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Monthly Client Update

June 2012

New contractor tax reporting requirements

A change to the reporting requirements for businesses in the building and construction sector is about to become a reality from July 1, 2012. The new 'Taxable Payments Report' will require operators to report on certain payments made to contractors. The Tax Office says data from the Taxable Payments Report will improve compliance and detect contractors who have either not lodged returns or not included all of their income.

Who is affected?

The additional payments reporting burden will fall mostly upon:

- building and construction businesses – required to report on payments made to contractors they engage, and
- contractors working in the construction industry – required to report on payments made to sub-contractors they engage.

Note that a contractor who does not pay other contractors does not need to do anything. The government says the Taxable Payments Report will only introduce further requirements for contractors themselves where they make payments to other contractors, or sub-contractors, where both are operating in the construction industry.

It should also be noted that the new regulations will not generally apply to domestic building projects — for example, a private home owner making payments to contractors for an extension to their house — but are intended to cover commercial building projects. However a domestic construction project where the engaged builder uses the services of sub-contractors will trigger a reporting requirement for that builder.

Generally, the new report will be required from businesses:

- with an Australian Business Number (ABN)
- that operate primarily in the building and construction industry, and
- that make payments to contractors for construction services.

A business is defined as being 'primarily in the industry' if more than 50% of *business activity relates to, or income is derived from* building and construction services in the current financial year. A business is also considered to be in the construction industry if, in the financial year *immediately preceding* the present year, 50% or more of business income is derived from building and construction services.

It will not be necessary to report payments which are subject to PAYG withholding.

The business will be required to report actual payments made to contractors, and include the following details:

- the contractor's name*
- their ABN
- the contractor's address
- total amount paid or credited to the contractor over the income year, and

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About this newsletter

Welcome to Murray Business Solution's client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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Also in this issue:

- whether any GST has been charged.

**A contractor can be an individual, partnership, trust or company.*

What needs to be included

The Tax Office maintains that all the details needed for the Taxable Payments Report will be contained in the invoices a construction business receives from its contractors — that is, the sort of information which businesses will already be keeping in their business records under existing tax law.

A construction business is not required to report on payments where the invoices are for goods only, such as building supplies and materials. However where there is a mixture of labour and goods, the whole amount must be included (unless the 'labour' is incidental, such as demonstrating the use of a particular item).

But only amounts relating to paid invoices at each June 30 should be included, not amounts a business has been invoiced for but has not yet settled by the end of the financial year.

Activities covered

The Tax Office says 'building and construction services' includes the following activities if these are performed on or in relation to a building or structure, other works, or surfaces or sub-surfaces:

Alteration	Erection	Management*
Assembly	Excavation	Modification
Construction	Finishing	Organisation*
Demolition	Improvement	Removal
Design	Installation	Repair
Destruction	Maintenance	Site preparation
Dismantling		

**of building and construction services*

When, and why the change

The first Taxable Payments Report will be required for the year ending June 30, 2013 and falls due 21 days later (or by July 28 if a business lodges business activity statements quarterly) — so affected builders will need to start keeping appropriate records from the end of June this year.

The Tax Office says that after the first year of operation, it plans to accept quarterly reports rather than annual reports from construction companies.

The Tax Office's expectation is that the resulting data will potentially lead to more auditing triggers being activated, and it says the reported data will be shared with state and territory revenue offices to verify compliance with obligations such as payroll tax or workers' compensation.

However building industry groups have warned that the new reporting regime will add costs and paperwork headaches, and also claim that the measures will do little to counter 'cash economy' activities.

Set-up costs for an individual construction business to cope with the new tax reporting regime, according to the government, should be about $300. The government estimates the additional annual running costs to be around $90. Building industry representatives however are estimating an impost for businesses of more than three times these amounts.

Whether the reporting regime will be extended to other industries is still being considered, says Treasury, however possible sectors under consideration include financial and insurance services, professional and technical services, rental, hiring and real estate services, the retail trade, and agriculture, forestry and fishing.

Builders and contractors: Beware the Personal Properties Security Register

Financial institutions are familiar with the idea of registering 'security interests' over loans or mortgages — which flags that the asset involved (such as property or a vehicle) has a payment obligation attached. But the Personal Properties Securities Register, that came into effect on January 30, 2012, extends the need to register interests to other industries, including the construction sector.

Although the requirement does not apply to land or buildings, it fundamentally changes the law and ongoing practices that businesses will have to adopt in relation to 'interests' in most other kinds of assets. In particular for the building industry, this will affect how construction businesses need to deal with their assets — which may include tools, machinery, equipment and building materials — to ensure protection of ownership and rights to payment for building and contracting arrangements.

Under the new regulations, a security interest also needs to be registered for goods hired or leased, as well as materials consigned or supplied. So any time valuable equipment, for example, is left on or supplied to a building site before payment is received, a risk will arise that title or a right to payment for these items can be lost unless interests are registered.

A real case illustrates the danger. A hire company leased a number of 'port-a-loo' units to a construction company. At the same time, the building business had taken out a secured loan from a financial institution, which consequently

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Streaming classes of trust income

Various aspects of the tax law relating to trusts have been the subject of long-term uncertainty. Some clarification was provided in the 2010 year High Court decision in the *Bamford* case, however the Tax Office indicated that the judgement of the court raised further issues, which it outlined in a Decision Impact Statement.

Background: *Bamford vs Tax Commissioner*

The *Bamford* decision highlighted the fact that the amounts on which a beneficiary is assessed for tax do not always match the amounts they are entitled to under trust law. This mismatch can result in unfair outcomes and, according to the Tax Office, opportunities for tax manipulation.

In *Bamford's* case, the High Court held that 'income of the trust estate' is to be determined according to trust law (as opposed to tax law concepts). The key impact of this is that when calculating what constitutes the income of a trust estate, the definition of the term in the trust deed is very important in determining the outcome. Because of this, the phrase 'taxable income' of a trust estate does not necessarily equal the 'income of the trust estate' — whether it does, or not, depends on the relevant clauses in the deed.

The *Bamford* case highlighted the importance of the definition of 'income' in a trust deed. In particular, it highlighted the problems with the potential mismatch between the definitions 'income of the trust estate' (to which the beneficiaries are entitled) and the 'taxable income' of the trust (on which the beneficiaries or trustee must pay tax).

The High Court in the *Bamford* case was not required to consider the issue of 'streaming' particular classes of income of the trust estate. However, the Tax Office concluded that the reasoning of the court made it clear that streaming would not be effective for tax purposes based on the law as it was at the time.

Amendments to the law were enacted on June 29, 2011, with effect for the 2010-11 year, to specifically enable capital gains and franked dividends to be streamed provided particular legislative requirements were satisfied.

What the amendments mean

The Tax Office says the legislated amendments have been made to ensure that, **where permitted by the trust deed**, the trust's capital gains and franked distributions can be effectively streamed to beneficiaries for tax purposes by making those beneficiaries 'specifically entitled' to those amounts. Beneficiaries specifically entitled to franked distributions will, subject to existing integrity rules, also enjoy the benefit of any attached franking credits.

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Builders and contractors: Beware the Personal Properties Security Register (cont)

registered its security interest over the construction company's assets. The port-a-loo business did not consider registering its interest in the leased port-a-loos as it seemed obvious that it was the legal owner of them.

When the construction firm became insolvent, the financial institution had the only registered interest in the port-a-loos — even though the construction firm had only hired the units and not bought them. Hence the port-a-loo hire company was not entitled to recover their own assets, and the units were instead sold off by the construction company's receivers.

Other examples of everyday construction needs that may come under the Personal Properties Securities Register regime include:

- cranes, forklifts, scaffolding or fencing supplied on hire to a building site
- building materials, equipment and other items (such as pre-fabricated frames, bricks, formwork, tiles, appliances) bought by the builder and supplied to the site before payment is received from the supplier
- tools, electrical or plumbing materials stored by contractors or sub-contractors in a building site shed.

A beneficiary specifically entitled to a capital gain will be assessed on that gain, regardless of whether the benefit they receive is income or capital for trust law purposes. That is, unlike the situation that applied prior to the amendments, a beneficiary may be assessed based on a specific entitlement to a capital gain, even though they do not have a 'present entitlement' to income of the trust estate.

Capital gains and franked distributions to which no beneficiary is specifically entitled may be allocated proportionately to beneficiaries based on their present entitlement.

IMPORTANT NOTE: In another change to the distribution rules for trusts, the Tax Office advises that all trustees who make beneficiaries entitled to trust income by way of a resolution (for 2011-12 and thereafter) must do so by the end of the relevant income year, or an earlier date if stipulated in the trust deed. Previously, an administrative concession adopted by the Tax Office allowed trustees to make such resolutions by August 31 after the end of the income year in certain circumstances.

Anti-avoidance rules

The changes also introduce two specific anti-avoidance rules to address the inappropriate use of exempt entities to 'shelter' the taxable income of a trust.

The first, the 'pay or notify rule', generally applies where an exempt beneficiary has not been notified of or been paid their present entitlement to income of the trust estate within two months of the end of the income year. In this circumstance, they are treated as not being, and never having been, presently entitled to that income.

The second rule, the '**benchmark percentage rule**', generally applies where an exempt entity's share of the income of the trust estate (ignoring any franked distributions and capital gains), exceeds a benchmark percentage. Broadly speaking, this rule applies where the exempt entity's share is greater than their entitlement to the trust amounts that make up the trust's taxable income. The benchmark percentage rule is designed to prevent exempt entities being used to inappropriately reduce the amount of tax payable on the taxable income of the trust.

Under both rules, the trustee is assessed on the share of the trust's taxable income that corresponds to the income 'to which the exempt beneficiary is taken as not being entitled to'. The Tax Office maintains discretion to not apply the anti-avoidance rules if in the circumstances it would be 'unreasonable for it to apply'.

Still as status quo, for now

These amendments do not give trustees the power to stream if they do not already have this power under the trust deed. Alternatively, a streaming power may be implied where the deed confers on the trustee a power to distribute income or capital at the trustee's absolute discretion and there is nothing further in the deed or trust law in the relevant jurisdiction that fetters that power. It would be prudent to seek professional advice if doubt exists as to the availability of a streaming capability for the trustee.

The existing integrity rules (such as the '45-day holding period') continue to apply in respect of the streaming of franked distributions, particularly to determine whether the beneficiary can receive the benefit of franking credits.

The streaming changes only affect trusts that make a capital gain or that are in receipt of a franked distribution for the 2010-11 or a later income year.

Pre-paying private health insurance

The private health insurance rebate is to be means tested from July 1, 2012, which will see the 30% rebate drop to 20% for singles earning more than $84,000 and families on $168,000. It will then fall to 10% for incomes of $97,000 and $194,000 respectively before dropping to zero at incomes above $130,000 and $260,000.

But a one-off method of extending the full rebate has emerged. Some private health insurance companies are accepting pre-payment of premiums before June 30, 2012. This means that private health fund members can lock in the current 30% rebate by paying their premiums before the means testing regime takes effect.

The Private Health Insurance Ombudsman's office says that the relevant legislation is worded in such a way to allow for the date when premiums are paid to determine under which financial year eligibility for relevant government rebates or offsets is set.

The Minister for Health, Tanya Plibersek, has confirmed that private health insurance premiums paid before June 30, 2012, will qualify the payer for the level of rebate under existing rules, but that payments made on or after July 1, 2012, will be subject to the new health insurance rebate means test.

The legislation allows health insurance providers to determine if they will allow pre-payment. Many health insurers have done just that, and allow pre-payment for up to 12 months, with some allowing 18 months and one company even providing for up to 30 months pre-payment of premiums.

End-of-year tax tactics for your business

There are legitimate ways to go about minimising your business's tax liability, and some simple tactics to achieve this. These may not suit every business, so check with your tax professional to ensure they are applicable. As plans of action invariably take a while to put in place, some of the strategies may be too late to initiate now, but can certainly be given consideration to make 2012-13 a better tax year.

And one practical tip; note that June 30 is on a Saturday this year, so make sure any last-minute banking or financial transfers are finalised with enough time to allow the transaction to complete. The Tax Office can be pedantic about following the letter of the law, even given that its own deadline is not on a business day.

Can you delay buying certain assets?

Business owners could consider deferring the purchase of assets, including new motor vehicles, until next financial year because much larger immediate deductions will be available. From July 1, 2012, eligible small businesses can instantly write-off assets costing up to $6,500 – a jump from the previous limit of $1,000. Also, small businesses can claim an immediate deduction of $5,000 for motor vehicles.

In a similar vein, if an asset can be depreciated, consider waiting until after June 30 before purchase — so you will have a full year over which to get the full benefits of depreciation.

Pay now, claim later

If your business's cash flow is robust enough, consider pre-paying certain costs to cover the first quarter of 2012-13 (July to September 2012), such as rent, interest on a business loan, or any expense for which you can claim a tax deduction.

Some financiers will allow you to package the interest on a loan, and pay the coming year's interest in advance. There may be a charge for doing so, but the resulting tax deduction could still render this tactic worthwhile. Depending on your circumstances, even arranging short term finance to meet the impost of pre-paying costs (to allow for a tax deduction) can still be beneficial – although you have to get the calculations spot on.

Not everything can be paid in advance, so you need to check (a) that a cost can be pre-paid, (b) that there will be a tax deduction available for it, and (c) that the full deduction will be available up-front.

Take an internal audit

Review your business asset register to determine if any furniture and fittings, plant and equipment items are obsolete, can be scrapped, sold or are accurately valued.

Time your losses, or your gains, if you can

If your business is due to sell some assets which will realise a capital loss, try to crystallise these losses before June 30. Losses can be offset against, and therefore reduce, taxable income. If however the sale will produce a capital gain, delay crystallising this gain until the 2012-13 income year so that you will have a full fiscal year to get in place options to offset that gain.

And if there are potentially capital gain producing assets on your register, this could help your decision about which capital losses to realise. It may even be worthwhile for you to sell an underperforming asset, and realise a loss, if this suits your CGT circumstances.

Small business CGT concessions

If you are a small business entity (turning over less than $2 million annually), there could be several CGT concessions available, such as being able to defer a capital gain in relation to a replacement asset ('CGT rollover' concession), a possible 50% discount on active asset gains, exemption for gains made on assets owned for 15 years or more, and a 'retirement' exemption.

A business with annual turnover of more than $2 million may still be eligible for the small business CGT concessions if the combined value of the net assets of the business, any connected entities, any affiliates and any entities connected to the affiliates, is less than $6 million.

Cut off customers who owe you money

If it seems that some invoices will never be paid, cut your losses and write them off as bad debts and claim a deduction (they must be written off in the same income year as the deduction is claimed).

If you have paid goods and services tax (GST) in relation to the amount written off as uncollectable, don't neglect to claim back the GST credit in your June BAS. If the debt is settled later, record this as assessable income in the period it is paid.

Consider delaying issuing some invoices

If your business revenue is assessable when invoiced rather than as cash arises from the transaction, try delaying invoicing clients until after July 1. This tactic will disrupt cash flow of course, but in recent times average payment days have been edging up anyway.

Stocktake time equals decision time

If you conduct your stocktake at the end of the financial year, determine what has no chance of moving and get it out the door before July, either by heavy discounting or promotions. The value of closing stock goes towards profit, so whittling down the stockpile can have a tax benefit.

R&D Tax Credit

The new Research & Development Tax Credit provides a 45% refundable offset to businesses with an annual turnover under $20 million for eligible R&D expenditure, and a 40% non-refundable offset to all other eligible entities. The new rules narrow the definition of eligible R&D but allow for holding intellectual property offshore, and businesses must separate their 'core' and 'supporting' R&D activities.

Employee bonuses & director fee bonuses

Many businesses are entitled to claim a tax deduction for an expense in the year in which the business has committed to the liability. If you have committed to pay employees end-of-year bonuses, the accrued expense can be claimed as a tax deduction even though it is physically paid next financial year (provided the employee is not an 'associate' of the business entity — such as a shareholder of the company).

A company can also claim director bonuses in the year the expense is accrued in the same way. For a company to claim a deduction for a director bonus without physically paying the money, the company must, before the end of the financial year, commit to and document the payment of a quantified amount.

Deductions that can slip into a black hole

There are the standard deductions for businesses — travel, vehicle expenses, rent, loan interest and so on. But an area often overlooked are deductions termed 'black hole' expenses. Broadly, these are items of capital expenditure not included in the cost base of a CGT asset. In other words, it is expenditure that is not generally covered by other income tax laws.

An example of a black hole deduction would be the cost of setting up a business structure. Taxpayers are allowed to deduct particular capital expenses, over five years, where it is not otherwise taken into account elsewhere in tax provisions, and where the deduction is not denied by other provisions.

The black hole expenditure rules can be complex, and therefore it would be prudent to obtain professional advice.

'Deemed' dividends & Division 7A

Make sure you don't have money loaned to shareholders or their associates, because this could be deemed to be a dividend. Under Division 7A rules, loans to private company shareholders or associates may be deemed as dividends unless a formal loan arrangement satisfying particular principal and interest repayment requirements is in place. The intention of the measure is to stop profits of private companies being distributed to shareholders as tax-free 'loans'.

And also watch for unpaid distributions from trusts to companies (unpaid present entitlements). The Tax Office issued a ruling that these may be treated as loans, and caught under the same Division 7A provisions.

End-of-year superannuation strategy checklist

Get your superannuation into its best tax position, for this year-end and into 2012-13 and beyond. Consult your tax agent on which strategies suit you best.

✓Maximise after-tax contributions

Double-check your non-concessional (after-tax) contribution figures to make sure contributions are made up to the allowable cap before the end of the 2011-12 financial year. Generally, unused cap amounts are not carried over to future financial years.

✓Consider salary sacrificing

If you are over 50, consider salary sacrificing because the $50,000 concessional contributions cap only applies until June 30, 2012. After that, it will be $25,000 for everyone. And if you are likely to receive a bonus, salary sacrifice it into superannuation rather than receiving it as cash to take advantage of the larger concessional contributions cap in this financial year. However, don't forget about excess contributions tax risks.

✓Put certain termination payments into super

Transitional termination payments can be directed into super by June 30, 2012 with amounts up to $1 million enjoying concessional tax treatment.

✓Using personal deductible contributions to offset a capital gain

If you satisfy super's '10% rule', you may be eligible to claim a deduction for your personal super contributions. A deduction could be used to possibly offset a capital gain from the sale of one or more assets. Personal deductible contributions are subject to the concessional contributions caps. For 2011-12 these caps are $25,000 and $50,000 for those aged over 50. Individuals over 65 will also need to meet the 'gainful employment test'.

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SMSFs: Travel – and keep your fund compliant

Are you a travel aficionado? Nothing unlawful about that, except there may be negative consequences if you are a trustee in a self managed superannuation fund (SMSF).

If a trustee relocates overseas for an extended period, the residency status of an SMSF, its compliance and its ability to receive tax concessions may be affected. Trustees will need to put strategies in place to avoid their SMSFs becoming non-compliant and losing their concessional tax rates (non-compliant funds are taxed at the highest marginal tax rate of 46.5%).

The two issues below often arise when a trustee in an SMSF relocates overseas for an extended period of time.

Issue 1: Central management; local control

If high-level decisions – such as the formulation of an SMSF's investment strategy or how assets are used to fund member benefits – are made outside Australia, trustees need to show that central management and control of their SMSF are 'ordinarily' in Australia and only temporarily overseas.

In general, an SMSF will still meet the 'ordinarily' requirements if its central management and control is temporarily outside Australia for up to two years.

In the event that the 'ordinarily' requirement cannot be satisfied, consider the following options:

- appoint a legal personal representative with an enduring power of attorney (could be one of your adult children for instance) to be trustee in place of you. They will have the same power as a trustee, they will make key decisions, take responsibility and can override your wishes as you cannot be seen to be making high-level decisions. If you are involved in high-level decision-making from overseas, central management and control has remained with you and will constitute a breach of the rules. The Tax Office can monitor email trails to ascertain if this has happened
- wind up the fund and roll benefits over into a retail/industry fund, and
- convert the SMSF into a small APRA fund.

Administrative duties are also imposed on trustees so although you are overseas, you may still find yourself needing to sign financial statements, for instance. An SMSF with up to two members needs to get all trustees to sign documents and an SMSF with more than two members must have at least two signatures.

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End-of-year superannuation strategy checklist (cont)

✓Get a super boost from the government

If your total income is less than $61,920 in 2011-12, and at least 10% is from employment or a business, a personal after-tax contribution may qualify you for a government co-contribution of up to $1,000. This will halve from July 1, 2012 so be sure to capitalise on the current rate.

✓Split super contributions with your spouse

Spouse earns less than $13,800 a year? Make an after-tax contribution for them of up to $3,000 and maybe qualify for a maximum tax offset of $540. This way, you can boost your spouse's retirement savings and reduce your tax liability. Remember however, contributions caps apply to the spouse on whose behalf the contributions are made.

✓SMSFs: Keep within in-house asset rules

If your fund's holding is more than the 5% limit on in-house assets, reduce it by June 30 this year.

✓SMSFs: Make insurance more affordable

Purchase life and total and permanent disability insurance via your SMSF to benefit from tax concessions.

✓SMSF in pension phase drawdowns

Make sure you have drawn down the required minimums by June 30, or the investment income derived from the assets supporting that pension may no longer be exempt from tax. If you're almost 60 and want to cash out some of your super, consider waiting until over 60 to minimise potential lump sum tax.

Problems emerge if you are overseas and unreachable as documents may need to be signed by you. A possible solution to this is to receive all communications through email but be sure to check that digital signatures can legitimately be used. Or perhaps use an administrator for the fund as they can be responsible for receiving and processing all your paperwork.

If the central management and control of an SMSF is permanently outside Australia for more than two years, you will not meet the 'ordinarily' requirements and your fund may be deemed non-compliant with significant tax consequences thereby arising.

Issue 2: Active member test

A member is classified as active if they are a financial contributor to the fund or if financial contributions to the fund have been made on their behalf.

The 'active member test' requires that a fund has either no active members or, if there are active members, that at least 50% of all active members' assets (either based on market value or the value payable to the member) are attributable to active members who are Australian residents.

It would be pointless to appoint a legal representative to stand in your place if you breach the active member test.

All in all, the two issues above must be addressed if you are planning to relocate overseas. Be sure to seek professional advice to maintain the residency status of your SMSF.

Dodgy tax scheme warning

The Tax Office is warning us to steer clear of tax avoidance schemes, especially in the lead up to 2012 tax return time. Tax Commissioner Michael D'Ascenzo says there's a marked increase in the number of schemes being promoted at this time of year. 'Modern tax schemes can be very sophisticated and may masquerade as complex investments or other arrangements that can appeal even to experienced investors.'

These schemes can come with the promise of 'wealth creation' or financial security, exploit one's social or environmental conscience by promising large up-front deductions for donations to charity or 'green initiatives'. Many are marketed with the stamp of approval from so-called 'experts', however the Tax Office warns that sometimes the promised tax benefits may not actually be available under the law.

Anyone considering entering into an arrangement needs to investigate and understand the consequences. Not getting the right information may lead to a tax debt, including substantial penalties and interest. 'Doing your research and seeking independent financial and tax advice from someone not involved with the arrangement before investing is your best protection,' D'Ascenzo says.

Upcoming key lodgement dates

The following deadlines are for lodgement with the Tax Office. Please make sure to get your documentation into this office in plenty of time to allow proper processing.

5 June 2012	• Income tax return for non-taxable or refund as per latest year lodged as well as actual non-taxable or refund in current year (unless due earlier) – all entities with a lodgement end date of 15 May 2012 except large/medium business taxpayers and head companies of consolidated groups. This includes companies and super funds that were not due earlier and have the above criteria. • Income tax return for individuals and trusts with a lodgement end date of 15 May 2012 provided payment is also made by this date. Note: This is not a lodgement end date but a concessional arrangement where failure to lodge on time (FTL) penalties will be waived if lodgement and payment is made by this date.
21 June 2012	• Monthly activity statement for May 2012.