.
- If assets are held for less than 12 months by individuals, trusts or super funds that are eligible for the CGT discount, consider delaying sale until 12 months has passed.
- Take care if using options to defer the date of sale of an asset to pass the 12-month rule for CGT discount or to delay CGT event until the next year, as certain options may not be effective for these purposes.
- Recoup capital losses against indexed capital gains before discounted gains.

CGT Small Business Concessions

- The concessions are:
  - 15-year exemption,
  - active asset reduction,
  - retirement exemption, and
  - small business rollover.
- To qualify for the basic concessions, the taxpayer must either pass the $6 million net asset value test, or be a small business entity with an aggregate turnover of less than $2 million; and the assets must satisfy the active asset test used in the relevant business.
- To qualify for the 15-year exemption, the taxpayer must also be retiring or permanently incapacitated and assets must have been held for at least 15 years.
- To qualify for retirement exemption, if the taxpayer is less than 55, the exempt amount must be contributed to a super fund.
- If the taxpayer is a trust or company, special rules determine if the entity can access the concessions.
- If the taxpayer sells shares in a company or interests in a trust which conducts a business, there are rules to determine whether the sale qualifies for the concessions.
- There are special rules where an asset owned by one entity is used in a business by a related entity.
- Also, consider the small business Restructure rollover relief that applied from 1 July 2016.
- Be aware of the amendments to the basic conditions where the asset being sold is a share in a company or an interest in a trust. The amendments took effect from 1 July 2017.

Depreciation

- Scrap all obsolete items by 30 June 2021 to claim undepreciated cost.
- Consider reassessing the effective life if the asset has excessive use.
- Balancing adjustment on disposal – excess assessable or deficit deductible – rollover is available.
- Consider delaying disposal of items for a profit until after 30 June and bringing forward disposal of items for a loss to before 1 July.
- Plant costing less than $1,000 - option to allocate assets to a low value pool:
  - Depreciated at diminishing rate value of 37.5%;
  - First year rate 18.7% diminishing value; and
  - New low value assets must go into low value pool.
- The replacement cost of items costing less than $100 each can be deducted in the conduct of a business where the items have a short life and may be subject to breakage or loss (see PS LA 2003/8).

Depreciation for Small Businesses

- Small businesses can claim an immediate deduction for assets they start to use or install ready for use, subject to the new asset costs thresholds
- A small number of assets are not eligible for the immediate write-off, including horticultural plants and in-house software allocated to a software development pool. In most cases, specific depreciation rules apply to these assets
- Assets valued in excess of the asset write off thresholds may be placed in the small business depreciation pool and depreciated at 15% in the first year and 30% in subsequent years
- The pool can be immediately deducted if the balance falls below the relevant thresholds over the period (including existing pools)
- These rules are also subject to the concessional rules for SME and larger businesses as part of the Government's investment incentives.

Depreciation for Computer Software

Software mainly used as a business tool rather than for sale (in-house software) is depreciated over four years if acquired before 1 July 2015 and over 5 years if acquired after that date.

Immediate Deduction - Non-Business Assets

- Immediate deduction for items less than $300 (non-business taxpayers) for:
  - Income producing assets used predominantly for non-business, e.g. tools of trade or briefcase, or small items of furniture in rental property;
  - Not part of set of assets costing more than $300; and
  - Not substantially identical to other assets which in total cost more than $300.

Personal Services Income (PSI)

- If you, or an entity you work for (personal services entity) receive income for the reward for personal efforts or skills (e.g. consultants), the PSI rules may limit the deductions that you or the personal services entity (PSE) may be entitled to claim, and you may be taxed on the PSI received by the PSE.
- The rules do not apply to a personal services business (PSB) if you or the PSE:
  - Pass the results test (engaged to produce a result); or
  - Do not receive more than 80% or more of PSI from one source and pass one of the PSB tests:
    - Unrelated clients test;
    - Employment test; or
    - Business premises test.
  - Where more than 80% of the PSI is derived from a single client and you do not pass the results test, you may apply for Tax Office discretion to be classified as a PSB.

Year End Cut-Off

- If the accounts close before or after 30 June, a tax adjustment may be required unless the taxpayer has an approved substituted accounting period.

Ceasing Business or Assets Sold

- Consider paying a redundancy or long service leave to employees - must be arm's length if paid to associate.
- Defer retirement payment beyond 30 June if employee will be on a lower marginal rate in the following year.
- Consider whether small business concessions, rollovers, or super contributions will still be available.
- Consider whether expenses incurred after a business ceases will still be deductible.

Project Costs/Business Related Costs

- Project costs can be pooled and deducted over the life of project using diminishing value -
- The costs include:
  - upgrade community infrastructure;
  - site preparation for depreciating asset;
  - feasibility studies; environmental assessment;
  - obtaining information associated with project.
- Mining and transport project capital expenditure not otherwise deductible may be amortised over project life.
- Other costs that are not otherwise deductible, not included in the CGT cost base of an asset, nor included in the depreciable cost of an asset, may be deductible over five years – they must be directly related to a business that is, was or proposed to be carried on for taxable purposes (blackhole expenditure).

Debt/Equity Rules

- Review all shares, loans and other financial instruments used to raise finance to determine whether they are debt or equity.
- This may include traditional non-debt or equity interests (contracts with remuneration contingent on profit are considered financing arrangements).
- Closely associated debt and equity transactions may be combined and treated as a whole as debt or equity.
- Year-end actions to consider for debt/equity rules:
  - Consider whether payments on instruments are deductible debt deductions (interest) or non-deductible dividends.
  - A non-share capital account needs to be established if instruments other than membership interests (shares) are issued by the company, which are treated as equity.
  - At call loans made on or after 1 July 2005 to a company from a connected entity may be equity. Companies with a turnover of less than $20 million are exempted from this rule.

Thin Capitalisation

- Consider whether thin capitalisation rules apply to reduce deductions for interest and debt deductions if the taxpayer:
  - has a foreign investment;
  - has a foreign owner; or
  - is a non-resident investor.
- Thin capitalisation applies to all debt deductions, not just related foreign party debt deductions (includes unrelated Australian or foreign debt).
- If the entity's debt exceeds maximum allowable debt, a proportionate amount of entity's debt deductions may be disallowed
- Consider whether the de minimis rules apply:
  - Interest amounts less than $2,000,000; or
  - Foreign assets constitute 10% or less of the taxpayer's combined total assets (applies to outward investors that are not also inward investors).

Year-end steps to meet thin capitalisation at 30 June:

- Review all entities to ascertain whether they are caught by the definitions of inward or outward investing entity;
- Calculate value of assets, liabilities and equity to determine maximum debt levels;
- Valuation must comply with relevant accounting standards;
- Identify and value assets. If possible consider revaluing upwards, to maximise the asset base;
- Identify and value liabilities with a view to revaluing them downwards;
- Review hybrid debt/equity instruments to determine whether they are debt or equity;
- Obtain reasonable valuation from a professional valuer as Commissioner can substitute values if assets are overvalued or liabilities undervalued.

Imputation

- Companies paying less than 100% franked dividends, benchmark franking percentage rules apply.
- The franking percentage chosen for the first frankable dividend paid in a franking period establishes the benchmark percentage.
- The franking period is usually the income year for private companies and six months for public companies.
- All frankable dividends paid during the franking period must be franked in accordance with the benchmark percentage.
- Companies should determine whether a franking account is in deficit and whether they are liable for Franking Deficit Tax, payable by 31 July 2021 for year ended 30 June 2021.
- Where the franking deficit exceeds 10% of the franking credits for the company in the year, the company's entitlement to a tax offset for FDT is reduced by 30%.

- If shares were acquired after 1 July 1997 and are not held at risk for at least 45 full days, the franking offset may not be available (except for individuals whose franking offset is less than $5,000).
- If shares were acquired by a trust after 31 December 1997, both the trustee and the beneficiary have to pass the 45 day holding period rule in order to obtain the benefit of franking credits.
- Trust beneficiaries that have a vested and indefeasible interest in the shares or a fixed interest in the corpus on which the dividends were paid will pass the 45 day holding period rule if the trustee does.
- Beneficiaries of a non-fixed trust (e.g.) discretionary trust will not pass the 45-day rule unless a family trust election is made or the Commissioner exercises his discretion to deem the trust to be a fixed trust or the beneficiary is an individual whose franking offset is less than $5,000.
- As noted above, the changes to the small business company income tax rate affect the imputation rules.
- Specifically, the maximum franking amount (amount of franking credits that can be attached to a fully franked dividend) will be either 30% or the reduced base rate entity rates. Refer to our earlier discussion regarding the calculation of the franking rate.
- Companies will need to consider their turnover levels prior to 30 June to determine whether they will suffer a lower franking rate in future tax years.
- Companies that are impacted by a changing rate may seek to pay higher fully franked dividends prior to 30 June to free up excess franking credits.

Consolidated Group

- If the taxpayer is a company with 100% owned subsidiary companies, partnerships or trusts, consider making a consolidation election before lodging the head company's first consolidated tax return.
- Company groups have to consolidate to be able to:
  - Transfer losses between members;
  - Pay unfranked dividends between members without paying income tax; and
  - Rollover assets between members without paying CGT or income tax.

There are various valuations and calculations that need to be done and documented in calculating the allocated cost of the entities joining or leaving a consolidated group – ensure these calculations and documents are finalised before the lodgement of the group's relevant tax returns.

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