client alert | explanatory memorandum

May 2008

1 Tax Planning

Put simply, tax planning is the arrangement of a taxpayer's affairs so as to comply with the tax law at the lowest possible cost. A common mistake is to believe that tax planning is optimised when every opportunity to reduce tax is taken. This is because some opportunities to reduce tax rely on strained interpretations of the law. Therefore, tax planning involves much more than taking the option that at first appears to result in lower tax costs. It involves objectively assessing and actively managing tax risk.

Common tax planning techniques that can be deployed are deferring of the derivation of assessable income and bringing forward deductions.

1.1 Part IVA and tax planning

Due to the broad scope of Part IVA and the consequences of its application, it should form an integral aspect of tax planning rather than an afterthought.

Before the Commissioner exercises his discretion under section 177F of ITAA 1936 to cancel a tax benefit, the requirements of Part IVA must be satisfied. These requirements are:

1. a tax benefit was or would have been obtained;
2. the tax benefit was or would have been obtained in connection with a 'scheme'; and
3. the scheme is one to which Part IVA applies.

The term "scheme" is defined in subsection 177A(1) of ITAA 1936 and includes any agreement, understanding, promise or undertaking, whether express or implied, and whether legally enforceable or not. Further, a scheme includes a scheme, plan, proposal or course of action, even if unilateral.

Whether a tax benefit has been obtained in connection with a scheme, it requires the consideration of the eight factors listed in section 177D(b). These factors are:

- the manner in which the scheme was entered into or carried out;
- the form and substance of the scheme;
- the time in which the scheme was entered into and the length of the period during which the scheme was carried out;
- the taxation outcomes, including the tax benefit and any other tax consequences arising from the scheme;
- any change in the financial position of the taxpayer that results, will result, or may reasonably be expected to result from the scheme;
- any change in the financial position of any person who has, or has had, connection (whether of a business, family or other nature) with the taxpayer that results, will result, or may reasonably be expected to result from the scheme;
- any other consequences for the taxpayer, or any other person connected with the taxpayer arsing from the scheme having been entered into or carried out; and
- the nature of any connection (whether of a business, family or other nature) between the taxpayer and the connected person.

Consideration may also need to be given to relevant specific anti-avoidance measures. For example, the anti-streaming rules relating to dividends.

1.2 Exempt income and tax planning

Although exempt income is not assessable income, it cannot be ignored for tax planning purposes. For example, the amount of a dependent rebate may be reduced by the separate net income of the dependent, which includes exempt ordinary income. The derivation of exempt income may also reduce or limit deductions.

Exempt income may also affect the rate of tax applicable to taxable income. For example, foreign employment income that is exempt under section 23AF or 23AG of ITAA 1936 is taken into account in determining the rate applicable to other assessable income.

2 Deferring assessable income

The derivation of assessable income depends upon the nature of the income and whether a taxpayer returns income on a cash or accruals basis. Consideration may also be given to whether an income is revenue or capital in nature. This is because of the difference in their tax treatment, which ultimately will have an impact on the tax position of a taxpayer.

2.1 Business income

Business income is assessable in the year in which it is derived. Generally, if a taxpayer is reporting income on an accrual basis, income is derived when a recoverable debt is created such that the taxpayer is not obliged to take any further steps before becoming entitled to payment. However, an exception applies (see section on **Payment received in advance**).

2.1.1 Payment received in advance

Income received in advance of services being provided may not be income until the services are provided (*Arthur Murray* principle). This principle applies regardless of whether a taxpayer is reporting its income on an accrual or cash basis.

The taxpayer's accounting records must classify the unearned income separately from income already earned for the principle to apply. This may be done by a single journal entry at year-end or periodically during the year.

2.1.2 Work in progress

In relation to manufacturers, partly manufactured goods that are not "finished" goods are treated as trading stock and it is necessary to determine the difference between the opening and closing value of the trading stock for the income year. (See section on **Trading Stock**.)

TIP

Taxpayers who provide professional services may consider, in consultation with their clients, rendering accounts after 30 June to defer the income.

2.2 Income from property

Income from property is essentially all income that is not personal exertion income and includes interest, rent, dividends, royalties and trust distributions.

Category	**Income is derived when**
Interest	In the year of receipt
Rental income	In the year of receipt
Dividends	In the year of receipt
Royalties	In the year of receipt
Trust distributions	In the year the distribution is declared

If the income has not been physically received by the taxpayer but has been applied or dealt with on the person's behalf or as that person directed, the taxpayer is taken to have received the income as soon as it is so applied or dealt with (principle of constructive receipt): see section 6-5(4) of ITAA 1997.

2.3 Sale of depreciating assets

A taxpayer is required to calculate the balancing adjustment amount resulting from the disposal of a depreciating asset. The balancing adjustment amount is calculated by comparing the termination value against the adjustable value. If the termination value is greater than the adjustable value, the difference is included as assessable income of the taxpayer. If the termination value is less than the adjustable value, the difference is a deduction available to the taxpayer.

If the disposal of an asset will result in assessable income, a taxpayer may want to consider postponing the disposal to the following income year. However, if it is not possible to delay the disposal, consideration may be given to whether a balancing adjusting rollover relief is available. If the disposal of an asset will result in a deduction, it may be beneficial to bring the disposal forward to the current year.

2.3.1 Balancing adjustment rollover relief

Balancing adjustment rollover relief effectively defers a balancing adjustment until the next balancing adjustment event occurs. Broadly, the rollover relief is automatic if conditions listed in section 40-430(1) of ITAA 1997 are satisfied. If the automatic rollover relief applies, the transferor must give a notice containing sufficient information about the transferor's holding of the asset for the transferee to work out how Division 40 applies to the transferee's holding of the depreciating asset.

An optional rollover relief is available in a partnership scenario if the composition of the partnership changes or when assets are brought into or taken out of the partnership. To defer any balancing adjustments, the existing partners and the new partner can jointly elect for the rollover relief to apply.

TIP

A small business entity can access the optional rollover relief.

The optional rollover relief is not available unless the original holder retains an interest in the asset after the change.

3 Maximising deductions

An outgoing will be deducted under either the general deduction provision (section 8-1 of ITAA 1997) or the specific deduction provisions (section 8-5).

3.1 Meaning of incurred

In Taxation Ruling TR 97/7, which sets out the Commissioner's view on the meaning of incurred for the purposes of section 8-1, he states the general rules that were settled by case law to assist taxpayers in defining when an outgoing has been incurred:

(a) a taxpayer need not actually have paid any money to have incurred an outgoing, provided the taxpayer is definitively committed in the year of income. There must be a presently existing liability to pay a pecuniary sum;

(b) a taxpayer may have a presently existing liability notwithstanding that the liability may be defeasible by others;

(c) a taxpayer may have a presently existing liability although the amount of the liability cannot be precisely ascertained, provided it is capable of reasonable estimation;

(d) whether there is a presently existing liability is a legal question in each case, having regard to the circumstances under which the liability is claimed to arise; and

(e) if a presently existing liability is absent, an outgoing is incurred when the money is paid.

The phrase "presently existing liability" means that a taxpayer is definitively committed (or completely subjected) to the outgoing, i.e. the liability is more than impending, threatened or expected.

An outgoing is still incurred even if the amount cannot be quantified precisely, provided it is capable of approximate calculation based on probabilities.

If a taxpayer could have claimed a deduction for an outgoing that was incurred but not paid in the particular income year but failed to do so, the taxpayer cannot claim a deduction in the year in which the liability is discharged, as the outgoing has not occurred in that year. The taxpayer is required to seek an amendment of the assessment for the previous year, within the statutory limits.

TIP

An outgoing may be incurred in one income year even if the liability is not discharged until a later year. Therefore, a taxpayer can claim a deduction for the outgoing.

Small business entities which were Simplified Tax System taxpayers may still use the mandatory cash accounting rules under the former system. If so, all outgoings are deemed to be incurred when paid.

3.2 Bad debts

A debt that is written off as a "bad" in an income year is an allowable deduction under section 25-35 of ITAA 1997, provided:

- the amount owned was either previously brought to account as assessable income in the current or a former income year or lent in the ordinary course of a money-lending business of the taxpayer;
- there must be a debt in existence at the time of writing off;
- the debt must be bad; and
- the debt must be written off as bad during the income year in which the deduction is claimed.

Taxpayers should review their debtors prior to year-end and assess which debts may be written off as "bad". Taxation Ruling TR 92/18 sets out the list of circumstances in which a debt may be considered to have become bad, and the appropriate steps to be taken to establish that a debt is bad.

TIP

1. Notwithstanding that a bad debt is not deductible under section 25-35, it may be deductible under section 8-1: see *(1968) 14 CTBR(NS) Case 80*.
2. A bad debt does not need to be written off in the account books of a taxpayer. In the case of a company, the requirements of section 25-35 will still be satisfied in the following circumstances:
   (a) a Board meeting authorises the writing off of a debt and there is a physical recording of the written particulars of the debt and Board's decision before year-end but the writing off of the debt in the taxpayer's books of account occurs subsequent to year-end;
   (b) a written recommendation by the financial controller to write off a debt which is agreed to in writing by the managing director prior to year-end followed by a physical writing-off in the books of accounts subsequent to year-end.
3. A bad debt deduction is also available for partial write-off of a debt, provided the above conditions are satisfied. One debt may, over a period, be subject to several partial write-offs.

3.2.1 Additional requirements for companies

A company must pass either the continuity of ownership test or the same business test in addition to satisfying the requirements of section 25-35.

Companies that have undergone a change in underlying ownership due to a sale of the business during the year will need to pass the 'same business test' to recoup bad debts.

1. A company cannot claim a deduction for a debt incurred and written off as bad on the last day of the income year.
2. Consideration must be given to the specific anti-avoidance provisions contained in Subdivision 175-C.
3. If a company was purchased through an asset sale, notwithstanding that the same business test may be satisfied, a deduction is denied because the requirements of section 25-35 have not been met.

3.2.1 Additional requirements for trusts

Special rules apply to deny trusts a deduction for bad debts unless certain strict tests are passed. The applicable tests depend on how the type of trust. (See section on **Trust losses**.)

3.3 Business-related capital expenditure

Business-related capital expenditure is deductible under section 40-880 of ITAA 1997 on a straight-line basis over five years if the expenditure is not deductible elsewhere in the income tax law and is not expressly made non-deductible.

A review of an entity's expenditure may be necessary to ensure that all potential deductions are captured. The types of expenditure that a taxpayer can deduct under this section are:

- expenditure to establish a business structure;
- expenditure incurred to convert a business structure;
- expenditure to raise initial and additional equity for a business;
- expenditure to defend a business against a takeover;
- expenditure incurred in an unsuccessful takeover attempt;
- expenditure incurred by a shareholder in liquidating a company, a beneficiary of a trust in winding up trust, and a partner in a partnership in winding up the partnership, provided the trust or partnership was carrying on a business; and
- expenditure incurred in ceasing to carry on a taxpayer's business.

TIP

Business-related capital expenditure incurred part-way through an income year does not need to be apportioned for that income year.

3.4 Capital allowance

A deduction may be available on the disposal of a depreciating asset if a taxpayer stops using and expects never to use it again. Therefore, asset registers may need to be reviewed for any assets that fit this category.

The effective life of an asset can be recalculated at any time after the end of the first income year for which depreciation is claimed by a taxpayer, if it is no longer accurate because of changed circumstances relating to the nature of use of the asset. Therefore, consideration may be given to the use of an asset to determine whether its effective live can be recalculated, which may result in an increased or decreased rate of depreciation.

TIP

1. The cost for capital allowance purposes is GST-exclusive, regardless of whether entitlement to input tax credits has been claimed.
2. The cost of an asset which may qualify for an immediate deduction is based on its GST-exclusive cost, regardless of whether entitlement to input tax credits has been claimed.

3.4.1 Immediate deduction

3.4.1.1 Non-business taxpayers

Non-business taxpayers are entitled to an immediate deduction for assets costing $300 or less, provided:

- the asset is used predominantly to produce assessable income that is not income from carrying on a business;
- the asset is not part of a set of assets that the taxpayer started to hold in the income year if the total cost of the set of assets exceeds $300; and
- the total cost of the asset and any other identical, or substantially identical, asset that the taxpayer starts to hold in that income year does not exceed $300.

TIP If two or more taxpayers jointly own a depreciating asset, a taxpayer is still eligible to claim an outright deduction, provided his or her interest does not exceed $300 (even if the asset costs more than $300).

3.4.1.2 Small business entities

A small business entity (see section on **Small business entities**) that chooses to apply the capital allowance rules contained in Division 328 of ITAA 1997 is eligible for an outright deduction for the taxable purpose proportion of the adjustable value of a depreciating asset in the income year it first starts to use the asset or installs it for a taxable purpose if:

- it starts to hold the asset when it is a small business entity, and
- the asset is a "low cost asset", i.e. its cost is less than $1,000.

The entity is also entitled to an immediate deduction for any addition to a low cost asset, provided the cost of the addition is less than $1,000.

3.4.1.3 Business taxpayers

For business taxpayers that are not small business entities, all capital items must be written off over their effective life under Division 40 of ITAA 1997 regardless of the cost (including low-value items). However, the Tax Office has adopted an administrative practice allowing an outright deduction for low-cost capital assets in certain cases.

Broadly, an expenditure of $100 or less (**inclusive of GST**) incurred by a taxpayer to acquire a capital asset in the ordinary course of carrying on a business will be assumed to be revenue in nature and therefore deductible in the year of the expenditure. It is important to note that because the threshold includes GST, for a business registered for GST, the threshold is effectively **$90.91**.

This administrative practice does not apply to expenditure incurred by a taxpayer on:

- establishing a business or business venture;
- building up a significant store or stockpile of assets;
- assets held under a lease, hire purchase or similar arrangement;
- assets acquired for lease or hired to, or that will otherwise be used by, another entity;
- assets included in an asset register maintained in a manner consistent with reporting requirements under generally accepted Australian accounting standards;
- any asset that forms part of a collection of assets that is dealt with commercially as a collection;
- trading stock or spare parts; and
- items that are part of another composite asset, i.e. items that are not functional on their own.

3.4.3 Pooling

Certain depreciating assets can be pooled, with the result that the decline in value is calculated for the pool instead of the individual assets.

For a small business entity, two pools are available: a general pool for assets with an effective life of less than 25 years, and a long-life pool for assets with an effective life of more than 25 years. If the cost of the asset is less than $1,000, the small business entity is entitled to an outright deduction.

For other taxpayers, there is the option of pooling "low-cost" and "low-value" assets to a low-value pool. A "low-cost" asset is a depreciating asset that costs less than $1,000. A "low-value" asset is a depreciating asset that has been depreciated using the diminishing value method, has an opening adjusted value of less than $1,000 in an income year, and is not a "low-cost" asset. If a taxpayer sets up a low-value pool, all low-cost assets have to be allocated to the pool. However, low-value assets do not need to be allocated to the pool.

Category of taxpayer	Assets allocated to pool during year are depreciated at	Assets allocated to pool in a previous income year are depreciated at
Small business entity - General pool	15%	30%
Small business entity - Long-life pool	2.5%	5%
Other taxpayers - Low-value pool	18.75%	37.5%

TIP If two or more taxpayers jointly own a depreciating asset, a taxpayer can set up a low-value pool to take advantage of the accelerated rate of depreciation, provided his or her interest is less than $1,000 (even if the asset costs more than $1,000).

3.5 Carried forward losses

The deductibility of carried forward losses will depend on the entity claiming the losses.

3.5.1 Corporate tax entities

The entitlement of corporate tax entities to deductions in respect of prior year losses is subjected to certain restrictions. An entity needs to satisfy the continuity of ownership test before deducting the prior year losses. If the continuity of ownership test is failed, the entity may still deduct the loss if it satisfies the same business test.

TIP An entity can choose the amount of prior year losses it wishes to deduct in an income year. This means that the entity can choose to "ignore" its carried forward tax losses and pay tax for an income year to generate franking credits for its distributions.

3.5.2 Other taxpayers

The method for deducting earlier tax losses incurred by other taxpayers is governed by section 36-15 of ITAA 1997. If a taxpayer derives net exempt income for an income year, the carried forward loss will need to be firstly offset against net exempt income before being available for deduction against assessable income.

TIP

1. Carried forward losses do not need to be offset against non-assessable non-exempt income derived by a taxpayer. It is net exempt income that is offset against any carried forward tax losses and not exempt income. Net exempt income is defined in section 36-20 of ITAA 1997 and exempt income is defined in section 6-20 of ITAA 1997.
2. Try to avoid deriving exempt income in an income year if there are carried forward losses.

3.6 Donations

While a deduction is claimed in the income year in which the donation is made, a taxpayer may make a written election to spread the deduction over a period of five years if:

- the donation was a gift of money of $2 or more;
- the donation was property valued by the Tax Office at more than $5,000;
- the donation was made under the Cultural Gifts Program; or
- the donation was a heritage gift.

If a taxpayer is anticipated to have an increase in assessable income in the coming income years, consideration may be given to spread the deductibility of the donation over five years.

TIP

As a general proposition, try to avoid making donations in a year of losses. This is because a deduction for a donation cannot add to or create a tax loss for the donor.

Professional advisers who have clients that donated to individuals and/or organisations collecting funds for emergency relief of victims of the Emerald and Mackay floods should be aware that those individuals and organisation have not received the deductible gift recipient endorsement. (This information is correct at the time of publication.)

3.7 Prepayments

One of the simplest methods to accelerate deductions is the prepayment of deductible expenses.

3.7.1 Excluded expenditure

The prepayment rules do not apply to "excluded expenditure", i.e. a taxpayer is able to claim an outright deduction. Excluded expenditure is defined as:

- expenditure that is less than $1,000;
- expenditure that is required to be made under a court order or by law; and
- expenditure that is for salary or wages.

1. If a taxpayer is entitled to an input tax credit in respect of the expenditure, the $1,000 is the GST-exclusive amount.
2. If a taxpayer is not entitled to an input tax credit in respect of the expenditure, the $1,000 is the GST-inclusive amount.

3.7.2 Small business entities and non-business individuals

Small business entities and non-business individuals are able to access the 12-month prepayment rule. If the prepaid expenditure is not excluded expenditure, it is deductible outright in the income year it is incurred, subject to two provisos: the eligible service period does not exceed 12 months, and ends in the expenditure year or the income year immediately following. If the prepayment has an eligible service period of greater than 12 months, the expenditure will be apportioned over the relevant period (on a daily basis) up to a maximum of ten years.

The eligible service period is the period over which the relevant services are to be provided.

3.7.3 Other taxpayers

If the eligible service period covers only one income year, the expenditure will be deductible in that particular year. If the eligible service period covers more than one income year, the expenditure is apportioned (on a daily basis) over those years up to a maximum on 10 years in accordance with the formula:

$$\text{Expenditure} \quad \times \quad \frac{\text{No of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

3.8 Repairs

A deduction is available for repairs to premises, part of premises or a depreciating asset (including plant) held or used by a taxpayer solely for the purpose of producing assessable income: see section 25-10(1) of ITAA 1997. If the relevant premises or assets are held or used only partly for income-producing purposes, expenditure on repairs is only deductible to the extent that it is reasonable in the circumstances: see section 25-10(2).

A common issue that arises is the distinction between restoration of an item to its former condition (deductible) and improvement of the item (capital and thus not deductible). It is important to realise the mere fact that different materials from those replaced are used will not of itself cause the work to be classified as an improvement, particularly in circumstances where the previous materials are no longer in current use. If the change is merely incidental to the operation of the repair, the deduction, generally, will be allowed.

Initial repairs, the replacement of the entire item, and improvements are not deductible, but may qualify for a periodic write-off under the capital allowance provisions. In addition, the expenditure may form part of the cost base of an asset for capital gains tax purposes.

3.9 Superannuation contributions

3.9.1 Deduction for employees contributions

Employers are entitled to a tax deduction for contributions made to a complying superannuation fund or a retirement savings account (RSA) for the purpose of providing superannuation benefits for an employee. Any contributions made are only deductible for the year in which the contributions are made: see section 290-60(3) of ITAA 1997. To maximise the deductions available, employers should ensure that the contributions are paid to their employees' superannuation funds or RSAs before 30 June. A mere accrual of the liability or a book entry is not sufficient.

For employees turning 75, the contribution must be made by the employer within 28 days after the end of the month in which the employee turns 75. However, the age limit does not apply in respect of a deduction for an amount that has to be contributed under certain industrial awards, determinations or agreements.

Superannuation guarantee charge

The superannuation guarantee charge (SGC) is imposed if an employer does not make sufficient quarterly superannuation contributions for each employee by the due date. If there is a shortfall in the required contributions, the employer is required to pay the shortfall, as well as interest and an administration charge, by the 28th day of the second month following the end of the quarter. The shortfall is not deductible for the employer.

Quarter ending	Employer contribution due date	SG statement and SGC payment due date
30 September 2007	28 October 2007	28 November 2007
31 December 2007	28 January 2008	28 February 2008
31 March 2008	28 April 2008	28 May 2008
30 June 2008	28 July 2008	28 August 2008

TIP

SGC is the only tax that the Commissioner wants employers to avoid having to pay.

A payment of SGC is not tax deductible.

3.9.2 Personal superannuation contributions

A deduction for personal superannuation contributions is available if less than 10% of a taxpayer's total assessable income and reportable fringe benefits for an income year is attributable to activities that result in the taxpayer being treated as an "employee" for superannuation guarantee purposes.

The contribution is only deductible for the year in which it is made. Further, the contribution is deductible in full, subject to the restriction that the maximum amount that is deductible is the amount stated in the notice of intention to claim a deduction, which is given to the superannuation fund.

However, excess contributions tax may apply for contributions above the contributions cap (see section 13.4 for the current contributions cap limit).

TIP

If a taxpayer who is eligible to make a personal contribution sold an asset during the year and realised a significant capital gain by making a deductible contribution to his or her superannuation fund, the tax payable on the capital gain may be reduced.

3.10 Trading stock

The tax treatment of trading stock, which is contained in Division 70 of ITAA 1997, impacts on year-end tax planning. This is because a taxpayer is required to either include in or deduct from his or her assessable income for an income year the difference between the opening and closing value of the trading stock.

3.10.1 Small business entities

If a small business entity elects to apply the trading stock concession under Division 328, it is permitted to ignore the difference between the opening and closing value of trading stock if the difference between the opening value of stock on hand and a reasonable estimate of stock on hand at the end of that year does not exceed $5,000. The effect of electing this concession is that the value of the entity's stock on hand at the beginning of the income year is the same as the value taken into account at the end of the previous income year.

However, a taxpayer could choose to account for changes in the value of trading stock even if the reasonably estimated difference between opening and closing values was less than $5,000.

TIP

Accounting for the difference between the opening and closing stock is a good tax planning method for two main reasons:

1. to avoid a large adjustment in the calculation of taxable income in a future year when the benefit of Division 328 is not available; or
2. to claim a deduction in the current year for a reduction in the value of trading stock.

3.10.2 Other business taxpayers

For other business taxpayers, it is a requirement to value each item of trading stock at the end of an income year at its cost, market value or replacement value. There is no requirement to permanently adopt any one of the three methods of valuation. Further, there is no compulsion for a taxpayer to use the same method across all item of trading stock.

Manufacturers who elect to value stock on hand at year end at cost price, and wholesale and retail industries must use the absorption cost method to value their trading stock: see Rulings IT 2350 and TR 2006/86.

3.10.3 Obsolete stock

The closing stock may be reviewed to identify whether any obsolete stock exists. Taxation Ruling TR 93/23, which states the Tax Office's view on the valuation of trading stock subject to obsolescence or other special circumstances, states that obsolete stock is either:

- going out of use, going out of date, becoming unfashionable or becoming outmoded (i.e. becoming obsolete); or
- out of use, out of date, unfashionable or outmoded (obsolete stock).

When valuing obsolete stock, a taxpayer does not need to use any of the prescribed methods (i.e. cost, market value or replacement value). Rather, provided adequate documentation is maintained, the Tax Office will accept any fair and reasonable value which is calculated taking into account the appropriate factors: see section 70-50 of ITAA 1997.

4 Division 7A

The broad thrust of Division 7A of ITAA 1936 is to deem certain loans, payments and debt forgivenesses by private companies to their shareholders and associates to be assessable unfranked dividends to the extent that there are realised or unrealised profits of the company.

4.1 Managing your Division 7A risk

To minimise any adverse Division 7A consequences, taxpayers must consider the following:

- repay private company loans by the earlier of the actual lodgement date or the due date for lodgement of the company's return for that year;
- ensure a loan agreement is in place by the earlier of the actual lodgement dated or the due date for lodgement of the company's return for that year;
- ensure minimum repayments are made on loans from prior years;
- a deemed dividend can only arise to the extent of a company's distributable surplus, so this issue needs to be considered along with planning opportunities;
- payments under a guarantee can trigger a deemed dividend and must be considered carefully;
- the payment of an actual franked dividend by a company to offset a loan which has been deemed to be a dividend can have adverse implications and should be carefully considered;
- the exemptions available should be considered and used if possible; and
- a deemed dividend can also apply if property is provided, so companies should consider requiring shareholders to pay market value.

4.2 Trusts and Division 7A

If a private company beneficiary of a trust has an unpaid present entitlement to an amount of the net income of the trust and the trustee subsequently makes a loan, payment or debt forgiveness to a (non-corporate) shareholder or associate of the private company, it is important to consider the application of Division 7A.

A deemed dividend arises here, had the actual transaction (a loan, payment or forgiveness) been done by the private company and the shareholder or associate. Whether the company's unpaid present entitlement arises before or after the transaction is immaterial.

The amount of the deemed dividend is the lesser of: (a) the amount involved in the actual transaction; and (b) the unpaid present entitlement less any amounts previously treated as deemed dividends.

TIP

If the present entitlement is paid to the company by the earlier of the actual lodgement date or the due date for lodgement of the trust's return for that year, a deemed dividend will not arise.

4.3 Amnesty granted by Commissioner

The Commissioner has issued Practice Statement PS LA 2007/20 explaining to taxpayers when he will exercise his discretion to disregard a deemed dividend. This amnesty will only apply if:

- the failure to comply was a result of an honest mistake or inadvertent omission;
- specific corrective action has been taken on or before 30 June 2008 (refer to the Practice Statement for the corrective actions required);
- a deemed dividend has arisen in respect of a transaction or action that occurred after 30 June 2001 and by the end of the 2006-07 income year; and
- the taxpayer has lodged all required returns for the 2000-2001 to 2006-2007 income years if necessary.

4.4 Amendments to Division 7A

Amendments to alleviate some of the punitive consequences of Division 7A were brought about by *Tax Laws Amendment (2007 Measures No 3) Act 2007*. The amendments have applied from the income year beginning on 1 July 2006 and are as follows:

- the refinancing of certain loans will not trigger a deemed dividend;
- the automatic debiting of the private company's franking account when a deemed dividend arises has been removed;
- the franking of a deemed dividend is permitted if it arises from a family law obligation;
- a "payment" can be converted to a loan that can be either fully repaid by the earlier of the actual lodgement date or the due date for lodgement of the company's return for that year;
- the Commissioner has been given the discretion to disregard deemed dividends (or allow them to be franked) if they have been triggered by honest mistakes or omissions by taxpayers;
- the Commissioner has been given the discretion to disregard a deemed dividend when the minimum yearly repayments have not been made on a loan because of circumstances beyond the control of the taxpayer;
- section 108 of ITAA 1936 has been repealed;
- if a company acts as a guarantor for a loan taken out by the shareholder or their associate, and the latter defaults on the loan, a loan agreement can be entered into to avoid a deemed dividend from arising;
- if the loan or payment is made by an interposed entity between a company and its shareholder or their associate, a commercial loan agreement may be made between the interposed entity and the shareholder to alleviate the operation of Division 7A;
- if the minimum yearly repayments under a loan fall short of the required amount by the due date, a deemed dividend will only arise in respect of the shortfall amount;
- later dividends distributed by a private company may be offset against a deemed dividend taken to be previously paid by the company to a borrower who is an associate of the shareholder;
- if a loan meets the requirements of an excluded loan under section 109N, it will be exempt from FBT; and
- if a deemed dividend arises because of a loan made by a company, the loan will not be subject to FBT.

4.5 Residual operation of section 108 of ITAA 1936

Although section 108 has been repealed from 1 July 2006, it has continual application to assessments for income years preceding its date of repeal. For those income years, the section continues to apply to:

- payments, credits and loans made before 4 December 1997, and
- payments, credits and loans made on or after 4 December 1997 if either made to another company (other than in its capacity of trustee) or made by the private company in the ordinary course of its business on the usual terms on which the company makes similar loans to parties at arm's length.

If the term of a loan made before 4 December 1997 is extended or the amount of the loan is increased on or after that date, Division 7A would apply as if the loan were made when the changes to its term occurred.

5 Personal services income

Broadly, the personal services income (PIS) rules attribute income derived by an interposed entity to the individual providing services to the entity. This is achieved by "forcing" individuals to include the income generated by their personal skill or efforts in their personal tax returns. The deductions of a taxpayer who receives PSI are, generally, limited to the amount that he or she would be entitled to deduct if the income had been received as an employee.

However, the PSI rules do not apply to individuals or interposed entities if one of the required personal services business (PSB) tests — results test, unrelated clients test, employment test and business premises test — is satisfied. The primary test to be applied is the results test. If this test is met, there is no further requirement to self-assess against the other tests and the PSI rules do not apply.

In addition, the Commissioner has the power to grant a Determination, which has the effect of exempting a PSB from the PSI regime. Generally, a Determination will be granted if unusual circumstances existed that prevented the business from satisfying the tests or the business would have had, but for the unusual circumstances, two or more unrelated clients in the current income year.

If a taxpayer fails the results test **and** 80% or more of the PSI in an income year comes from one client, the taxpayer is not permitted to self-assess itself against the remaining tests. The PSI rules will apply unless a PSB determination is obtained from the Tax Office.

5.1 General anti-avoidance and PSB

It is a common misconception that income earned by a PSB is income from a business structure. The income derived by a PSB is still categorised as PSI for income tax purposes if it is income that is mainly a reward for an individual's personal efforts or skills. Therefore, the income (as distinct from income from a business structure) that is derived by the PSB may be subject to the application of Part IVA, if:

- the income is split with an associate; or
- the income is split with another entity associated with you; or
- the income is retained in a company and taxed at the lower company tax rate.

However, remuneration paid to an associate (or service trust) for bona fide services related to the earning of PSI will not attract the application of Part IVA if the amount is reasonable.

The Tax Office has stated that Part IVA will not apply in the following situations:

If the PSB is conducted through	Situation
Company	There is no income splitting and no retention of profits in the company.
	If there is a bona fide attempt to break even, a relatively small amount of taxable income may be returned by the company provided that income is distributed to the individual by way of a franked dividend in the following year.
Trust	If the trustee is a corporate trustee, the situations are the same as a company.
Partnership	If a partnership income results from the services of employees or the use of income-producing assets.

TIP

A partnership with a spouse will not attract the operation of Part IVA if it is a genuine partnership.

6 Non-commercial losses

An individual taxpayer should consider whether a loss from his or her business activity (whether carried on alone or in partnership) will be deferred under the non-commercial loss rules, which are contained in Division 35 of ITAA 1997. This is because the individual's overall tax position will be impacted when the loss is deferred.

In essence, an individual may only offset a loss arising from a business activity against other income derived in the same income year if the business activity satisfies at least one of the four commerciality tests – the assessable income, profits, real property, and other assets tests. If the individual does not satisfy at least one of the tests, the loss is carried forward and applied in a future income year against assessable income from the particular activity.

The Commissioner has the discretion to override the provisions of Division 35. Further, an exemption is available for individuals who carry on a primary production or professional arts business and whose assessable income for the year from other sources does not exceed $40,000.

TIP

Division 35 does not apply to activities that do not constitute the carrying on of a business.

7 Small business entities

The small business entity regime replaced the Simplified Tax System (STS) with effect from 1 July 2007. Under the small business entity regime, a taxpayer does not need to elect to enter into the regime. Instead, it will be apparent from a small business entity's tax return whether it has used the tax concessions.

7.1 Concessions available

The concessions, which were previously available under the STS, have been incorporated into the small business entity regime. These concessions are:

- the simpler depreciation rules,
- the simpler trading stock rules,
- the entrepreneurs' tax offset,
- the prepaid expenses rules, and
- the two-year period of review.

In addition, a small business entity will be able to access other various concessions (subject to any additional criteria set out in the particular concessions themselves). These are:

- the CGT 15-year exemption, CGT 50% active asset reduction, CGT retirement exemption and CGT roll-over;
- the use of the GDP-adjusted notional tax method to work out PAYG instalments;
- the FBT car parking exemption; and
- the choice to account for GST on a cash basis, apportion GST input tax credits annually and pay GST by instalments.

7.2 Definition of a small business entity

An entity will be classified as a small business entity for an income year if:

- it is carrying on a business in the current year, and
- it had an aggregated turnover for the previous year of less than $2 million or an aggregated turnover for the current year likely to be less than $2 million.

The aggregated turnover is the annual turnover of the entity's business plus the annual turnover of any businesses that the entity is connected to or affiliated with. The aggregated rules are similar to the former STS grouping rules.

An entity satisfies the aggregated turnover test if:

- its aggregated turnover for the previous income year was less than $2 million;
- its aggregated turnover for the current income year, worked out as at the first day of the income tax year, is likely to be less than $2 million; or
- its aggregated turnover for the current income year, worked out as at the end of the current income year, is actually less than $2 million.

(Note: The definitions of a connected entity and an affiliate have changed with the introduction of the small business entity regime.)

TIP

The definition of a small business entity is broader than that of a STS taxpayer. Therefore, more taxpayers will be able to benefit from the concessions available under Division 328.

7.3 Transitional provisions

Transitional provisions apply for any entity that, in an income year before 2007-2008, was an STS taxpayer and stopped carrying on any business. Such an entity can continue to use the pre-1 July 2007 concessions (ie the capital allowance, trading stock, prepayment and amending assessment concessions) in 2007-2008 and later income years if it is winding up the business it previously carried on.

An entity that is determining whether it is a small business entity for the 2007-2008 and 2008-2009 income years can work out its aggregated turnover for 2005-2006 and/or 2006-2007 on the basis that current small business entity rules were in force in relation to those years. If the entity's aggregated turnover for 2006-2007 is not under $2 million, it will be taken to have an aggregated turnover of less than $2 million if its STS group turnover for 2005-2006 is less than $2 million.

8 Companies

The tax treatment of companies will depend on their classification: private company or public company. For example, only a private company is subject to the operation of Division 7A. Companies are subject to a flat rate of tax on the entirety of their taxable income. This rate applies whether the company is public, private, resident or non-resident.

8.1 Franking account

It is a requirement that every entity that is (or has ever been) a corporate tax entity has a franking account. The franking account is recorded on a “tax paid” basis and operates on a rolling balance basis.

8.1.1 Franking of distributions

All distributions are frankable unless specifically deemed unfrankable. Unfrankable distributions includes:

- deemed dividends under Division 7A of ITAA 1936; and
- deemed dividends in relation to excessive payments made by a private company to its shareholders, directors and associates.

8.1.2 Benchmark rule

The benchmark rule requires all frankable distributions made by an entity during its franking period to be franked to the same extent (the ‘benchmark franking percentage’).

It should be noted that a corporate tax entity would incur an over-franking tax if the franking percentage for a distribution exceeds the benchmark percentage, or a franking debit (for under-franking) if the franking percentage is less than the benchmark rate. (Certain concessions to this rule may apply to public companies.)

If the benchmark percentage varies by more than 20% from the last frankable distribution in the last franking period, an entity must notify the Commissioner in writing.

8.1.3 Franking period

The franking period of a corporate tax entity will depend on whether is it a public company or a private company. The franking period of a private company is the same as its income year. Generally, a public company has a six-month franking period.

8.1.4 Distribution statements

Entities that make frankable distributions must provide their shareholders with a distribution statement. (Section 202-80 of ITAA 1997 states the information that must be disclosed on the statement.) For entities that are private companies, the distribution statement must be given to their shareholders within four months after the end of the income year in which the distribution was made, or such further time as the Commissioner allows. If this statement is not received, the shareholder will not be able to claim a franking credit tax offset.

TIP

As a private company has four months after the end of the income year to provide the distribution statement, in effect, the company can retrospectively frank a distribution.

It is an offence under the *Taxation Administration Act 1953* if a corporate tax entity fails to give a distribution statement or makes a misleading statement in connection with a distribution.

8.1.5 Franking account balance

A company's franking account should be reviewed to ensure that the company is not liable for franking deficit tax. If the company is liable for franking deficit tax, it must be paid within a month of the end of the franking period. Franking deficit tax is not a penalty but an early payment of income tax that is offset against future tax obligations.

8.2 Concession for private companies

A private company generating profit in its first income year is prevented from making a franked distribution to its shareholders because of insufficient franking credits. However, a concession, which allows the company to make a franked distribution to its shareholders, exists if the following conditions are satisfied:

1. it is liable to pay income tax for the income year that is sufficient to generate franking credits equal to at least 90% of the deficit in its franking account at the end of that income year; and
2. it is the company's first income year.

9 Trusts

The provisions that determine in whose hands trust income is assessed, and the amount assessed, are convoluted. A good starting point is always the trust deed. This is because the deed governs the operation of the trust, from who is entitled to receive a distribution to what the nature of the trust is.

9.1 Trust losses

The trust loss recoupment rules restrict the circumstances in which prior year and current year losses of trusts can be claimed as a deduction in calculating the net income of a trust. The applicable tests that must be satisfied to be able to utilise trust losses will depend on the type of trust. These tests must also be satisfied when the trust is claiming a bad debt deduction.

Type of trust	Category	Ownership/control tests			Income injection test
		50% stake test	Pattern of distribution test	Continuity of ownership test	
Fixed	Ordinary fixed trust	✓	N/A	N/A	✓
Non-fixed		✓[1]	✓	✓[2]	✓
Excepted	Family trust	N/A	N/A	N/A	✓

1. Only when certain fixed entitlements exist.

2. Not relevant for current year losses.

9.2 Trust distribution minutes

The drafting of the distribution minutes needs to take into account the following tax issues:

- if there is a corporate beneficiary, will the distribution to the corporate beneficiary create an "unpaid entitlement" and thus potential Division 7A issues?
- if a family trust election has been made, is the income being distributed to a person outside the family group?
- if the trust does not have any net income for the year, does it need to nominate a controlling individual to ensure the relevant trust loss recoupment rules are satisfied?
- if applicable, does the distribution of dividend income to the beneficiaries require a family trust election to be made to satisfy the "holding period rule"?
- if applicable, have the relevant trust loss recoupment rules been taken into account when drafting the minutes to ensure access to the small business CGT concessions for the beneficiaries?

TIP

1. A minor (i.e. under 18 at the end of the income year) can receive up to $1,667 in non-taxable distributions for the 2007-2008 income year.
2. If possible, distribute all income to the beneficiaries. This is because income retained in the trust will be subjected to tax under section 99 or 99A of ITAA 1936, i.e. at 46.5%.
3. If the trust deed permits, a trustee may want to consider streaming the income to beneficiaries that are able to benefit the most from the distribution.

1. The trustee's minute distributes "trust income" not "taxable income".
2. If a trustee has distributed income to a minor up to his or her non-taxable limit and the trust's net income is subsequently amended, the minor would need to receive an additional amount in proportion to the original distribution. The additional amount will normally be taxed at the top marginal rate, i.e. 45%.
3. If a trust derives dividend income that is being streamed, consideration must be given to the anti-streaming rules.

9.3 Capital gains distribution

There are two methods which a trustee can use to distribute the income of the trust: the quantum approach and the proportionate approach. The preferred method is the proportionate approach based on the volume of case law regarding trust distribution, which distributes the income based on the proportions of the trust income to the beneficiaries. For example, if a beneficiary is presently entitled to 10% of the trust income, he or she will be taken to be presently entitled to 10% of the net income for tax purposes.

However, a strict application of the proportionate approach will result in an anomaly if capital gains are derived by the trust, and there are separate and distinct income beneficiaries and capital beneficiaries. This is because under section 97 of ITAA 1936, a beneficiary who is entitled to the 'income' would be taxed on all of the 'taxable income' (including the capital gains, even though the beneficiary has not received any of the capital distribution). To overcome this anomaly, in Practice Statement PS LA 2005/1 (GA), the Commissioner has stated that he will permit the use of the capital beneficiary approach or the trustee approach. For a trust to be able to use either one of these approaches, documentation as discussed must be made no later than two months after the end of the relevant income year.

9.3.1 Capital beneficiary approach

The capital gain may be assessed to a beneficiary (or a trustee on his or her behalf) if:

- the beneficiary has a vested and indefeasible interest in the trust capital representing the trust's capital gain;
- the beneficiary would have had an interest if the trust's capital gain had been a 'deemed' amount for tax purposes or the gain had been represented by actual trust capital; or
- the beneficiary has been allocated the trust's capital gain as a present entitlement no later than two months after the end of the income year.

A capital beneficiary must agree in writing on the approach to be used, and he or she must prepare his or her tax return in a way that corresponds to the agreement. The agreement must be made within two months after the end of the income year, or such further time as the Commissioner allows. The trustee resolution allocating the capital gain must also be made by the time the agreement is made.

9.3.2 Trustee approach

If there is a capital gain that is not to be included in the share of the net income of a beneficiary, the trustee will be assessed under section 99 or 99A of ITAA 1936.

This approach can only be used if the beneficiaries and trustee have agreed in writing to use it. Any agreement must be made within two months after the end of the relevant income year.

If a party does not prepare his or her income tax return in accordance with an agreement, the Tax Office will ignore the agreement in assessing the capital gain.

9.4 Proposed changes

The Labor Government has proposed to reverse the changes made to family trusts as a result of *Tax Laws Amendment (2007 Measures No 4) Act 2007*, which were introduced in September 2007. The changes were:

- allowing the revoking of family trust elections and interposed entity elections in limited circumstances;
- allowing the test individual specified in the family trust election to be changed in limited circumstances;
- broadening the definition of 'family' to include lineal descendants;
- ensuring that the death of a family member does not by itself result in another family member ceasing to be a member of the family;
- including family trusts with the same test individual in the definition of family group; and
- including former spouses, former widows/widowers and former step-children in the definition of family group.

At the time of publication, the Government has not indicated whether the proposed reversal will be proceeding.

10 Capital gains tax

A taxpayer may consider crystallising any unrealised capital gains and losses in order to improve his or her overall tax position for an income year. For example, if the taxpayer is anticipating a significant capital gain in an income year, consideration may be given to reducing the gain by crystallising a capital loss in the same income year.

10.1 Small business CGT concessions

Broadly, the small business CGT concessions contained in Division 152 of ITAA 1997 provide a range of concessions for a capital gain made on a CGT asset that has been used in a business if certain conditions are met. These concessions are:

1. the 15-year asset exemption: a capital gain may be disregarded if the relevant CGT asset has been continuously owned by the taxpayer for at least 15 years. If the taxpayer is an individual, he or she must be at least 55 years of age and the CGT event must happen in connection with the taxpayer's retirement, or he or she is permanently incapacitated at that time. If the taxpayer is a company or trust, a person who was a significant individual just before the CGT event must satisfy the requirements;
2. the 50% reduction: a capital gain resulting from a CGT event happening to an 'active asset' of a small business may be reduced by 50%;
3. the retirement exemption: a taxpayer can choose to disregard all or part of a capital gain up to a lifetime maximum of $500,000; and
4. the asset roll-over: a taxpayer can disregard all or part of a capital gain if a replacement asset, which is an active asset, is acquired.

TIP	1. The concessions do not apply to deny capital losses, i.e. a taxpayer is still able to utilise any capital losses against other capital gains derived for an income year. 2. A taxpayer can choose not to claim the 50% reduction on a gain. If the taxpayer is a company or trust which cannot pass on the full benefits of the 50% reduction to shareholders or unit holders, by not choosing this option, the taxpayer will be able to pass on the full benefits of the retirement exemption. 3. Partial use of an asset in the course of carrying on a business will suffice for the active asset test. 4. A small business entity wanting to access the small business CGT concessions is exempted from the maximum net asset value test.
	1. Unless specifically excluded, all assets, including depreciating assets, are taken into account in the maximum net asset value test. 2. Consideration should be given to the integrity measures contained in the CGT regime: sections 115-40 and 115-45, Division 149 and CGT event K6.

10.2 Rollover relief

Rollover relief is available to provide taxpayers with the option to defer the consequences of a CGT event. Apart from disregarding any capital gains or capital losses that would otherwise arise from a CGT event, a rollover usually places the transferee under the rearrangement in the same CGT position as the transferor was before the event occurred. Some of the rollover reliefs will apply automatically while some will require taxpayers to elect the use of the reliefs, which is indicated by the way their tax returns are prepared.

Two types of rollovers are available: the replacement asset rollover and the same asset rollover. A replacement asset rollover allows the deferral of a capital gain or loss until a later CGT event happens to the replacement asset. A same asset rollover allows the deferral of a capital gain or loss arising from the disposal of the asset until the later disposal of the asset by the successor entity.

The table below sets out the common rollover reliefs that may be considered for tax planning purposes:

Type of rollover	Brief description	Election required
Rollover from individual to company	Individual disposes assets to a resident company	Yes
Rollover from trust to company	Trustee of a trust disposes assets to a resident company	Yes
Rollover from partnership to company	Partnership disposes assets to a wholly owned resident company	Yes
Assets compulsorily acquired, lost or destroyed	Disposal of an asset from being compulsorily acquired, lost or destroyed	Yes
Fixed trust to company	Fixed trust disposes all of its assets to a resident company	Yes
Marriage breakdown	Taxpayer disposes assets to his or her spouse pursuant to an order of a court under the *Family Law Act*	No
Small business replacement asset rollover	Taxpayer who is eligible for the small business CGT concessions acquires a replacement asset or improves an existing asset	Yes

10.3 Quick reference tables

10.3.1 Availability of CGT discount and indexation

Entity	CGT event after 21/9/1999 and asset acquired after that time	CGT event after 21/9/1999 and asset acquired before that time
Individual	▪ CGT discount only ▪ No indexation	▪ CGT discount or indexation[1] (frozen at 30/9/1999)
Trustee	▪ CGT discount only[2] ▪ No indexation	▪ CGT discount or indexation (frozen at 30/9/1999)
Trustee of superannuation fund	▪ CGT discount only ▪ No indexation	▪ CGT discount or indexation (frozen at 30/9/1999)
Company	▪ No CGT discount ▪ No indexation	▪ No CGT discount ▪ Indexation frozen at 30/9/1999

1. CGT discount and indexation method requires asset to be held for at least 12 months.
2. CGT discount not available when the trustee is assessed under section 98(3) or 99A of ITAA 1936.

10.3.2 CGT discount

Entity	CGT discount (%)
Individual	50
Trustee (if entitled to the CGT discount)	50
Trustee of superannuation fund	33.3
Company	0

11 Salary sacrifice arrangement

An individual taxpayer may consider entering into a salary sacrifice arrangement for the coming income year as part of his or her year-end tax planning.

It is a misconception that only taxpayers in the top marginal tax bracket will benefit most from entering into a salary sacrifice arrangement. There are benefits to be derived for employees at all levels of pay, provided the appropriate benefit is available and the correct method of paying any tax on the benefit is selected. If an employee sacrifices part of his or her income into lower taxed benefits, such as superannuation or a motor vehicle, he or she will obtain an effective saving which will result in a higher total of net disposal income and in-kind benefits.

If an individual taxpayer is expected to derive bonuses and/or commissions at the close of the income year, he or she may consider salary sacrificing those amounts to reduce his or her tax liability.

TIP

Particularly since the repealing of the superannuation surcharge, salary sacrificing part of the cash salary into superannuation can reduce a taxpayer's income tax liability and increase the level of savings within the taxpayer's superannuation account.

12 Superannuation strategies

Generally, earnings from investments derived by a superannuation fund are taxed at 15%. The lower tax rate along with various tax concessions makes a superannuation fund an integral part of tax planning. Some common superannuation strategies which can be used as part of a taxpayer's tax planning have been discussed previously (making a personal contribution when selling an asset and salary sacrifice).

Other strategies to be considered are:

- splitting superannuation contributions with a taxpayer's spouse;
- qualifying for Government superannuation co-contribution for eligible taxpayers; and
- moving assets into a superannuation fund, if permissible;

13 Tax Office's focus

A well-executed tax planning should take into consideration the Commissioner's approach to administering tax law, such as pronouncements on aggressive tax planning, Taxpayer Alerts as to arrangements that have come to the Commissioner's attention, and the annual Compliance Program of the Tax Office.

13.1 Compliance Program 2007-2008

13.1.1 Micro enterprises

A micro enterprise is defined as an entity with an annual turnover of up to $2m. This category includes sole traders, partnerships, trust, companies and superannuation funds. The specific compliance issues that the Tax Office is focusing on for the 2007-2008 income year are:

- ABN registration;
- record-keeping requirements;
- the timely lodgement of returns;
- incorrect or fraudulent statements and returns for GST and income tax;
- personal services income;
- the correct claiming of business expenses;
- the correct reporting of CGT on property transactions;
- the correct reporting of GST on property transactions;
- aggressive tax planning with focus on prepaid service warrants, some film investments and employee benefits arrangements;
- fuel tax credits; and
- the cash economy.

13.1.2 Small to medium enterprises

A small to medium enterprise is defined as an enterprise with an annual turnover of between $2m and $100m. The specific compliance issues that the Tax Office is focusing on for the 2007-2008 income year are:

- the lodgement of all necessary activity statements and returns;
- the claiming of losses only when the necessary conditions are satisfied;
- capital gains;
- business owners extracting value from their businesses without paying the correct taxes;
- international transactions, in particular profit shifting through tax havens;
- taxpayers who use service trusts;
- tax evasion through phoenix arrangements; and
- the proper GST treatment for property transactions and financial supplies.

13.1.3 SMSFs

The specific compliance issues that the Tax Office is focusing on for the 2007-2008 income year are:

- that in-house assets rules are not breached;
- loans to members;
- income tax issues such as the deriving of special income; and
- auditor contravention reports.

13.1.4 Individuals

The specific compliance issues that the Tax Office is focusing on for the 2007-2008 income year are:

- high-income individuals;
- CGT on the disposal of property and other assets, in particular if the disposal was to a super fund;
- work-related expenses. The target occupations for the 2007-2008 income year are travel industry employees, fitness and sporting industry employees, construction industry employees, guards and security employees, and mining site employees;
- rental income and expenses;
- non-disclosure of income and benefits;
- contributions to super funds being from income sources that have been properly taxed; and
- aggressive tax planning, in particular involving financial products such as prepaid service warrants.

13.2 Taxpayer Alerts

Taxpayer Alerts are only intended to be an "early warning" of tax planning arrangements that the Tax Office have under risk assessment. However, it is expected that the Tax Office will follow up on the release of any Alert with a public ruling or determination.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in an Alert can seek a formal determination of the Tax Office's position through a Private Ruling.

13.2.1 Taxpayer Alert TA 2008/1 – Stapled securities involving notes and preference shares

This Alert warns taxpayers investing in certain stapled securities involving notes and preference shares that the Tax Office is considering whether they are entitled to a deduction under section 70B of the ITAA 1936 on the disposal of the stapled securities at a loss on the ASX or on the occurrence of an "Assignment Event". (See Explanatory Memorandum accompanying the March 2008 issue.)

13.2.2 Taxpayer Alert TA 2008/3 – Uncommercial use of trusts

This Alert describes a non-arm's length arrangement under which taxpayers use borrowed funds to acquire an interest, such as units, in a certain type of trust, which uses the funds to purchase income-producing property. The Tax Office says the arrangement seeks to provide income tax deductions to the taxpayers for all of their interest payments and other borrowing costs.

The Tax Office view is that the arrangement does not provide a sufficient connection between the expenditure and the production of future income and/or capital gains, which may be distributed to other beneficiaries of the trust who may have a lower tax rate.

13.2.3 Taxpayer Alert TA 2008/4 – SMSF deriving income from certain uncommercial trusts

This Alert describes a non-arm's length arrangement under which a self-managed superannuation fund (SMSF) derives income through a direct or indirect interest in a closely-held trust. The arrangement may be of the type of trust described in Taxpayer Alert TA 2008/3 if an individual or another entity borrows funds to invest in a trust and seeks a tax deduction for the interest costs.

According to the Commissioner, the income derived directly or indirectly by the SMSF from the trust under such an arrangement is disproportionate to its investment in the trust. As such, the SMSF derives more income from the trust than it might be expected to derive from an ordinary commercial arrangement.

The Tax Office warns that such income derived by the SMSF is taxed at 45% (instead of 15%). The Commissioner also says that other taxation consequences arise for the individual or other family members as discussed in Taxpayer Alert TA 2008/3.

13.2.3 Comments on TA 2008/3 and TA 2008/4

The Commissioner says the Tax Office is not concerned about all "discretionary" or "hybrid" trust arrangements. Rather, he said the Tax Office is concerned about negatively-geared trust arrangements which involve the taxpayer incurring interest expenses or borrowing costs if all or a proportion of the borrowed funds could be used for the benefit of the beneficiaries, or if the taxpayer's interest in the trust could be brought to an end before their costs of investment have been recouped.

14 Tax rates for 2007-2008 income year

14.1 General rates – residents

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

* Medicare levy is payable at the flat rate of 1.5% of taxable income, subject to concessions for low income earners and various exemptions

TIP The tax-free threshold for 2007-2008 may effectively be increased up to $25,867 for qualifying pensioners/self-funded retirees via the senior Australians tax offset and low income tax offset.

14.2 Division 6AA income – resident minors

Division 6AA income ($)	Tax payable ($)
0 – 416	Nil
417 – 1,307	66% of excess over 416
1,308 +	45% of entire amount

TIP A minor is also eligible for the low income tax offset, which will effectively increase the Division 6AA tax-free threshold from $416 to $1,667.

14.3 Companies

Company tax rate	30%
Division 7A benchmark interest rate for 2007-2008	8.05%

14.4 Complying SMSF

Investment income and other income (other than non-arm's length income)	15%
Capital gains (after 1/3 discount if eligible)	15%
Non-arm's length income	45%
Concessional contributions (below contributions cap[1])	15%
Concessional contributions (above contributions cap)	15%[2]
Non-concessional contributions (below contributions cap[3])	Nil
Non-concessional contributions (above contributions cap)	Nil[4]
SMSF supervisory levy for 2007-2008	$150[5]

1. The concessional contributions cap is $50,000 for those under 50 (or $100,000 until 30 June 2012 for those aged 50 or over).
2. If the contributions are above the concessional cap, the fund continues to pay tax on those contributions at 15% but extra tax is levied on the excess contributions on the individual contributor at 31.5%.
3. The non-concessional contributions cap is $150,000 per person per year (or $450,000 every 3 years for people under age 65).
4. If the contributions are above the non-concessional cap, the individual, rather than the fund, is taxed on the excess at 46.5%.
5. The SMSF supervisory levy has increased from $45 (for 2006-2007 and earlier income years) to $150 (for 2007-2008 and later income years).

14.5 Miscellaneous rates

14.5.1 Cents per kilometre rates

Description	Engine capacity non-rotary engine (cc)	Engine capacity rotary engine (cc)	Rate per kilometre (cents)
Small car	0 – 1,600	0 – 800	58.0
Medium car	1,601 – 2,600	801 – 1,300	69.0
Large car	2,601 +	1,301 +	70.0

The rates for the 2007-2008 income year did not change from the 2006-2007 rates.

14.5.2 Luxury car limit / car depreciation cost limit

Year of first use	Limit ($)
2006 – 2007	57,009
2007 – 2008	57,123

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