

News

May 2006

Our Partners Are Your Partners



Avoid The Race To The Bottom

Business owners striving for success and concerned with the long term health of their business do not want to get involved in the race to the bottom. This is a race where businesses compete only on price and important issues such as quality are pushed aside.

In a market where competitors lower prices to win work and secure orders their profit margins will be driven down and every other business which follows in the race. If they wish to continue to make a profit they will need to make cost savings to maintain their bottom line. This can lead to a lower quality product as cheaper raw materials are used, fewer or less valuable resources are put towards production, or after sales service or support are cut. These are the

common ways to reduce costs in the absence of production efficiencies, purchase discounts from suppliers, improved productivity, or improved processes – all of which take considerably more time and planning to achieve.

In the end who wins this race? Or does everybody lose? The business selling at a lower price may work harder to make the same or less profit. The customers may enjoy a lower price but this may be reflected in an inferior product or service.

There should always be a position in the market for quality goods and services – so long as there are customers who respect good quality or prefer to 'buy once, buy right'. Businesses that trade

at the medium and higher ends of the market should enjoy more success if they get it right in the production and management areas. For most business people this is also more satisfying, not just in the financial rewards.

A business built on quality, sound management, and a solid reputation should also be stronger and more valuable in the long term. Provided of course it is not reliant on the individual business owner and is transferable. These businesses should also be more resilient to competition from lower priced but inferior products or services. Ultimately, this is the better position to strive towards. Better to be running the race to the top than the race in the other direction.

Superannuation Splitting 1.1.06 & 1.7.06

If you are confused about the two dates, superannuation contributions splitting has effectively started. Whilst you cannot instruct your fund until 1 July 2006, contributions made from 1 January 2006 can be split to your eligible spouse. Your spouse should be eligible if they have not yet reached their preservation age, or if they have but not age 65 and they have not retired from the workforce. This is a voluntary service and not all funds may offer splitting.

Contributions splitting will be particularly effective for couples where one person is not working, has a low income, or for other reasons has a substantially lower superannuation account balance. Splitting contributions to balance the two accounts will give more flexibility and choice

in the couple's retirement planning including access to a greater total of concessional taxed retirement benefits.

You can split contributions to an account held by your spouse within the same fund or to a different fund. Choice of fund means superannuation administrators may be receiving contributions in a year and paying them to another fund when split – if this is your choice be aware of exit or transfer fees. In a recent survey 75% of respondents said they had not considered changing funds despite the introduction of fund choice. This is perhaps because more than 50% of respondents found it difficult to compare superannuation funds.

Note that you do not have to be married to split contributions to your spouse. A couple will qualify if, although not legally married, they live together on a genuine domestic basis as husband and wife. Contact your Sothertons partner for more details.

INSIDE

> The Federal Budget

> Tax Effective Investments

AUDIT AND INVESTIGATION

ADELAIDE

LITIGATION SUPPORT

CORPORATE ADVISING

BRISBANE

STRATEGIC PLANNING

FRANCHISING

GLADSTONE

INSOLVENCY

INFORMATION SYSTEMS

MELBOURNE

SUPERANNUATION AND PERSONAL-INVESTMENT

TAXATION

PERTH

The Investor

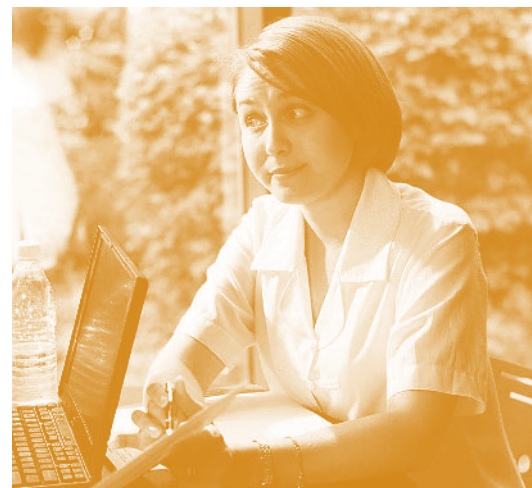
Tis the season for... tax effective investments. As 30 June and the tax year end approaches you may be encouraged to enter such investment arrangements. The crucial thing to remember when examining such an investment is to be careful – be educated, be cautious (perhaps even cynical), and read all of the fine print. It is important that you consider the investment that underlies the scheme as well as the immediate tax benefits. Are you getting sound investment advice that will help to build your wealth or is it simply advice on how to save tax?

Note also that some investments involve an ongoing commitment. After your initial investment in many agricultural based schemes there may be an annual maintenance or service fee – if you bought a woodlot, someone has to tend to your growing trees. You may have obtained a greater tax deduction by borrowing some of the investment amount, so you will also have the debt

to service. Give thought to directing the tax saving towards repaying the debt.

Before taking the plunge you should also consider the real value of the investment and whether you are comfortable with the secondary market – who could I sell my investment to? Can I only forfeit it to the investment company at their valuation? Is it worth more than my outstanding debt that I used to buy it?

Tax effective investments are often promoted with a favourable product ruling from the Tax Office – this is not the ATO's 'stamp of approval' but merely the opinion on tax deductibility based on the details provided by the investment company. If you think you may have been offered an aggressive tax plan be very careful and consider what might happen if the ATO rejects the plan's validity. Such plans usually look 'uncommercial' so ensure that you do your homework.



Film Fails Screening

A recent case involving an investment in a film scheme demonstrates the possible dramas that may occur with a tax effective investment that is not properly structured or is not properly administered. It also highlights the commercial reality that a tax deduction will rarely be allowed where no money has been spent or there is no obligation to outlay money.

The taxpayer 'invested' in a scheme whereby he subscribed to purchase units to be held on trust and for the purchase of parcels of film service monies (FSM). The taxpayer subscribed for one unit for \$200 and 8 parcels of FSM for \$40,000 by borrowing from a finance company. The arrangement provided for a small annual return plus an ultimate return, each contingent on the success of the film – however the film was never completed.

The prospectus contained a tax opinion from a large accounting firm which stated that the \$40,000 investment was deductible to the investor – the FSM were essentially prepayments of film production costs. The \$40,000 was held

on bare trust at the time of investment until the scheme was fully subscribed. The production costs would be paid out of those amounts once full subscriptions were received.

The Tribunal held that the taxpayer had not incurred the \$40,000 in the relevant income year as there was no evidence that the scheme was fully subscribed by the end of that income year. Essentially, the Tribunal found the money continued to be held in bare trust for the taxpayer. The Tribunal also found that the taxpayer was not in the business of film production even via the collective arrangement. On this basis, the Tribunal found that the taxpayer had not incurred the \$40,000 and was therefore not entitled to claim the deduction in accordance with Section 51(1) of the tax act.

A lack of evidence did not assist the taxpayer's case – he was unable to prove he had paid the \$40,000. His argument was limited to "because the claim was included in his income tax return, then it must be deductible". He could not say where the film was and only discovered that

production had never proceeded when the Tax Office told him. For completeness, the Tribunal also noted that assuming the \$40,000 was incurred and was therefore deductible, it would have been disallowed under Part IVA... "on an objective basis, the sole purpose was tax avoidance, there was in fact no other purpose".

Many people make sound tax effective investments in films (Crocodyre Dundee had handsome returns). The integrity of this scheme however failed and the taxpayer with it. Even if it looked to be legitimate and properly structured in the prospectus, the investment scheme was not properly carried out and allowed the Tax Office to attack it with hindsight.

DESK DIARY

"Always be a first rate version of yourself instead of a second rate version of someone else."

Judy Garland, actress

The Federal Budget

...PERSONAL TAX CUTS

...POSSIBLE CHANGES TO SUPERANNUATION

Federal Treasurer Peter Costello recently delivered the 2006-07 Commonwealth Budget. The generous personal tax cuts hand back a large slice of the Government's surplus to individual taxpayers and there are also improved concessions to make investing in business infrastructure more attractive. The potentially big changes to superannuation are in the planning phase and look likely to commence in earnest on 1 July 2007.

The personal tax cuts improve upon those announced last budget with the 30% bracket extending out to \$75,000 rather than the previously announced \$70,000, and the 42% rate reducing to 40% as well as extending the bracket. The top marginal tax rate will reduce from 47% to 45% with a threshold of \$150,000. There is also a flow on effect as the top marginal tax rate is applied to other areas of tax law – notably the fringe benefits tax rate. Including the FBT cut, the tax cuts total \$36.7 billion over 4 years (equivalent to 1% of household disposable income). Rates will now change to:

Up to 30 June 2006		From 1 July 2006	
\$ tax income	% tax rate	\$ tax income	% tax rate
0 - 6,000	0	0 - 6,000	0
6,001 - 21,600	17	6,001 - 25,000	15
21,601 - 63,000	30	25,001 - 75,000	30
63,001 - 95,000	42	75,001 - 150,000	40
95,001 +	47	150,001 +	45

Other Budget highlights include:

- The income levels for 'senior Australians' will increase improving eligibility for the Senior Australians Tax Offset and Medicare levy relief. The effective 'tax free' income levels will be \$24,867 for a single and \$41,360 for couples.
- The income threshold for Family Tax Benefit part A will increase to \$40,000 in the 2007 financial year (up from \$33,361).
- Commencing in the 2007 financial year, the part year tax free threshold applied to students ceasing full time education for the first time will be removed.
- Deductions will be allowed for charity donations of publicly listed shares which had been held for at least 12 months and are valued up to \$5,000 (capital gains tax still applies of course).
- \$82 million of additional resources has been earmarked for the ATO's High Wealth Individual Taskforce over the next 4 years. This is expected to reap an additional \$615 million of tax revenue out of tax compliance audit and improvement.

- From the new financial year, the income tax and capital gains tax concessions applying to employee share schemes will be extended to stapled securities where one of the bundled securities is an ordinary ASX listed share.
- Legislation is to be drafted to improve the flexibility of family trusts by allowing certain irrevocable elections to be revoked and expanding the definition of "family group".
- Businesses will enjoy the increase in the diminishing value depreciation rates which will increase from 150% to 200% of the ordinary rates. This applies to eligible assets acquired on or after 10.5.06 and brings forward the timing of tax deductions.
- The fringe benefits tax rate will reduce from 48.5% to 46.5% from 1.4.06 in line with the reduction in the highest personal income tax rate.
- FBT will be simplified from 1.4.07 with:
 - ▶ the annual FBT free limit for in-house benefits (goods and services provided to employees that the employer provides to the general public) will increase from \$500 to \$1,000
 - ▶ the minor benefits exemption will increase from \$100 to \$300
 - ▶ the threshold for exclusion of reportable fringe benefits will increase from \$1,000 (value before grossing up) to \$2,000.
- From 1 July 2006, the low income tax offset will increase from \$235 to \$600 and the phase out threshold will increase from \$21,600 to \$25,000. This means the effective tax free threshold is \$10,000.
- Small business owners may enjoy the change in the capital gains tax concession whereby the 50% controlling individual test is to be replaced by a 20% significant individual test. This is part of numerous changes commencing 1.7.07 (more next issue).

'SIMPLERSUPER'

Substantial changes are proposed to the superannuation system which will influence the way people fund their retirement savings and withdraw their benefits. Briefly (further details will be provided next month) the measures to be considered for a 1.7.07 start include:

- Superannuation benefits paid from a taxed superannuation fund will be tax free to retirees aged 60 & over – as a lump sum or a pension this will not be assessable income so you need not be concerned about income tax effects if you are still working

- Reasonable Benefit Limits will be abolished – encouraging you to save and invest more in your superannuation fund
- Superannuation contributions and fund earnings will continue to be concessional tax
- Aged based maximum deductible contribution (MDC) limits will be replaced with one limit of \$50,000 regardless of age.

Thankfully the discrimination against self-employed persons will be removed and they will now be allowed a full tax deduction for contributions (rather than 75% of the amount over \$5,000). Self employed persons will also be eligible for the government's co-contribution.

Whilst there were no major budget changes to indirect taxes including GST, the GST revenue is budgeted to increase by approximately twice the rate of inflation assisted by more funding towards ATO compliance and collection activities. The Government's plan is to spend \$46 million over 3 years to collect an additional \$190 million in GST. The Government also proposes to increase the cash accounting turnover threshold from \$1 million to \$2 million from 1.7.07.

There is also a promise that Federal and State governments will, over time, abolish certain 'inefficient' state taxes to save taxpayers \$1 billion each year. The Federal Government will push to abolish stamp duty on business property. Though there still remains the potential conflict of Federal and State governments in the respective collection and spending objectives as well as the political influences.

And the Government's 2007 **forecasts:**

- following the expected 2006 surplus of \$14.8 billion, the underlying cash surplus for the 2007 financial year is forecast to be \$10.8 billion
- growth, as measured by GDP growth, is expected to move from 2.5% in 2006 to 3.25% in 2007
- inflation as measured by CPI to be 2.75% - the 2006 forecast was 3%
- the unemployment rate to remain steady at 5.25%
- the wage cost index is also tipped to remain steady at 4%.

Budget announcements and proposals can be dependent on legislation passing successfully. It is often necessary to examine the detail of the legislation for a full understanding and this may be introduced into parliament gradually. Contact your Sothertons partner for further details.

Barter Schemes Beware

Barter exchange schemes have recently attracted the Tax Office's attention. The Tax Commissioner warned barter trade exchanges and their members that the ATO is investigating schemes designed to increase GST refunds.

Barter exchanges involve the purchase and sale of goods or services between members using 'trade dollars' rather than legal tender or real dollars. The ATO is suspicious of situations where a barter trade exchange (the entity administering the barter system) uses trade dollars to buy goods or services at grossly inflated prices using trade dollars. These inflated prices are then used to make GST credit claims, thereby converting trade dollars into real dollars in the form of GST refunds.

Hypothetically, the barter exchange could grant itself unlimited trade dollars. By buying at commercially unrealistic prices from its members, and ensuring that acquisitions continually exceed supplies, it could claim significant GST refunds. The business receiving the inflated income (in trade dollars remember) would inherit the tax problem. It is worth noting that the ATO does not accept barter dollars for payment of income tax or goods and services tax – only real money. Such a scenario would damage the integrity of the whole barter dollar system if 'trade dollars' could be artificially created and thrown around to obtain tax benefits.

IMPORTANT: Professional advice should be considered before acting in any area. Clients and readers should not act solely on the material contained in this newsletter which is in the nature of general comments only. Material may or may not be applicable to your particular circumstances and changes in legislation sometimes occur quickly.

For details of each firm's financial planning arrangements and assistance with your financial affairs, please contact your Sothertons partner. Any decision to invest or not to invest should only be made after considering the specific advice of a licensed financial adviser.

Independent associated accounting firms in the National Sothertons Group

Adelaide

Sothertons
GPO Box 2193, Adelaide 5001
42 Hurtle Square, Adelaide
South Australia 5000
Australia
Telephone: (08) 8223 7311
Fax: (08) 8223 7488
e-mail: sothertons@sothertonsadelaide.com.au

Brisbane

Sothertons
GPO Box 1568, Brisbane 4001
8th Floor
10 Market Street, Brisbane
Queensland 4000
Australia
Telephone: (07) 3221 1877
Fax: (07) 3221 8261
e-mail: sothbris@sothertons.com.au

Gladstone

Sothertons
1st Floor, 100 Goondoon Street
PO Box 5066
Gladstone
Queensland 4680
Australia
Telephone: (07) 4972 1300
Fax: (07) 4972 4386
e-mail: sothertons@sothertonsgladstone.com.au

Melbourne

Sothertons
Level 6, 468 St Kilda Road
Melbourne
Victoria 3004
Australia
Telephone: (03) 9820 6400
Fax: (03) 9820 6499
e-mail: advice@sothertonsmelbourne.com.au

Perth

Sothertons
PO Box 458,
Level 3, Tower B, Centrepoint Tower
123 Colin Street, West Perth
Western Australia 6005
Australia
Telephone: (08) 9322 6280
Fax: (08) 9322 5564
e-mail: sothertons@sothertons-wa.com.au

