Tel: 08 9481 8448
Fax: 08 9481 8449
Web: www.mkttax.com.au

MKT TAXATION ADVISORS

AFSL Number: 485223

IN THIS ISSUE

TWO SME HOT SPOTS

There are a number of tax issues facing SME's over the next 18 months that will need to be considered and planned for. We believe these are the two most important.

Reducing Corporate Tax Rates

Corporate tax rates for Small Business Entities (SBE's) fell to 28.5% in 2016 and are proposed to fall further to 27.5% in the current 2017 tax year. Furthermore, it also proposed to increase the turnover threshold for SBE's from $2 million per annum to $10 million per annum also from the 2017 tax year.

However the Bill to implement these changes is still before Parliament, which leaves considerable uncertainty surrounding which entities qualify as SBE's and what benefits (and tax rate) apply to those entities.

SBE's will need to monitor whether the changes are passed in order to fully benefit from these changes this financial year.

Loans from Private Companies - Division 7A

Taking loans from private companies is fraught with danger and leads many a shareholder down a never ending path of forced dividend repayments, higher tax bills and multiple loan agreements just to comply with Division 7A.

Whilst changes have been planned for Division 7A for some time, the most recent announcement from the Government was that the Board of Tax's Review and subsequent recommendations into Division 7A would be further consulted on before a proposed new start date of 1 July 2018.

The Board’s recommendations include:

- Making the terms of all loans 10 years, instead of 7 years (unsecured) or 25 years (secured);
- Making Principal and interest repayments due only at the end of years 3, 5, 8 and then 10;
- Not requiring written loan agreements for new loans;
- Ensuring both pre 1997 loans and pre December 2009 UPE’s are required to be repaid under 10 year loans;
- Allowing existing 25 year secured loans to continue (only if in place before 1 July 2018); and
- Allowing a self-correction mechanism where taxpayers inadvertently breach Division 7A.

With the proposed start date of these changes just over 12 months away, SME’s should carefully consider their current Division 7A position.

If you would like to discuss the proposed changes and how they may apply to you, please contact Sean Pearce.

Claiming Deductions for Commercial Website Expenditure

It is increasingly common for small businesses to set-up and run a commercial website to promote their businesses. The question that may invariably arise is the deductibility of the expenses incurred on the initial set-up and running of the website. The Australian Taxation Office (“**ATO**”) has recently issued Taxation Ruling TR 2016/3 stating their views on this matter.

Generally speaking, expenditure incurred in acquiring or developing a commercial website for a new or existing business is capital in nature. This means it cannot be claimed as a deduction outright. However, the commercial website can qualify as a depreciating asset. In particular, most commercial websites can be classified as software and the expenditure can generally be claimed over 5 years.

For taxpayers that qualify as Small Business Entities (“**SBEs**”), more generous concessions may be available under the Simplified Depreciation rules. If the cost of the initial development or set-up of the website is less than $20,000, it can be claimed in full as deductions in the year it is incurred. If it costs more than $20,000, the expenditure should then be allocated to the General Small Business Pool.

However, if the entity has an existing Software Development Pool, the Simplified Depreciation rules cannot be used and the expenditure must be allocated to that Software Pool instead. It should be noted that the $20,000 threshold ends on 30 June 2017 and the threshold will revert back to $1,000 effective 1 July 2017.

Expenditure incurred in maintaining an existing website can generally be claimed as a deduction for the full amount. Maintaining a website, in this sense, involves routine and regular activities, such as domain name registration and server hosting costs. Minor enhancements (or piecemeal modifications) to existing functionality are considered to be part of maintaining the website.

However, if the modification to the website is significant, it is arguable that the 'profit-yielding structure of the business' (of which the website is a part) is significantly enhanced and the expenditure is likely to be capital in nature. In this case, the expenditure is not immediately deductible but can be claimed over a period of time as discussed above.

It is also common for businesses to maintain a social media presence. Typically, the company information, member profile information and content entered onto social media reside on the social media platform. Further, the cost of setting up the profile is often minimal and the profile is maintained mainly for marketing purposes. In this case, the expenditure is generally treated as a revenue expense and is immediately deductible.

The ATO previously held the view in the now withdrawn Taxation Ruling TR 2001/6 that the initial set-up of a commercial website that contains no software, such as online purchase and information validation or processing functions, can be immediately claimed as a deduction. This view is no longer current and taxpayers cannot rely on this to claim an immediate deduction for their commercial website set-up expenditure. If you have any queries on this please contact Peter Hong.

PROPERTY CONTRACTS AND GST (BEWARE OF CONTRACT WORDING)

In *A & A Property Developers Pty Ltd v MCCA Asset Management Ltd* [2016] VSC 653, the Supreme Court of Victoria has found that GST was not to be added to the purchase price payable under a contract of sale, thereby leaving the vendor out of pocket for the GST component of the transaction.

The case centred on the issue of whether the sale price under a contract of sale was exclusive or inclusive of GST and the effect of including the word "GST" rather than "plus GST" in the particulars of sale.

The parties (A & A and MCCA) entered into a standard form LIV contract of sale which contained particulars of sale stating that:

> *'[t]he price includes GST (if any) unless the words 'plus GST' appear in this box',*

with a blank space in a box next to these words for the parties to fill out as per their agreement.

Additionally, Clause 13.1 of the General Conditions of the contract provided that:

> *'[t]he purchaser does not have to pay the vendor any GST payable by the vendor in respect of a taxable supply made under this contract in addition to the price unless the particulars of sale specify that the price is "plus GST"'.*

The dispute arose because in the executed contract of sale, the box dealing with GST contained the letters 'GST' and not the words 'plus GST'.

The Court considered that the box containing the letters 'GST' in the contract was capable of being interpreted several ways. Firstly, that GST was to be paid by the purchaser; second, that the parties did consider who should be liable to pay GST but that the parties did not reach a decision; and thirdly, that the letters were inserted erroneously and were intended to be deleted.

The Court was of the view that it should not insert words into a written contract unless it is clear that words have been omitted. After reviewing evidence of the parties' negotiations, the Court did not find evidence of a mistake concerning liability to pay GST, nor did the Court find that the contract was ambiguous. The Court therefore upheld the plain meaning of the contract, finding that the **purchaser was not liable to pay GST in addition** to the purchase price, thereby leaving the vendor out of pocket for the GST component of the transaction.

This case highlights once more that it is essential to consider the impact of GST during contract negotiations and to ensure that written wording is clear as to which party will be paying the GST on the transaction. We strongly recommend that when entering into negotiations, the GST aspects of the transaction be discussed and that GST clauses in contracts be reviewed and considered for potential risks and traps to avoid costly mistakes after the contract is executed.

Please call Mimi Ngo if you would like to discuss these matters.

ACCOUNTANTS GUIDE TO CHANGES IN SUPERANNUATION

With the changes to superannuation due to take effect on July 1, 2017 there is still much confusion amongst advisers and SMSF Trustees as to what needs to be done to comply with the new regulations and what their impacts are going to be going forward. There are several things that Trustee's will need to ensure occurs as part of the new changes or severe tax consequences may result.

Requirement to commute pensions at June 30, 2017:

Under the new rules, if a member doesn't already have a pension account, they can transfer a maximum of $1.6 million from their accumulation accounts into pension phase once they choose to retire. This applies as a total across all superannuation accounts and not per fund. There will continue to be no limit on the amount they can hold in an accumulation account that is taxed at 15%.

All Australians start with a transfer balance cap of $1.6 million at July 1, 2017. As monies are transferred into pension phase, those amounts will apply against this cap. The transfer balance will be indexed proportionately each year in line with the overall transfer balance cap.

If members already have a pension account at the start date, they will need to determine the total value of their pension interests and assess this against the transfer balance cap. If the balance is less than $1.6 million, they can use any remaining cap to transfer more capital into pension phase in the future. If the value of their pension interests is greater than $1.6 million at the start date they will be required to withdraw the excess either by rolling back to accumulation phase or withdrawing the excess from superannuation, or a combination of both.

At 1 July 2017, pension balances in excess of the cap can be subject to an excess transfer balance tax. This will initially be the 15% tax that should have been paid on earnings had the money been in the accumulation phase, but based on notional rather than actual earnings. The penalties become more punitive if the issue is not rectified in good time.

Where SMSF trustees have pension phase assets greater than $1.6 million, they will effectively have two choices:

1. Commute the excess from pension back to accumulation phase, keeping the assets in the fund but now subject to a 15% tax rate on earnings; or

2. Withdraw the excess from superannuation and invest it outside of superannuation where earnings will be taxed at the individual's marginal tax rate (or alternative tax arrangement).

Trustees and members should seek advice in relation to the two options from a suitably licensed adviser to ensure that they make the best decision based on their individual circumstances.

Election to reset the cost base of assets:

The transfer balance cap measure includes transitional CGT relief via a cost base reset. This relief is designed to ensure that only capital growth post the introduction of the transfer balance cap (i.e. from 1 July 2017) is taxed. There are three conditions to applying this relief:

1. **The fund must be in pension phase:**
   The measure applies to any superannuation fund that is in pension phase (either in part or in full). This is regardless of whether any members will exceed their cap at 1 July 2017. This will include funds that have transition to retirement income streams that will cease to qualify for pension phase at 1 July 2017.

2. **Assets must be held prior to 9 November 2016:**
   The relief only applies to assets held prior to 9 November 2016. Any assets acquired after that date (even if before 1 July 2017) will not be eligible to the cost base reset.

3. **Fund trustee must make an election to choose the relief**
   The relief is not automatic. An SMSF trustee must elect to choose the relief for each asset of the SMSF. The election is irrevocable and must be made before the SMSF trustee is required to lodge the SMSF's tax return for the 2016/17 year. The law currently requires that the election must be made on or before the day the SMSF's 2016/17 annual return is due to be lodged. Therefore, it is very important that SMSFs do not lodge late and miss this opportunity to take advantage of this CGT relief.

The relief works by deeming an elected asset to be sold on 30 June 2017 for its market value and repurchased at that price. This effectively, resets the cost base of the asset to market value on 30 June 2017. Consequently, only gains from 1 July 2017 onwards will be taxed.

For SMSFs using the segregated method, the cost base reset works by resetting the cost base to market value for each elected asset at 30 June 2017. Therefore, SMSF trustees using the segregated method must review each asset held on or before 9 November 2016 and held at 30

June 2017 and elect whether to choose the cost base reset at 30 June 2017. An SMSF trustee could elect that all assets be reset, no assets be reset or some but not all assets be reset.

SMSFs using the proportionate method are also eligible to reset the cost base of their assets at 30 June 2017. Again, this can be elected on all of the SMSF's assets or just on selected assets.

However, the big difference between the segregated method and the proportionate method is that the proportionate method cost base reset will trigger a capital gain on assets not fully in pension phase and therefore potentially trigger a taxable capital gain. As a result of this taxable capital gain, the Government has given SMSFs two options for dealing with this.

Option 1 – pay the tax in the 2016/17 year:

Under this option the SMSF will pay the tax on the asset in the 2016/17 year.
For example, if an SMSF has $6 million in assets and $3 million (1/2) is in pension phase. The cost base of the assets is $1 million and all assets have been held for 12 months or more. The SMSF trustee elects that all of the assets will receive the relief. On 30 June 2017, the SMSF is deemed to make a capital gain of $2.5 million (i.e. 1/2 of the value of the asset ($3 million) less 1/2 of the cost base ($500K). The SMSF pays $250K of tax for the 2016/17 year and holds assets with a cost base of $6 million.

Option 2 – defer notional tax on assets until they are sold:

Under this option, the SMSF does not pay tax on the gain on the asset until the asset is sold. The capital gain cannot be offset against capital losses incurred at that time. Therefore, the deferral will be maintained until the asset is sold.

<u>Funds lose ability to use segregated method for determining Exempt Current Pension Income:</u>

Where any SMSF has at least one member who has a total superannuation balance that exceeds $1.6 million and that member is in receipt of a superannuation pension, then, from 1 July 2017, that SMSF can no longer use the segregated method for calculating their exempt current pension income. SMSFs which don't have any such members can continue to use the segregated method.

Therefore, at 1 July 2017, SMSFs with at least member who has a pension and more than $1.6 million of benefits, must use the proportionate method. This will be the case even if the member's balance in the SMSF is under $1.6 million but they have superannuation benefits in another fund and the their total superannuation interests are greater than $1.6 million.

The Tax Office have released LCG 2016/D8 which runs through all the aspects of the transitional measures including situations where the Tax Office will look to apply the anti-avoidance measures to strategies aimed at putting SMSF's in a position to apply the transitional measures where they would not otherwise be able to. Advisers are encouraged to refer to this publication for further information.

Trustee's and their advisers will need to carefully consider the changes and their application to members who have balances close to or above $1.6 million as action may be required to ensure that no adverse tax consequences are triggered when the new legislation takes effect on July 1, 2017. The legislation and associated impacts are quite complex and so advisers need to ensure they fully understand how the rules will operate so if required they can advise Trustees of any implications.

For any further information on the Superannuation changes related to the Balance Transfer Caps and their impacts on retirees please contact Chris Schoeman or Justin McGovern.

MKT Case Study: Superannuation Changes – Guide for Advisers

MKT will be presenting a series of sessions in April 2017 in relation to the changes and their impacts titled, *Superannuation Changes- Guide for Advisers*.

In this session Chris Schoeman will discuss the changes and what Accountants and Advisers need to ensure their clients do prior to July 1, 2017 to comply with the new rules using detailed examples to illustrate how this will work in practice. He will also discuss the long term impacts on Fund members.

Topics that will be covered include:

- Requirement to have $1.6 million or less in pension phase prior to July 1, 2017
- Transitional measures to allow for Cost Base Reset of Assets at June 30, 2017
- The new rules regarding fund's being able to apply the segregated method for determining Exempt Current Pension Income
- New restrictions on making non concessional contributions
- How changes will effect members entitlements in the long term specifically in relation to:
    - Tax on Income going forward
    - Tax on Death Benefit payments
    - Reversionary Pensions
    - Ability to keep assets within the superannuation system
    - Estate Planning

To register for this upcoming session, please contact Nicola.

Premium Accountants Network (PAN) – New Subscription Period

Would you like Priority Access to Tax Advisors that spend every day dealing with Business Tax matters?

MKT Tax Advisors has been providing specialist tax support to Accountants, Lawyers and Financial Planners for over 20 years through our Accountant's Network and are proud to offer our Premium subscription that elevates the services and value we provide to you and your clients.

The MKT PAN subscription is offered on a six monthly basis with the next period beginning on the **1st April 2017** - for more information contact Sean Pearce on 08 9481 8448 or head to our website www.mkttax.com.au/premium-accountants-network.

2017 PAN Conference

MKT are excited to announce that we are hosting the annual PAN Conference, exclusively for PAN Members, at the **UWA Club on Friday 7th April 2017**.

New and renewing PAN Members can attend the PAN Conference using their PD Vouchers and hear from a number of Perth's most respected professionals on topics as diverse as Selling your Clients business to the ATO's current Hot Spots. View the Brochure here.
