BRIEFINGS

WATERHOUSE
CHARTERED ACCOUNTANTS

EDITION #46 JULY / AUGUST 2018

Company Tax Change in Limbo

An issue that many business owners and investors will need to grapple with is uncertainty on the tax rate that applies to companies for the year ended 30 June 2018 and the maximum franking rate on dividends paid during the 2018 income year.

While the Government introduced a Bill to Parliament back in October 2017 which seeks to change the rules in this area, the Bill is still not yet law. As a result, it looks like we will need to apply the existing provisions for determining company tax rates and maximum franking rates (which are based on whether the company carries on a business), but also be aware that the position might change if and when the Bill passes through Parliament.

Under current rules, a company would be subject to a 27.5% tax rate if it carries on a business (which could include investment activities as long as there is a genuine expectation of making a profit) and the aggregated turnover of the company and certain related parties is less than $25 million.

If the Bill passes in its current form then the tax rate and maximum franking rate position will depend on whether more than 80% of the company’s income is passive in nature (e.g. interest, rent, etc.). If more than 80% of the company's income is passive in nature, then a 30% tax rate should apply. The $25 million aggregated turnover test will also need to be applied.

1 July 2018 Personal Income Tax Cuts

New personal income tax rates came into effect from 1 July 2018.

The top threshold of the 32.5% personal income tax bracket has increased from $87,000 to $90,000. Dovetailing into the tax bracket change is the introduction of the low and middle income tax offset for those with taxable incomes up to $125,333. The offset is a non-refundable tax offset that you receive when you lodge your income tax return.

If your annual taxable income is $80,000 in 2018/19, then the personal income tax changes provide an annual tax reduction of $530 per year. If your annual taxable income is $120,000, then the changes give you an annual reduction of $215.

New Minimum Pay Rates from 1 July 2018

New award wages and allowances came into effect from 1 July 2018.

If you’re an employer, it’s important that you are aware of the new rates and apply them. The Fair Work Ombudsman’s online Pay Calculator can help you determine the right rates to apply.

When can You take Your Super?

The cash sitting in your superannuation fund can be tempting, particularly if you are short of cash. But the reality is there are very few ways you can take advantage of your superannuation once it has been contributed to the fund – even if you change your mind.

The sole purpose test underpins access to your superannuation, that is, superannuation is for the sole purpose of providing retirement benefits to fund members, or to their dependants if a member dies before retirement. It is important to keep this in mind because it is often forgotten when people are tempted by 'too good to be true' schemes to access their superannuation early.

The Australian Taxation Office (ATO) recently warned against a scheme spreading through suburban Australia where scammers encourage people to access their superannuation early to pay debts, take a holiday or provide money to family overseas in need. All the scammers need is a fee for their services and you to sign blank forms and provide identity documentation. Typically, the forms are used to roll over your superannuation from an industry fund, establish a self-managed superannuation fund (SMS), and open a bank account for the new SMSF. Once the superannuation is rolled into the SMSF, the funds are accessible to withdraw. The problem is, accessing the superannuation is illegal unless you meet the conditions. Any superannuation that is withdrawn early is taxed at your marginal tax rate even if the money is returned to your fund later. In addition, you are disqualified from being a trustee of your SMSF. If you knowingly allow superannuation benefits to be accessed illegally from your fund, penalties of up to $1.1 million and a jail term of five years can apply.

Generally, you can only access your superannuation once you turn 65, when you reach preservation age and retire or when you reach preservation age and choose to keep working and start a transition to retirement pension. Currently, the preservation age is 55 years for those born before 1 July 1960. It then increases by one year, every year, up to the maximum of 60 for those born after 30 June 1964. There are some very limited circumstances where you can legally access your superannuation early.

Treasury is in the midst of a review into the early release of superannuation. The review was sparked by a rapid increase in requests for early access to fund medical treatments such as gastric banding surgery.

"A significant proportion of recent applications appear to relate to out-of-pocket expenses associated with bariatric surgery (that is, weight loss surgery), with a smaller proportion attributable to assisted reproductive treatment (ART), also referred to as in-vitro fertilisation (IVF) treatment."

The review, however, is focussed on more than medical treatments, looking at the issue broadly, including whether it is appropriate to provide early access to superannuation to pay compensation to victims of crime.

Compassionate Grounds

Superannuation benefits can be released on compassionate grounds to meet expenses related to medical treatment, medical transport, modifications necessary for the family home or motor vehicles due to severe disability, and palliative care. Funds may also be released on compassionate grounds to prevent foreclosure of a mortgage or exercise of a power of sale over the fund member's home (principal place of residence) or to pay for expenses with a dependant's death, funeral or burial.

Early access to superannuation needs to be a last resort. It is up to the person applying for early access to prove to the regulator that they do not have the financial capacity to meet these expenses without accessing their superannuation.

In 2016/17, the Department of Human Services received 37,105 applications for early access to superannuation on compassionate grounds, with 21,258 approved. The average amount released was $13,644. The great majority of funds released (72%) were on medical grounds; 18% were released for mortgage payments.

A person seeking early release for medical treatment must provide written evidence from at least two medical practitioners - one of whom must be a specialist - certifying that the treatment or medical transport:

- Is necessary to treat a life threatening illness or injury; or alleviate acute or chronic pain; or alleviate an acute or chronic mental disturbance; and
- Is not readily available to the individual or their dependant through the public health system.

At present, the Department of Human Services will respond to applicants within 28 days. The applicant then must approach their superannuation fund trustee who has ultimate discretion regarding the release of the funds. From 1 July 2018, however, the ATO will take over administration of early release applications, streamlining the process so applicants and superannuation funds receive the compassionate release notice electronically and simultaneously.

First Home Buyers

The *First Home Super Saver Scheme (FHSS)* enables first home buyers to save for a deposit inside their superannuation account, attracting tax incentives and some of the earnings benefits of superannuation.

Home savers can make voluntary concessional contributions (for example by salary sacrificing) or non-concessional contributions (voluntary after-tax contributions) of $15,000 a year within existing caps, up to a total of $30,000. Mandated employer contributions cannot be withdrawn under this scheme; it is only voluntary contributions made from 1 July 2017 that can be withdrawn.

When You Die

Superannuation is not an asset of your estate so your superannuation is provided to your eligible beneficiaries - your spouse, de facto, children or a financial dependant - by the fund trustee.

Putting in place a binding death nomination, however, will direct your superannuation to whoever you nominate so long as they are an eligible beneficiary. If you have nominations in place, it is essential that you keep these current. Death benefits are normally paid as a lump sum, but in some circumstances can be paid as an income stream.

You need to be aware that with the $1.6 million transfer balance cap in place, if your superannuation is paid as a death benefit pension to your nominated beneficiary, this could tip them over the cap. It is a good idea to get estate planning advice to manage it correctly.

Divorce and Superannuation

The *Family Law Legislation Amendment (Superannuation) Act 2001* allows superannuation to be split during a divorce either by agreement or by court order.

Before making a superannuation agreement, the parties must receive separate and independent legal advice. The agreement must be in writing and must be endorsed by a qualified legal practitioner.

Where the superannuation is split by order of the family court, the court decides on how the fund is split.

Essentially, the amount of split superannuation is rolled into the other party's superannuation fund. The same rules apply to accessing superannuation, that is, it cannot be accessed until you turn 65 or reach preservation age.

If you and your spouse have an SMSF, you need to continue to manage the fund. Relationship breakdown does not suspend your obligations as trustee.

What Happens if You Contributed too Much?

If you contributed too much superannuation to your fund, you cannot simply withdraw the amount.

If you breached your contribution caps, you can apply to withdraw the amount above your cap from the fund. The excess amount is treated as personal assessable income and taxed at your marginal tax rate plus an excess concessional contributions charge. Withdrawal of the excess amounts should not occur until the ATO provides you with a release authority that then needs to be given to the superannuation fund.

If you did not breach your contribution limit but simply overcommitted to superannuation, you cannot simply withdraw the amount.

Using SMSF Assets and Funds

In general, the assets of an SMSF cannot be used for the personal use or enjoyment of the fund members (or their associates such as friends or family). If the SMSF owns a holiday home, you cannot use it. If the fund has vintage cars, you cannot drive them. If your fund owns art, you cannot hang the art in your home or your office.

The exception to this is business real property. For example, assuming the trust deed allows for it, business owners can use their SMSF to purchase a building, then lease that building back to their business. Business real property is land and buildings used wholly and exclusively in a business.

$10k Limit on Cash Payments to Business

One of the interesting approaches to tackling the black economy in the recent 2018/19 Federal budget was the announcement of a $10,000 limit on cash payments to business.

Unrecorded and untaxed transactions that occur in the community are estimated at up to 3% of GDP or around $50 billion. We have all seen examples of the black economy in action in the form of cash payments and money not ringing through a retailer's till. This initiative targets high value transactions that are generally used to avoid tax obligations or for laundering the proceeds of a crime.

How Will the New Rules Work?

The cash payment limit targets larger cash payments - typically made for cars, yachts and other luxury goods, agricultural crops, houses, building renovations and commodities - removing the ability of any individual or business to make a single cash transaction of $10,000 or more.

The limit would apply to all payments made to businesses with an ABN for goods or services. The impending restrictions would not apply to private sales where the seller does not have an ABN, or cash payments to financial institutions.

Transactions at or in excess of the $10,000 threshold would need to be made electronically or by cheque. Splitting the payment into smaller amounts either as cash payments or a combination of cash and electronic payments would not be allowed. There would also be restrictions to prevent payment structuring to get around the payment limit.

At present, only financial services, banks and gambling industries have obligations for cash transactions of $10,000 or more. Under the *Anti-Money Laundering and Counter-Terrorism Financing* rules, transactions of $10,000 or more must be reported to the Australian Transaction Reports and Analysis Centre (AUSTRAC) within 10 working days.

Australia will not be the first country to introduce cash payment limits. France, Spain and Italy all impose limits at varying levels and generally for much smaller amounts than $10,000. For example, France imposes a €1,000 limit for goods and €450 for certain services. There are some exemptions for non-residents, salaries paid in cash, and for those who do not have access to any other form of payment.

The Australian limit on cash transactions is intended to apply from 1 July 2019. The legislation enabling the measure is currently in the consultation phase and is not yet law. We will keep you up-to-date on progress.

$20k Accelerated Deductions for Small Business Extended Another Year

The ability for small business entities to claim an immediate deduction for assets costing less than $20,000 has been extended for another 12 months, until 30 June 2019.

From 1 July 2019 the immediate deduction threshold will reduce back to $1,000.

There are no limits to the number of times you can use the immediate deduction assuming your cashflow supports the purchases.

If your business is registered for GST, the cost of the asset needs to be less than $20,000 after the GST credits that can be claimed by the business have been subtracted from the purchase price. If your business is not registered for GST, it is the GST inclusive amount.

Second hand goods are also deductible. However, there are a number of assets that do not qualify for the instant asset write-off as they have their own set of rules. These include horticultural plants, capital works (building construction costs etc.), assets leased to another party on a depreciating asset lease, etc.

If you purchase assets costing $20,000 or more, the immediate deduction does not apply, but small businesses have the ability to allocate the purchase to a pool and depreciate the pool at a rate of 15% in the first year and 30% for each year thereafter.

Will Australians Pay More for a Good Cause?

In the same month that desperate farmers made headlines preparing to destroy starving flocks and pleading with the public to pay a few cents more for their dairy products, Dick Smith's nationalistic brand announced is closure. The question is, will Australians pay more for a cause?

Comments like "we're with you" and the 2.8k heart emoji's on Facebook do very little when you cannot feed your herd. It is nice that there is emotional support and the plight of farmers is recognised, but what does it really achieve?

Country Valley Milk reached out on Facebook two months ago asking people to sponsor a cow –they estimated that each cow will cost $1,350 to feed until the end of September. Those that have contributed are rewarded with images of their cows - cow 84's new calf was shared with their adopted family on Facebook (named Splotch MacGonagall by the adopted family).
Farmer Jason Maloney started a GoFundMe page called Food for Cows. In a video with the Illawarra Mercury, Mr Maloney breaks down explaining that asking for help is the hardest thing he has had to do, but there has been no significant rain in two years and he does not have enough food or water for the herd. He has already sent part of the herd to market. "I've never felt so ashamed and so desperate," he says. The video is hard to watch.

Interviewed on the *Today Show*, Mr Maloney went on to say that if consumers were willing to pay "20 cents extra for a litre of milk that goes to the farmer, that's all it takes."

The farm gate milk price is the price farmers receive from processors for the milk they produce. There is no legislative control over the price milk processing companies pay with pricing deregulated in 2000/01. Milk prices are based on the milk fat and protein solids content of the milk supplied.
According to Dairy Australia, the typical factory price paid for farm gate milk per litre is $0.49 in NSW ($6.81 kg of milk solids (kgMS)), $0.38 in Victoria ($5.04 kgMS), $0.60 in Queensland ($8.22 kgMS), $0.37 in South Australia ($5.19 kgMS), $0.51 in Western Australia ($7.06 kgMS $0.39 in Tasmania ($4.97 kgMS). Both Coles and Woolworths sell their home brand milk (2 litre) for $1.00 per litre. The named milk brands tend to move between $1.50 and $2.93 per litre.

But will buying the more expensive branded milk guarantee that farmers get more? Choice says it is hard to say. The two largest processors are Fonterra Australia (owned by a New Zealand dairy cooperative) and Parmalat (an Italian company with French owners). Another large player, Murray Goulburn recently sold to Canadian company Saputo. Lion is owned by Japanese company Kirin.

The processors purchase the milk from farmers and produce the varying products. Parmalat, for example, supplies Pauls, Farmhouse Gold and Ski. Fonterra produces Mainland Cheese, Bega, Western Star and Perfect Italiano.

The price of these brands varies, but the price paid by the processor to the farmer is the same. The final price to the farmer depends on domestic and international demand. For example, Fonterra's opening average milk price is $5.85 per kilogram of milk solids (kgMS) for season 2018/19, with the updated forecast closing average milk price range $5.85 to $6.20 kgMS.

Choice says that consumers can support brands that process their own product and buy products from farm controlled co-operatives (co-operatives are owned by the farmers so not only do they get the farm gate price, but also a dividend). But, above all, buy more Australian made dairy product.

Fundamentally, however, what the farmer is paid is based on demand and supply. Buying cheaper product will drive the price down. If demand is strong for premium products the price paid should go up. But there are no guarantees.
In July, Dick Smith announced that his Dick Smith Foods business will close down. In the five page letter to Woolworths, Coles and Metcash, Mr Smith places the blame for his food group's failings at the feet of Aldi, heading the letter "Secretive German Company Now Most Trusted Brand in Australia." "Secretive" because Aldi is a family owned German business and not publicly listed.

Smith cites Windsor Farms as an example of the negative impact of a low price model. "Windsor Farms was forced on the road to bankruptcy when Aldi started selling Australian canned beetroot at 75 cents per can. This product had typically sold for $1.30 per can. Very quickly, your companies [Coles, Woolworths, Metcash] matched the price - I can understand you had to do this. Within six months, Windsor Farms and their Cowra Cannery (the only Australian owned cannery remaining) had to close. All the loyal, hard-working staff, many of them Aussie battlers, lost their jobs. The investors lost millions of dollars, and small businesses in the Cowra area were never paid, with substantial amounts owing. I understand the unsecured creditors were over $750,000. The local transport company in Cowra lost $550,000 and their local electrician lost nearly $30,000. The main shareholder lost over $6 million. He was a wonderful Australian who did everything he could to keep the company going." The collapse of the Cowra cannery occurred in 2013. Windsor Farms was sold to Spice Masters Australia.

The demise of Dick Smith Foods, however, did not come as a surprise to analysts. The company entered a mature, competitive and crowded market with nationalism as its differentiator - Australian grown, made and owned. The group's Ozemite sells for $2.69 per 100g whereas market leader Vegemite is $2.23 per 100g for a similar, small sized jar (Vegemite was bought by Bega in 2017). Not all of the product range are above the market leader's pricing point, but most offer little incentive to switch brands beyond a perception of doing the right thing.

Aldi are trusted as they perceive to be giving 'ordinary Australians' a 'fair go' at the checkout. They introduced competition to a sector where there was little choice between the major players. Consumers have responded well despite the reduced range, a lack of known brands and service extras, as long as they can pay less and get the Aldi special buys. Any potential impact on the manufacturing food chain of cheap pricing is too far removed.

The bottom line is that consumers will preference a product linked to a cause they identify with, but only if there is a benefit in doing so. Cage-free eggs are a case in point. While more expensive than caged eggs the demand for cage-free eggs has grown. No one wants their egg choice to support perceived cruelty and free range eggs are perceived to be healthier and more natural.

One of the great things about Australia is that when the country has been in turmoil, it is the willingness of Australians, either individually or through their businesses, to do something that has made the difference. The Government is there for support, but in a more rigid and structured way. If you think something should change, change it – as a nation we do not wait for someone else to find the solution. Business can be an exceptional driver of change because of the reach and influence they have.

But ultimately it is our capacity to innovate and find new solutions to problems that will succeed. If we are uncompetitive we will find ways to shift focus and deliver what the market wants. Take the example of Just Veg owned by Queensland based Kalfresh. Kalfresh has grown from a farm business to one of "Queensland's leading vegetable production companies and boasts a state-of-the-art washing and packing facility". They take "wonky carrots", the ones that cannot be sold to fussy consumers and turn them into farm to fork cut carrots for lunchboxes – perfectly sliced into bite sized sticks.

You can help farmers in need right now by donating to Rural Aid's Buy A Bale program, Aussie Farmers Foundation, Thirsty Cow, and Need for Feed to name a few. Woolworths announced a $1.5 million donation to Rural Aid on 29 July 2018 (the store also came under pressure on social media to donate to farmers the $71 million they are estimated to make from the plastic bag ban).

Clothing Deductions Hung out to Dry

The ATO is closely examining work-related clothing and laundry expense claims of taxpayers submitting their 2017/18 tax returns.

The ATO says that clothing claims are up nearly 20% over the last five years with people either making mistakes or deliberately over-claiming. Common mistakes include people claiming ineligible clothing, claiming for something without having spent the money, and not being able to explain the basis for how the claim was calculated.

"Around a quarter of all clothing and laundry claims were exactly $150, which is the threshold that requires taxpayers to keep detailed records. We are concerned that some taxpayers think they are entitled to claim $150 as a 'standard deduction' or a 'safe amount', even if they don't meet the clothing and laundry requirements," Assistant Commissioner Kath Anderson said.

While this particular announcement focuses on clothing-related expenses, it has been clear for some time now that the ATO is paying very close attention to work-related expenses in general. All claims should be supported by evidence – just in case the ATO decides your claim requires closer scrutiny. We have heard of a number of real life examples in the last year or so where the ATO has queried and challenged very small deduction amounts which could not be supported by appropriate evidence.

What Can I Claim?

You can only claim a deduction for the cost of buying and cleaning:

- Occupation-specific clothing - for example, the checked pants a chef wears;
- Protective clothing – fire-resistant and sun-protection clothing, safety-coloured vests, non-slip nurse's shoes, rubber boots for concreters, steel-capped boots, gloves, overalls, heavy-duty shirts and trousers, and overalls, smocks and aprons you wear to avoid damage or soiling to your ordinary clothes during your income-earning activities; and
- Unique, distinctive uniforms – clothes that are designed and made for the employer and not publicly available - like shirts with the company logo.

Just because your employer requires you to wear a suit, this does not mean you can claim the cost of the suit or its cleaning.

If you claim $150 on clothing and laundry expenses, be aware that you might be asked to prove these expenses.

Are you Holding Back your Business?

Overcoming the biggest problems in business often comes down to the simple things. Here are a few simple things you can do to capitalise on your opportunities and reduce your risks.

"I didn't get time…" No More Excuses

Most people simply do not set aside the time to do the forward planning they know they need to do. Here is a simple test: write down your goals for the business. Now ask yourself, are you doing something to achieve those goals every day or every week? If not, it is not a goal; it is just a nice thought.

Set a Realistic Budget

Financially mapping your business reduces your risk and removes some of the surprises that can occur. Your budget needs to be realistic – not just a percentage increase on last year.

Start with an operating budget and assess each line critically. Map your revenue to see where, how and when the money is coming in to create a reliable estimate of your income for the coming year. Once you have your revenue expectations in place, look at what is required to generate that income. For example, what advertising, marketing and resources will be required?

Once you are comfortable with your revenue, work up your expenditure budget. Be tough on costs. Do not forget to allow for growth and the increases that are likely to flow through.

Once your budget is complete and you have a good idea of your likely profit margins, do a couple of alternative estimates for your key revenue drivers so you understand the impact of changes to your assumptions. Once you have all this in place, track and measure it throughout the year.

Where possible, your management team should be a part of this process and take responsibility for achieving the budget numbers they give you. When people do not take the steps that they knew were required to achieve the budget the gaps become obvious fairly quickly. Having a budget in place that you need to report on regularly makes you focus on what really needs to be done.

Map Your Cash

Even some very large businesses have failed because they ran out of cash. Understanding your cashflow needs is vital, particularly for high growth business.

Understanding your cash position is about understanding the timing differences: how long will it take for your customers to pay you? How much stock will you need to hold? And what are the payment terms required by your suppliers? With your cashflow, do not forget to allow for things like tax payments, loan repayments, dividends and any capital purchases that are planned. These can be 'big ticket' items and if you do not allow for them then you will get caught out.

As part of your cashflow forecast, identify your capital expenditure requirements. Do not deal with these on a one-off basis as they arise; plan them in advance.

Expect the Unexpected

Growing to death is often the result of unplanned growth opportunities. It is ironic that seizing a major sales contract or big new client can be your business's ruin, but it is more common than you think.
Many business operators are very good at what they do. Most have an excellent knowledge of the business they conduct and understand their products and services. Most also have an in-depth knowledge of sales performance and revenue. Few, however, have a high level of financial management expertise, so when a big new opportunity presents, critical financial questions are not part of the vocabulary. As a result, there can be a sudden and unintended impact on their financial position. A rush of sales might be a great thing, but it is not always counterbalanced by a rush of income and profit. Free cash and liquidity are the victims.

Take All the Tax Advantages You Can

For small business in particular there are a range of concessions and funding you can access. Many businesses simply do not realise the opportunities available to them.

A simple example is trading stock valuations. Your trading stock is an asset that is recorded on your balance sheet. In most cases it should be tax neutral to you. The cost of purchasing stock is expensed in your profit and loss account and offset by the value of the stock asset, until you sell it. While the amount of stock you are carrying will impact on your cash position, because you have your funds tied up in it, there is no direct impact on your profits or taxable income until you sell that stock. However, if at 30 June some of your stock is worth less than its cost price, you have the option to value it at the lower figure and take the tax write off now, rather than wait until the stock is sold. This reduction in your stock value will produce a tax saving for you.

For tax purposes, there are a number of ways of valuing stock. Once you have done your stocktake (assuming you need to do one), you can choose what method to apply depending on the stock and your circumstances. The different ways of valuing stock can produce different results. Most businesses choose to value trading stock at cost, but you have the option of valuing your stock at cost, market selling price or replacement value. For example, if you have stock that is about to become obsolete, valuing it at cost price for tax purposes is not going to help you. In this situation you might be better off to value the stock at market selling price, particularly if it is a large quantity.

The tax rules also allow you to use a value that is lower than cost, market selling price or replacement value if this is warranted because of obsolescence or other special circumstances as long as the value you elect is reasonable. Take the example of vitamins with a use by date that only has a month or two left on it. Leading up to and once the vitamins reach their use by date they are unsaleable. In this case, you would estimate how much of the stock you are likely to sell prior to the use by date and at what price. Using previous sales as a guide, if you only expect to sell 15% of the stock prior to the use by date, you would use the market value of this 15%. Other than when you sell your stock, your tax return gives you a once a year opportunity to adjust your stock values and realise any losses.

Another way businesses disadvantage themselves is not taking the Government concessions available to them. The R&D tax incentive and Export Market Development Grant are a classic case. In the case of R&D incentives, if you develop new technologies or products, you might be eligible for a 43.5% tax offset (if your business has a turnover under $20 million). The Export Market Development Grant reimburses up to 50% of eligible export promotion expenses above $5,000 provided that the total expenses are at least $15,000.

Staff Changes

We have had some staff changes recently.

Kirsten Burch has resigned to spend more time with her family and work with her partner in his business. Her cheery presence in the office will be missed.

Camille Bunder is now working as my PA. She hails from Queensland and we hope she enjoys living and working on the Northern Beaches.

After working at Waterhouse Chartered Accountants for four years and following completion of the CA program, Charl Van der Walt has resigned to work at an accounting firm in Mosman. We wish him well and hope he enjoys new challenges in this next step in his career.