

# TAX RETREAT NEW CALEDONIA

24 – 25 MAY 2017

Chateau Royal, Noumea

## Key Income Tax Issues Affecting Small Businesses in 2017

Session 3



IPA INSTITUTE OF PUBLIC  
ACCOUNTANTS

## Overview

- Small Business Entity Turnover Threshold
- Small Business Restructure Rollover
- Work related expenses risk profile
- ATO disclose tax debts credit agencies
- Division 7A unpaid present entitlements

## Small Business Entity Turnover Threshold

- The Government will increase the small business entity turnover threshold from \$2 million to \$10 million. from 1 July 2016.
- The current \$2 million turnover threshold will be retained for access to the small business capital gains tax concessions, and access to the unincorporated small business tax discount will be limited to entities with turnover less than \$5 million.
- Companies with an aggregated turnover of between \$2m and \$10m, will now have the benefit of being able to access the following small business concessions:
  - –Simplified depreciation rules
  - –Small business restructure rollover
  - –Simplified trading stock rules
  - –GST & Excise concessions
  - –Immediate deduction for prepaid expenses
  - –Small Business Superannuation clearing house
  - –Two year amendment period
  - –FBT concessions
  - –PAYGI concessions
  - –Deductions for professional expenses for start ups

## Increase the unincorporated small business tax discount

- The Government will increase the tax discount for unincorporated small businesses incrementally over 10 years from 5 per cent to 16 per cent.
- > From 1 July 2016, the tax discount will increase to 8 per cent, remain constant at 8 per cent for eight years
- > The tax discount will then increase to 10 per cent in 2024–25, 13 per cent in 2025–26 and reach a new permanent discount of 16 per cent in 2026–27. The increases will coincide with staggered cuts in the corporate tax rate for certain entities to 25 per cent.
- > The current cap of \$1,000 per individual for each income year will be retained.
- > Access to the discount will be extended to individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than \$5 million, increased from \$2 million

# Small Business Income Tax Offset

Income year/s	Rate of small business income tax offset	Corporate tax rate applying to small businesses
2015-16	5 per cent	28.5 per cent
2016-17 to 2023-24	8 per cent	27.5 per cent
2024-25	10 per cent	27 per cent*
2025-26	13 per cent	26 per cent*
2026-27 and later income years	16 per cent	25 per cent*

The available concessions for small businesses, depending on thresholds, can be summarised as follows.

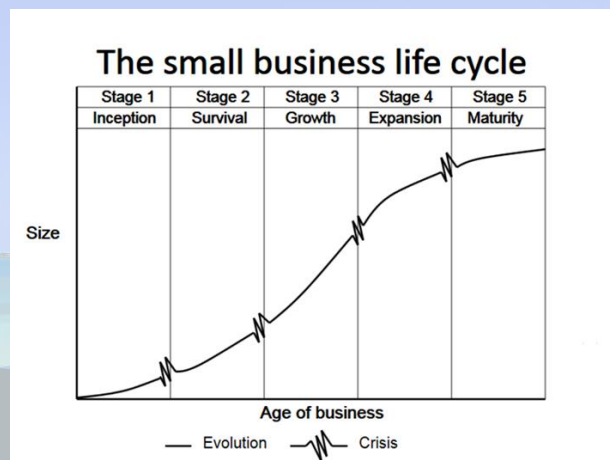
## Tax Concessions summary

Aggregated annual turnover	\$20,000 instant asset write-off	Small business CGT concessions	Small business restructure roll-over	Company tax cuts	Small business income tax offset	Small business pool	Immediate deduction for certain start-up costs
< \$2m	Yes	Yes	Yes	Yes	Yes	Yes	Yes
< \$5m	Yes	No	Yes	Yes	Yes	Yes	Yes
< \$10m	Yes	No	Yes	Yes	No	Yes	Yes

# Company tax rate reduction for small companies triggers lots of questions

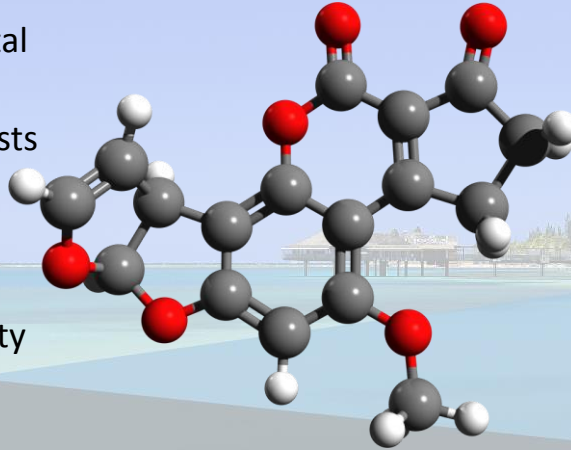
- Questions received mainly focus on:
- Is a passive investment company eligible for the 28.5% and 27.5% rate? That is, is such a company a small business entity?
- How will company PAYG instalments be adjusted for companies that are eligible for the 27.5% rate in the current 2016-17 income year?
- Dividends have already been declared and fully or partially franked during 2016-17 assuming a company tax rate of 30% for the 2016-17 year. What's the rectification procedure given that franking percentages should have been calculated by reference to the 27.5% rate?
- Some shareholders who received franked dividends at the 30% rate have already had their 2017 assessments determined (i.e. deceased estates, persons departing Australia permanently). Should amended returns be prepared?

## SMALL BUSINESS LIFE-CYCLE MODEL



## FACTORS IN DETERMINING STRUCTURE

- Access To Capital
- Compliance Costs
- Flexibility
- Personal Liability
- Tax



## WHY CHANGE STRUCTURE

- Continue To Grow/Develop
- Unnecessary Compliance Costs
- Enhance Business Efficiency
- Move Into More Efficient Structure
- Adapt To Current Conditions

## Structure Options

- Sole Trader
- Partnership
- Trust
- Company
- Hybrid – partnership/trust/corporate trustee

The roll-over provides for tax neutral consequences for a transfer by "switching off" the application of the existing income tax law - but only for the purpose of the transfer and not for the purposes of GST, FBT or stamp duty

## Perfect Structure

- Asset protection
- Ability to stream profits and capital gains
- Pass on CGT discounts
- Losses transfer to economic holders
- Access to imputation benefits



# WHAT ARE THE ELIGIBILITY CONDITIONS

## ALL OF THE FOLLOWING 6 CONDITIONS MUST BE MET:

- (1) Transfer of asset must be part of a "genuine restructure of an ongoing business"
- (2) Each party to transfer must be:
  - a) SBE for income year when the transfer occurred;
  - b) Entity who has an affiliate that is a SBE for that income year;
  - c) Entity who is connected with an entity that is a SBE for that income year; or
  - d) Entity which is a partner in a partnership that is a SBE for that income year;
- (3) Transaction must not materially change the ultimate economic ownership that an individual has in the asset
- (4) Asset must be an active business asset at the time of transfer
- (5) Transferor and transferee must be Australian residents for tax purposes
- (6) Transferor and transferee must each choose to apply for the roll-over to the assets transferred

*Note: The roll-over applies on an "asset-by-asset" basis*

## EFFECT OF THE ROLL-OVER

ASSET TYPE	TRANSFEROR	TRANSFEEE
Pre-CGT asset	Tax free	Retains pre-CGT status
Discount Capital Gains (CGT Asset)	Cost base	Acquire CGT asset as at transfer time at cost base (refresh happens!)
Trading stock	Cost, or if item held at start of the income year, value at start of income year	Acquire Transferor's cost and other attributes
Revenue assets	Amount that results in no profit or loss	Acquires Transferor's cost attributes
Depreciating assets	Roll-over relief under s.40-340 Cost which would result in a nil balancing adjustment	Acquires transferor's depreciation method and effective life

## Small Business Restructure Rollover

- The roll-over does not require that market value consideration, or any consideration, be given in exchange for the transferred assets
- Part IVA of the ITAA 1936, containing the general anti avoidance provisions of the taxation law, is not prevented from applying to a scheme involving the application of the roll-over

## Active asset requirement

Section 328-430 requires the asset to be an active asset at the time the transfer takes effect. An active asset is defined in section 152-40 ITAA 97

Some entities hold assets used by another entity in a small business. The roll-over extends eligibility to those passive entities where they:

- have an affiliate that is a small business entity for that income year;
- are connected with an entity that is a small business entity for that income year; or
- are a partner of a partnership that is a small business entity



## Active asset requirement

- Unfortunately assets specifically excluded from being an active asset include **assets whose main use is to derive rent**, unless the main use for deriving rent is temporary
- Assets used mainly to derive rent are excluded from being an active asset even if they are used in the course of carrying on a business (eg commercial premises rented to unconnected tenants)
- This exclusion means that rental properties will generally not qualify for the SBRR

## GENUINE RESTRUCTURE - MEANING

- Integrity Measure
- Question Of Fact
- Positive Factors
  - Bona fide commercial arrangement
  - Business continues under same ultimate economic ownership
  - Transferred assets continue to be used
  - New structure is the one likely to have been adopted originally
  - Restructure not artificial/unduly tax driven
  - The restructure is not a divestment or preliminary step to facilitate the asset realisation



## GENUINE RESTRUCTURE – SAFE HARBOUR

### **PROVISO IS THAT FOR 3 YEARS FOLLOWING THE ROLL-OVER:**

- No change in the ultimate economic ownership of any of the significant assets of the business that were transferred (except trading stock)
- Those significant assets continue to be active assets
- No significant or material use of those significant assets for private purposes

If SBE does not meet the requirements of safe harbor, it can still access the rollover provided it can satisfy the genuine restructure of an ongoing business requirements

## Ultimate economic ownership

- There must be no material change in the ‘ultimate economic ownership of the assets’ by individuals. The proposed legislation does not define this central concept of ‘ultimate economic ownership’.
- The EM expands upon the concept by describing the ultimate economic owners of an asset as the individuals who, directly or indirectly, beneficially own an asset.
  - Further, where a company, partnership or trust owns the asset, you need to look through to the natural person owners of the interests in these interposed entities to find the individuals who ultimately benefit economically from that asset.
- Where there is more than one individual ultimate economic owner of the asset, each of those individuals’ ultimate ownership share in that asset must be maintained in the same proportions

## Concession for Discretionary Trusts - the ultimate economic ownership test

- There is a concession for non-fixed trusts (e.g. discretionary trusts). Due to the nature of discretionary trusts, beneficiaries of the discretionary trust generally do not have an interest in the assets of the trust
- Rules use the term 'ultimate economic ownership' which is a new term and the EM implies that, as a group, all the beneficiaries of the discretionary trust have 'ultimate economic ownership' of the trust assets. However, it may not be possible to identify the **proportion** of the ultimate economic ownership that each beneficiary of the discretionary trust has in the trust assets. Without a concession, the transfer of assets to or from a discretionary trust would not be eligible for the rollover because the proportion of ultimate economic ownership by each of the individual beneficiaries cannot be determined

## Concession for Discretionary Trusts - the ultimate economic ownership test

- A concession has been provided for discretionary trusts that have made a family trust election (FTE) under the 'trust loss rules'
  - This concession deems there to be no change of ultimate economic ownership, or of any individual's share of that ultimate economic ownership of an asset where, every individual who had ultimate economic ownership of the transferred asset before the transfer, and every individual who has ultimate economic ownership of the transferred asset after the transfer, are members of the family group relating to the FTE
- This is an important concession as it generally allows small businesses to move the ownership interests of the business assets from one or more family members to a family discretionary trust that can then benefit any of the members in the family group

## LCG 2016/3- Example

- Mark has been operating a small bookkeeping business and has branched out into financial planning after receiving his financial planning licence. Mark's business has grown significantly and his financial advice arm now generates much larger profits
- After being sued by a client for negligent financial advice, Mark has decided he is not prepared to conduct his business on his own account
- Mark transfers his active assets used to carry on his financial planning business into a discretionary family trust. He and his wife are the beneficiaries and Mark is the primary individual specified in the family trust election in force in respect of the trust. For asset protection purposes, a corporate trustee is appointed and the trust contracts with clients. Mark does not personally provide guarantees or indemnities. Mark has also caused the trustee to employ other staff to service the larger client base. The trustee pays Mark and the other employees a salary commensurate to the services they provide to the business
- Mark and the trustee of the discretionary family trust choose to apply the SBRR.

## LCG 2016/3- Example

### ***Relevant considerations***

- Mark is transferring assets from the original entity (himself) to quarantine his business from his personal assets. This is a benefit to Mark in terms of his ability to grow the riskier operations and enhance its profits
- The evidence available supports Mark's claim of asset protection. Mark's asset protection strategy and commitment to expand his business is comprehensive and effective

### ***Conclusion***

- Mark has achieved benefits to the ongoing efficient conduct of his small business. The restructure is a response to his business needs, facilitates further growth and is not unduly tax-driven. The economic ownership of the business is maintained. Accordingly the 'genuine restructure of an ongoing business' condition is satisfied

# Work Related Expenses

No budget changes announced

Tax agent prepared returns still over 70 per cent

Future changes be prepared

Policy vacuum ATO will ramp up compliance

Last year 8.4 million taxpayers claimed a total of \$21.3 billion in work-related expenses (WREs). This amount continues to grow

## Tax agent WRE risk profile

### **Profile / Prompter approach**

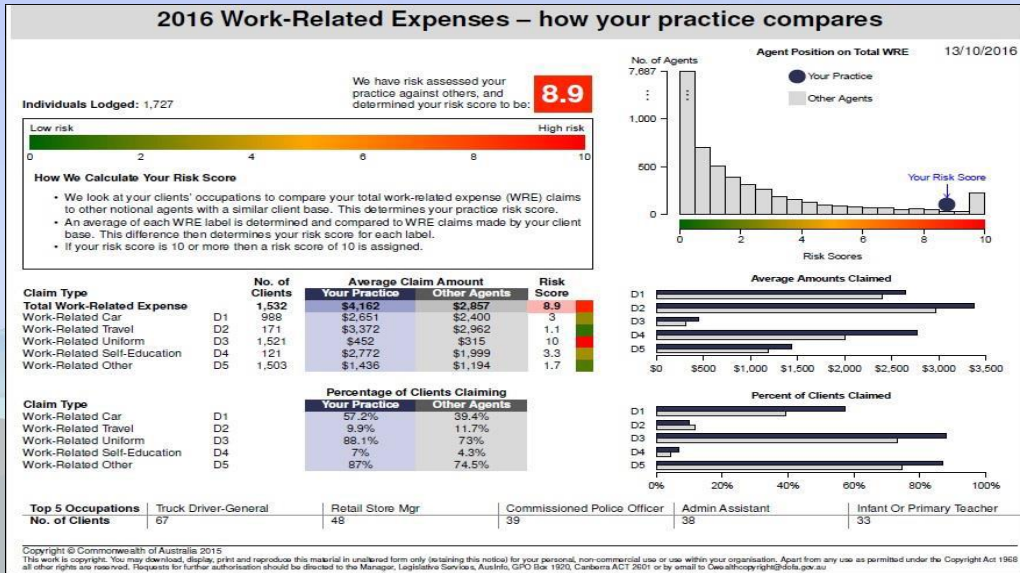
- The first pilot involved the ATO engaging directly with the agent to discuss the work-related expense risk profile of their client base (see attachment B)
- As part of this conversation the ATO provided the agent with a list of their clients with higher risk work-related expense claims, and asked them to review and make any appropriate amendments. The clients were also provided with a prompter letter requesting they review their claims.
- As at the end of April 2017, the ATO have completed 180 agent cases under this approach and issued almost 11,000 prompter letters to clients

### **Letter approach**

- The second pilot was a less intensive approach where the ATO simply sent the tax agent a letter that set out the percentage of the agent's client base that the ATO considered to have higher risk work-related expense claims (see attachment C)
- The ATO also provided the agent with a sample of their clients with higher risk work-related expense claims, and asked them to review and make any appropriate amendments
- The ATO sent out over 1100 of these letters on 10 March 2017. Sample client listings were capped at 20 clients, as the majority of agents contacted were small-medium practices



# Attachment B



# Attachment C

PO BOX 908 ALBURY NSW 2640

Australian Government  
Australian Taxation Office

<TITLE> <FIRST NAME> <MIDDLE NAME> <SURNAME>  
 <SUFFIX>  
 <ORGANISATION>  
 <ADDRESS LINE 1>  
 <ADDRESS LINE 2>  
 <LOCALITY> <STATE> <POSTCODE>

Our Reference: IND ITO WRE  
 TAN: <XX XX XX>  
 <Letter Date>

## We are examining work-related expense claims

Check your clients' claims for 2015-16 and amend their tax returns to correct any errors

Dear <First Name><Sir/Madam>.

We use data analytics to compare work-related expense claims made by tax practitioners with a similar client base.

**Your clients' work-related expense claims are in the top <X>% of higher-risk claims**

While we recognise that larger-than-usual claims may be legitimate, tax practitioners with higher risk clients are likely to attract closer ATO scrutiny.

**What you can do to reduce the likelihood of client audits**

We have enclosed a sample of your clients whose claims are higher than we would expect. By checking your clients' work related expense claims for 2015-16, you can help reduce their chance of being audited.

As your clients' trusted advisor, it's important that you help them get things right and avoid unnecessary audits in future. For example, check with your clients whether their employers, if we asked them, would confirm that their expenses were required to earn their income and were not reimbursed.

If any of your clients have incorrectly claimed a work-related expense, you will need to amend their tax return. We will not apply penalties for amendments lodged by **42 days from issue date** <DD Month CCYY>.

Yours <sincerely>-faithfully-

**NEED HELP?**

Find out more about work-related expenses at [ato.gov.au/workrelatedexpenses](http://ato.gov.au/workrelatedexpenses)

If you have any questions, phone us on 1800 193 393, Fast Key Code 5, between 9:00am and 5:00pm, Monday to Friday.

**Alison Lendon**  
Deputy Commissioner of Taxation



# ATO to disclose tax debts credit agencies

The MYEFO included an announcement that from 1 July 2017 the ATO can disclose to Credit Reporting Bureaus the tax debt information of businesses that have not effectively engaged with the ATO to manage those debts. This will be a new and unprecedented power for the ATO.

- This measure is part of the Government's strategy to reign in overdue tax and improve transparency of taxation debts, and will initially only apply to businesses with an A B N and tax debt of more than \$10,000 that is at least 90 days overdue
- The MYEFO confirms the ATO is owed \$19b in overdue tax, approximately two thirds of which is owed by small businesses with a turnover under \$2m. The rising level of debt, particularly in small business, presents a growing challenge for the ATO
  - Balance of collecting tax arrears without (where possible) suffocating the cash flow of the business
- ATO debt is often pushed to the back of the queue, and will be allowed to accumulate—often until the ATO pursue legal proceedings
- That landscape is about to change, as defaults being recorded on a taxpayer's commercial credit file will have immediate and lasting consequences for a defaulting taxpayer
  - A credit default is a black mark that lasts for five years, and creates an environment where support from financiers may be withdrawn and supplier credit stopped.
- Need to consider the potential ramifications for small businesses to avoid potentially imposing irreversible damage on thousands of small businesses from 1 July 2017
- Clearly, there has never been a more important time to engage with the ATO to manage unpaid tax

# Unfinished business - Division 7A unpaid present entitlements

- **ATO to commence consultation process on Division 7A unpaid present entitlements and maturity of "Option 1" safe harbour in PS LA 2010/4 (7 year interest only loans)**
- Specifically, this consultation process will focus on:
  - unpaid present entitlements (UPE) owing from a trust to a private company in the same family group where the trustee holds the funds representing the UPE on sub-trust for the sole benefit of the private company beneficiary, and
  - that sub-trust has come about because the funds were invested in the main trust using the "Option 1" safe harbour outlined in PS LA 2010/4 – that is, the funds representing the UPE were invested as an interest only 7-year loan (see paragraphs 40 to 58, and 62 to 73 of the practice statement)
  - Investments falling into this "Option 1" safe harbour are likely to mature in the income year ending 30 June 2018, although there may be some that may mature in the income year ending 30 June 2017
  - The ATO is conscious of the time sensitivity for taxpayers who have availed themselves of this "Option 1" safe harbour and expects to complete this consultation process in March 2017

# THANK YOU



**IPA** INSTITUTE OF PUBLIC  
ACCOUNTANTS