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

MKT
TAXATION ADVISORS

IN THIS ISSUE

SMALL BUSINESS MEASURES FROM THE FEDERAL BUDGET

The Government's cornerstone measures from this year's Federal Budget are the raft of changes to businesses that qualify as a Small Business Entity (SBE).

The key condition in qualifying as a SBE is that the aggregated, annual turnover of the business is less than $2 million in either the current year or the previous financial year.

Where a business qualifies the following changes will apply:

Small Business Tax Rate cut to 28.5%

From 1 July 2015, companies that are SBE's will have their tax rate cut to 28.5%. Furthermore, the franking credit rate will remain at 30% for SBE's, preserving the status quo with regards the payment of fully franked dividends to shareholders.

5% Tax Discount for unincorporated SBE's

Recognising that most small business are not incorporated and that the reduction in the SBE company tax rate will not apply to all SBE's, the Government has announced a 5% tax discount to unincorporated SBE's by providing a discount on the actual tax the SBE pays for that year. The discount is capped at $1,000 per individual, per year and is delivered as a tax credit in their tax return.

Although this is more readily targeted at sole traders and individuals, it would appear to also apply to individual beneficiaries of a Trust that is an SBE. By carefully considering the 2016 (and subsequent) trust distributions, trustees can ensure they get the maximum benefit of the 5% discount across a number of individual beneficiaries, without breaching the $1,000 per person cap.

Small Business Asset Write-off up to $20,000 per year

From 13 May 2015, SBE's can immediately write-off assets they start to use or install ready for use provided each asset costs less than $20,000. The threshold applies on a per asset basis from today until 30 June 2017.

Most business assets used by an SBE can qualify, with the only exceptions being horticultural plants and in-house software.

Assets costing over $20,000 can be pooled and depreciated together under the SBE pools (15% in year on and 30% thereafter).

This measure is merely a change in thresholds where the previous $1,000 per item threshold is increased to $20,000. Therefore, items of plant and equipment used in the SBE's business up to $20,000 (GST exclusive) can be fully written off. New or second hand items can qualify.

CGT roll-over relief for change to entity structure

Small businesses will be able to move from any legal structure to another without incurring a capital gains tax liability, using a new rollover from 1 July 2016.

It will enable SBE's to alter their legal structure as they find suitable without being impeded by potential CGT implications.

Currently, CGT roll-over relief is available under Division 122 of the 1997 Act for individuals, trustees or partners in a partnership that incorporate as a company. This measure recognises that new small businesses might initially choose a legal structure that they later determine does not suit them when their business is more established. An example given is that the CGT rollover will enable a sole trader to change their business structure to a Trust without incurring a CGT liability.

Interesting this change does not apply until 1 July 2016, making SBE's wait a little longer to access the CGT rollover. On the positive side it does enable businesses to restructure into trusts, which will benefit many sole traders and partnerships, but a negative in WA is that duty will apply on the transfer of the business assets even though federally, the tax burden has been removed.

Immediate deductibility for professional expenses re start-ups

Businesses will now be able to immediately deduct professional expenses incurred in starting a new business, such as legal and accounting advice in establishing a company, trust or partnership. The measure is proposed to take effect from 1 July 2015.

Under the current law, these expenses are capital in nature and may be deducted over a 5-year period as blackhole expenditure provided the relevant requirements are satisfied. It is intended that the immediate deduction of the expenses will provide much-needed cash flow for new businesses.

No FBT on work-related electronic devices

SBE's that provide employees with more than one qualifying work-related portable electronic device will be exempt from FBT, even where the items have substantially similar functions.

Currently, the exemption only applies in limited circumstances where only one work-related portable electronic device is allowed, if the device performs substantially the same functions. It is intended that removing the restriction will remove confusion where there is a function overlap between different products, such as between a tablet and a laptop. The change is proposed to take effect from 1 April 2016 (that is, the 2016-17 FBT year).

Whilst these changes are to be welcomed, the restriction of these measures to SBE's and the continued $2 million turnover threshold (originally set in 2007) severely restricts the ability for all small businesses to benefit from this tax rate reduction. Surely the next step is to increase the threshold to account for the past 8 years inflation at the very least, as well as ensuring small businesses are not penalised for growth by breaching the current $2 million turnover threshold.

If you would like to discuss any of the proposed Budget measures please contact Nigel Kingston, Sean Pearce or Peter Hong.

CGT Treatment of Earnout Arrangements

An earnout arrangement is an arrangement whereby as part of the sale of a business, the buyer and seller agree that subsequent financial benefits (e.g. cash) may be provided, based on the future performance of the business or the related business in which the assets are used. Earnout arrangements are commonly used in the sale of businesses where there is difficulty agreeing about the value of the business due to difficulty determining its future economic performance. For example, the buyer and purchaser of a business may agree on an upfront amount on the sale of the business, which may then increase subject to the business maintaining an agreed level of turnover, profitability or number of customers over a number of years.

There has been uncertainty as to the tax implications of this type of arrangements due to the controversial draft ruling issued by the Australian Taxation Office's (ATO) in December 2007. After years of uncertainty, the government has finally released draft legislation to introduce the "look-through" Capital Gain Tax (CGT) treatment for earnout arrangements.

Under the proposed amendments, the financial benefits (e.g. cash) received under the earnout arrangement will be treated as part of the capital proceeds of the original sale of the business, rather than giving rise to separate capital gains or losses. Further, the benefits paid under the arrangement will also increase the cost base of the business for the seller.

To be eligible for the "look-through" treatment, the earnout right must be created as part of an arrangement for the disposal of a business entered into on an arm's length basis, the future financial benefits must be linked to the future economic performance of the business and the right must not require financial benefits to be provided more than 4 years after the sale of the business.

The proposed amendments will apply to all earnout arrangements entered into on or after 23 April 2015. Transitional rules apply to taxpayers that have reasonably and in good faith anticipated changes to the tax law in this area as a result of the announcement by the previous Government. This will operate by placing a statutory bar on the Commissioner amending an income tax assessment in relation to a particular contained in a statement, to the extent that the particular represents the taxpayer's reasonable anticipation of the announced changes to the law and satisfies the timing conditions.

Given the complexity of the proposed legislation, it is advised that clients, who have used this arrangement or are planning to use such arrangements, carefully consider the implications. If you require any assistance on this, please contact Peter Hong or Sean Pearce.

WELCOME CHANGES TO EMPLOYEE SHARE SCHEME (ESS') TAX RULES

Legislation changing the ESS tax rules for the better is currently before the Senate. If enacted, the revised rules will apply from 1 July 2015.

The tax rules will be amended to remove a major disadvantage under the existing rules where employee options are assessed when they 'vest'; rather, in most cases options will now be taxed when they are exercised.

This taxing point can be further extended for up to 15 years if there are forfeiture risks and/or disposal restrictions, including on shares acquired on exercise of the options.

Disappointingly, the Government has not seen fit to change the rules so that there is no tax at the time an employee ceases employment.

Other welcome amendments include:

- removal of a technical risk that 'no-discount' options generate FBT liabilities for the employer;
- revised option valuation Tables which broadly reduce the taxable value of options with effect from 1 July 2015;
- broadening of the refund entitlements where income tax has been paid on ESS shares or options which have been forfeited or lapsed;
- an increase from 5% to 10% of share ownership beyond which deferred taxation is not available; and
- further concessions for employees of start-up companies.

ESS arrangements should be reappraised in the light of the revised ESS rules, which have the potential to improve tax outcomes for employees participating in such arrangements.

Please contact Walter Tieleman should you wish to clarify the impact of these changes.

CLIENTS WITH ATO DEBTS

We have noticed a marked increase in the ATO's enforcement activity in recent months in collecting unpaid taxes. We have also seen an increase if the ATO using its other powers to recover outstanding debts, such as the use of garnishee notices and the issuance of Directors Penalty Notices.

In a recent speech to members of the Tax Institute, the Commissioner of Taxation said:

"We have shifted our approach to:

- Increase help and support for people who are trying to do the right thing – giving them better information, additional tools and a more empathetic hearing. We now have online payment facilities (including for credit cards), SMS reminders, and we're taking a more flexible and tailored approach so that payment arrangements are better suited to individual circumstances.

- We are intervening earlier to prevent debts from escalating beyond people's control – connecting with people to ensure they stick to repayment arrangements and prevent things getting worse.

- Focus on business viability and ability to meet future obligations.

- We will be taking legal action earlier when warranted. This means initiating bankruptcy and wind-up action where there is evidence that a taxpayer is insolvent, and looking to use other statutory powers where businesses have failed to pay employee superannuation entitlements or pay amounts held in trust. In the past we have waited for a taxpayer's debt to escalate to on average over $300,000 before initiating bankruptcy proceedings, compared to other creditors who often take action at around an average of $35,000. For corporates, we wait for their debt to be more than $340,000 compared to other creditors who initiate action at an average of $93,000."

Where clients are experiencing difficulty with the payment of tax debts, getting on the front foot and contacting the ATO sooner rather than later is still the preferred option and is more likely to get the relationship off on a good footing that to wait for the inevitable ATO follow up.

If you are experiencing difficulties in meeting your tax obligations, please contact Mimi Ngo to discuss a way forward.

TRUSTEE RESOLUTIONS MUST BE MADE BY 30 JUNE OF EACH YEAR

Amendments made to the tax law in 2011 detailing how trustees can distribute certain income, specifically franked distributions and capital gains to beneficiaries, as well as changes in ATO guidelines, now require that trustee resolutions are made by 30 June of each year.

This creates both risks and opportunities for trustees. Risks in that resolutions not prepared by 30 June, or prepared without due reference to the Trust Deed, will be ineffective triggering either the default beneficiary to be assessed on trust income, or worse still the Trustee at 49%.

At this time of the year, it is an opportunity to review your trust's 2015 income year in real time, implement tax planning strategies and effectively draft a Trust Resolution that gives the trustees and beneficiaries the most tax effective outcome.

Of course, the first step in the process is to ensure that the relevant Trust Deed enables the trustee to make the distributions desired. In particular, where the trustee wishes to stream franked distributions and/or capital gains, the trust deed must contain the relevant clauses to enable them to do so.

If you have any queries or require any assistance with reviewing Trust Deeds or preparing your 2015 Trust Resolution please contact Peter Hong.