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Small business benchmarking and the ATO

There has been increased ATO audit activity in the small business sector particularly where the ATO has used small business benchmarking. Benchmarks are financial ratios developed from information provided to the ATO on tax returns and activity statements.

Below you will find some examples of some ATO benchmarks for a coffee shop business.

Example of ATO benchmarks – coffee shop business

Key benchmark ratio	Annual turnover range		
	\$65k-\$250k	\$250k-\$600k	More than \$600k
Income tax return			
Cost of sales/turnover	36%-43%	35%-41%	33%-38%
Average cost of sales	39%	38%	35%
Total expenses/turnover	79%-88%	84%-91%	87%-93%
Average total expenses	83%	88%	90%
Activity statement			
Non-capital purchases/total sales	56%-71%	53%-66%	50%-59%

The ATO uses benchmarks to help compare a business against similar businesses in the same industry. It also helps identify businesses that may not be reporting all of their income

(particularly where cash transactions occur).

In the absence of a satisfactory explanation, the ATO uses benchmarks to issue assessment notices for income it thinks has not been reported. This means the onus of proof passes to the taxpayer to disprove the ATO assessment.

Benchmarks have been published for businesses in more than 100 industries.

Private companies need a capital management strategy too

Recent press coverage of special dividends and capital distributions from some of Australia's largest listed companies has prompted a range of inquiries from clients who have investments in those companies.

Private companies however also need to think about their own capital management strategy.

It always pays to think ahead, particularly when the Government has promised a 1.5% cut in the company tax rate from 1 July 2015.

Under the ATO's dividend imputation system, Australian income tax payments (but **not** the proposed Paid Parental Leave levy paid by large companies) generate franking credits, which can be used to 'frank' dividends paid to shareholders.

Talk to Graeme or Shawn and start planning for a range of post 1 July 2015 scenarios including one where the value of flow-through franking benefits to shareholders may be reduced. Depending on the shareholder's



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particular circumstances, this could mean more tax payable at shareholder level.

On the other hand, a carefully executed return of share capital to a shareholder is not a frankable dividend and can be treated as non-assessable in the hands of shareholders. Capital distributions can also have other tax ramifications.

Taking all this into account, company directors need to be aware that making distributions to shareholders requires careful planning.

The more complex the capital management strategy, the more likely it is that tax advisers need time to liaise with the ATO to obtain a private binding ruling that provides certainty to both the company and its shareholders.

End of September quarter 2014 ATO activity statements

ATO activity statements will be due on 28 October 2014 for those who lodge and pay on a quarterly basis.

These first quarter statements need to be considered carefully because they provide some clients with an opportunity to choose the most advantageous PAYG instalment payment method. They will also reflect recently enacted personal income tax rate increases for those with a taxable income exceeding \$180,000.

At its most basic level, tax is about managing cash flow.

Reviewing your activity statements on a regular basis is one way to help identify opportunities to reduce tax outlays now, rather than waiting for refunds on lodgement of the annual tax return.

Undisclosed offshore income

The ATO's *Project DO it* offers taxpayers with unreported income from offshore investments to make a full voluntary disclosure. In return, the ATO will reduce tax penalties to a very low 10% and will only look back over the past four years. It is even willing to discuss ways of repatriating offshore assets to Australia in a tax effective manner.

This is a good opportunity to fix up tax problems which may have been festering for many years, perhaps because of bad advice from promoters of tax schemes or because of inherited offshore assets bequeathed by deceased family members.

Is there a lost superannuation account in your family?

The tax office says \$14 billion in lost super is waiting to be claimed. Does some of this relate to you or your family members?

The problem arises because people – particularly in their younger years – had many jobs and employer superannuation contributions were made to funds which have lost contact with the member. More than 40 per cent of super account holders have more than one account.

It's important to keep member details up-to-date for typical life events, such as changing surname when getting married and moving address.

Talk to Graeme or Shawn if you need help finding your super.

Correctly reporting property transactions

For every property transaction that you make there may be a GST consequence you need to consider. If you are making transactions involving property you will need to report your GST obligations.

Transactions that may have a GST consequence include:

- buying
- selling
- renting
- developing
- building
- renovating
- using a property to run a business.

For example, if you purchased a property and subsequently subdivided it for sale, you may have a GST taxable supply that you need to report.

It is important that you understand your tax reporting obligations in order to minimise the risk of costly penalties.

Many people are actually carrying on a business when making property transactions but do not register for GST when they are required to do so. Even with a 'one-off' transaction you may still be required to register for GST because your one-off property transactions may be considered a business.

If you are dealing with property (for example, you buy, sell, lease or develop), you may be considered to be conducting a business. If your turnover from these activities is more than the GST registration threshold you may be required to register for GST. The current threshold for GST registration is \$75,000 of turnover.

For GST purposes, property includes any of the following:

- land
- land and buildings
- an interest in land
- rights over land
- a licence to occupy land.

Selling property and GST

When you sell a property, there are several ways that the property may be treated for GST purposes:

- The sale may be taxable which means you are liable for GST on the sale, and you can claim GST credits for anything you purchase or import to make the sale.
- The sale may be GST-free which means you are not liable for GST on the sale, but you can claim GST credits for anything you purchase or import to make the sale.
- The sale may be input taxed which means you are not liable for GST on the sale and you cannot claim GST credits for anything you purchase or import to make the sale.
- The sale may be mixed which is a combination of any of the above.

Given the many permutations available it is very important that you discuss your property transactions with your accountant in order to treat your property transactions in the correct manner for GST.

You apply GST differently to property depending on whether it is either commercial or residential property.

Residential premises include houses, units and flats. It does not include vacant land.

Properties are residential premises if they can be occupied, are occupied or are intended to be occupied as residences.

New residential premises

Generally residential properties are input taxed however there are different treatments for GST purposes if the premises are considered to be new residential premises.

Residential premises are new when any of the following apply:

- they have not been sold as residential premises before
- they have been created through substantial renovations
- new buildings replace demolished buildings on the same land.

Residential premises are no longer new residential premises if they have been continuously rented for five years after first becoming new residential premises. They may still be considered new residential premises where they have been held for a dual purpose.

One example of a dual purpose is where the premises is being marketed for sale whilst being rented out as an input taxed supply. That is because they have not have been held 'solely' for making input taxed supplies for at least five years.

You can claim GST credits for any purchases you make for the sale of new residential premises (subject to the normal rules on GST credits) and you are liable for GST on the sale.

If GST applies to your sale of new residential premises, you generally pay GST of one-eleventh of the sale price. You may be eligible to use the margin scheme to work out the GST you must pay.

Commercial residential premises

Commercial residential premises include:

- hotels, motels, inns
- hostels, boarding houses
- caravan parks, camping grounds

- establishments that provide residential premises that are similar to hotels, motels, inns, hostels and boarding houses.

Commercial accommodation is accommodation in these commercial residential premises.

If you sell a commercial residential premises you are generally making a taxable sale and you are liable for GST of one-eleventh of the sale price.

You may also sell commercial residential premises in either of the following ways:

- under the margin scheme
- as a going concern

You can claim GST credits on purchases you make that relate to selling your property (subject to the normal rules on GST credits), for example, the GST included in real estate agents' fees.

If you purchase commercial residential premises, you can claim the GST included in the purchase price of the property as long as either:

- the seller did not use the margin scheme to work out the GST included in the price
- the sale was not a GST-free sale of a going concern to you and the seller was registered or required to be registered for GST.
- You may also be able to claim a GST credit on other expenses, such as solicitor's fees, that relate to buying the property.

Generally, the amount of GST you must pay on property sales is equal to one-eleventh of the sale price. If eligible, you may be able to use the margin scheme on your property sale. The margin scheme is a way of working out the GST you must pay when you sell property. You can only apply the margin scheme if the sale is taxable.

The margin is generally the difference between the sale price and one of the following:

- the amount you paid for the property
- an appropriate property valuation.

Whether you can use the margin scheme depends on how and when you purchased your property.

The above reading gives an insight into the complications that may arise when it comes to property and GST transactions. For further advice on any of the above please talk to Graeme or Shawn.

Dealing with Statutory demands

Pursuant to the Corporations Act, a creditor that is owed more than \$2,000 is eligible to issue a statutory demand against a company requiring it to either make payment, or come to a satisfactory arrangement for settlement of the debt within 21 days of service of the demand.

In the winding up process, an expired statutory demand evidences the insolvency of the debtor company.

A creditor is not required to obtain judgment prior to issuing a statutory demand, however, the creditor runs the risk that it had no right to make the application on the basis that the debt is disputed. Obtaining judgement prior to issuing a statutory demand will expose any such potential dispute.

A debtor, having been served with a statutory demand, may seek to have the demand set aside should there be a "genuine dispute" to the debt and/or an offsetting claim. Should the debtor fail to attempt to set aside the demand within the 21 day period, the debtor is unable to raise any dispute relating to the

debt in subsequent hearings of a winding up application.

Controversy has emerged as a result of a recent case, *Britten-Norman Pty Ltd ("Britten") v Analysis & Technology Australia Pty Ltd ("A&T")* (2013) ("the case"), where many in the legal profession argue that the standard of evidence in demonstrating a "genuine dispute" has been lowered as a result of the decision of the NSW Court of Appeal.

In short, Britten leased a surveillance system to A&T, which was required to be a certain level of accuracy to allow Britten to secure a contract to provide aerial surveillance to aid bushfire fighting. Britten claimed the system failed to meet the required level of accuracy, which cost them the contract. Britten was unable to meet the lease payments for the system and A&T issued a statutory demand.

Britten relied upon oral representations, which were not necessarily supported by documentary evidence to dispute the demand. Further, it claimed estimated loss of profits for the first year of trading, which was not supported by any kind of expert report.

The Court of Appeal ruled that a "genuine dispute" was evident and Britten demonstrated sufficient evidence to satisfy the Court that the offsetting claim exceeded the amount specified in the demand. Accordingly, the demand was set aside.

The case reinforces the risk of issuing a statutory demand without judgment in the instance where the debtor may raise the "genuine dispute" defence. Further, in those circumstances, it may be that an adverse costs order is made against the creditor that issued the statutory demand.

Given the potential risks, it may be prudent to consider firstly seeking judgement prior to issuing a statutory demand.

Too good to be true tax savings

There are many wise sayings when it comes to managing money, such as 'If it looks too good to be true then it probably is'.

In tax circles, we often look at investment opportunities identified by clients and ask: 'Does this proposal stack up without the associated tax savings?'

That may sound odd coming from a tax adviser, but our approach acknowledges that tax savings shouldn't be the most important factor when developing an investment strategy.

Investments which rely heavily on beneficial tax outcomes also attract ATO scrutiny. Those who design such investments will therefore often seek an ATO Product Ruling in advance to help potential investors understand the associated tax issues. But it's very important to understand that the ATO does not endorse an investment by issuing a Product Ruling: the ruling simply sets out the ATO's opinion on the tax ramifications for those who do invest.

As an investor, focus on the commercial viability of the project. For more information talk to Graeme or Shawn for an independent second opinion.

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