Tax and Small Business: Navigating the ATO minefield as June 30 draws closer

The small business sector has variously been described as the engine room of the economy, as well as the biggest employer in the country – and it’s not hard to see why. Recent research undertaken by the Council of Small Business Organisations of Australia (COSBOA) showed that small businesses were responsible for generating 5.1 million jobs, or around half of private sector employment. The Tax Office says that there are about 3 million small businesses in Australia, including primary production concerns, which represents around 96% of all business.

What is a small business?
The definitions of what constitutes a small business are not consistent however. The Australian Bureau of Statistics defines a small business as having less than 20 employees, while for the purposes of corporation law it is set at fewer than 50. From a tax perspective, the bar is set at having annual turnover of less than $2 million.

To stop businesses splitting activities so they can slip under the $2 million threshold and gain access to the various tax concessions, the law stipulates that turnover needs to be made from the ‘aggregated’ amounts, which basically means annual turnover (which is gross income, excluding GST) of every ‘connected’ or ‘affiliated’ business.

The one thing that everyone agrees on however is the central role that small business plays in the Australian economy. Just how important can be underlined by the fact that the government gives the small business sector a break on a range of tax matters. Called small business tax concessions, there are several options that smaller enterprises can take up if they satisfy that $2m turnover test.

Tax Breaks for Small Businesses

*Instant asset write-off*
Between now and 30 June 2017, you can immediately write off any asset purchase costing less than $20,000.

Retailers are reporting a boom in enquiries and surveys indicate that the Treasurer’s message to go out and “have a go” has resonated with many taxpayers, who are rushing to take advantage of the new instant deduction.
Trading stock
The tax law provides a set of simplified trading stock rules where, if your trading stock has not changed in value over the tax year, either up or down, by more than $5,000, you can choose not to do an end-of-year stocktake and merely include the same stock value at year-end as at the start of the year – that is, as if no change had occurred.

Pre-paid expenses
A small business can also get an immediate tax deduction for certain pre-paid business expenses. If a payment covers an expense that goes over into the next financial year (like insurance premiums, membership to an organisation like Taxpayers Australia, or rent) you can claim that deduction in the current income year.

GST
Taking care of your GST obligations can be made less of a headache as well, as eligible businesses are only required to account for GST once payment is received. On top of that, you can also pay GST in instalments, and the Tax Office will work out for you how much the instalments are. A small business can also, if using some items for private uses, choose to claim the full GST credits and make one single adjustment for the percentage of private use at the end of the tax year.

Another concession available to small business concerns pay-as-you-go tax instalments, where you can pay a quarterly instalment that is worked out based on your most recently assessed tax return. The income recorded there is adjusted to align with the latest increase in gross domestic product, and will save you the time and the effort in having to do the ‘long form’ calculations.

Help for capital gains tax
The special small business CGT concessions are in addition to the 50% general CGT discount applying to individuals, trusts and super funds (but not companies).

There are four CGT concessions that may be available to eliminate or reduce capital gains made by a small business or its owners where it disposes of “active” assets. “Active” assets include goodwill, trademarks and business premises but do not extend to passive assets such as an investment portfolio. The reliefs are available to businesses which are small business entities (ie, they carry on a business and satisfy the $2m turnover test) or where the net CGT as sets of the taxpayer (plus its connected entities and affiliates) do not exceed $6m:

1. **The 15 year exemption.**
   Available where a taxpayer who is at least 55 years of age and is retiring disposes of a CGT asset that has been owned for a minimum of 15 years.

2. **The retirement exemption.**
   A taxpayer may apply capital proceeds from the disposal of a CGT asset to the retirement exemption, up to a lifetime maximum of $500,000 – as it is not necessary to actually retire, the concession can be utilised more than once.

3. **The 50% active asset reduction.**
The capital gain arising from the disposal of a CGT asset may be discounted by 50%, but there are specific rules about what qualifies.

4. **The CGT rollover.**
   A capital gain arising from the disposal of a CGT asset may be deferred provided a replacement asset is acquired within a two year period – the gain is deferred until disposal of the replacement asset.

**Don’t blur the lines between the company’s money and your own**

Many small businesses get caught out by the so-called „deemed dividend” rules. Under tax law, loans and advances to private company shareholders or their associates are deemed to be taxable unfranked dividends for the shareholders. The intention of these rules is to stop the profits of private companies being distributed to shareholders as tax-free „loans”.

So, if you find yourself borrowing money out of the company of which you’re a shareholder, try to ensure those borrowings are repaid by the time the company’s tax return for the year is due. If that isn’t possible, declare a dividend and treat the amount as income, in which case, the dividend would be franked if applicable.

Alternatively, enter into a complying loan agreement, complete with commercial interest and capital payments and a defined loan period.

Look out too for the tax consequences of the private use of company assets for less than market value, because this can also be caught by the deemed dividend rules. The amount of the deemed dividend is equivalent to the arm’s length price that would have been paid for the use of the assets, less any amount actually paid for the use.

To get round that, it’s worth considering transferring the asset to the shareholder in lieu of a cash dividend, a so-called „in-specie” dividend. Whether that’s cost-effective will depend on what the market value of the asset actually is. Alternatively, if the shareholder has previously lent money to the company, the asset could be transferred to the shareholder as a repayment of that loan, subject to valuation.

**The Golden Rule - Keep Records!**

Good record keeping is your best friend for efficient business management and will also make life easier if the Tax Office ask you questions. Tax law requires that records be kept for five years, and they should include:

- sales receipts
- expense invoices
- credit card statements
- bank statements
- employee records (wages, super, tax declarations, contracts).
- vehicle records
- lists of debtors and creditors
- asset purchases.

Records can be kept on paper or electronically, but should be easily retrieved. In my experience, businesses often stumble when asked by the Tax Office to verify transactions by providing supporting records, with the
consequence that even “innocent” businesses can find themselves stung by the tax man where they are unable to provide the requested evidence.

And what about your deductions?

You’ve got to spend money to make money, right? And if you spend it to produce ‘assessable’ income, then your business will usually be entitled to a tax deduction. Many businesses trip up by inflating their deductions or claiming for something they shouldn’t, but a surprising number also miss out on deductions they could have claimed. In reality there are legitimate, not-to-be-forgotten deductions that almost every business can take advantage of.

The basic rule of course, to keep your nose clean and yourself out of hot water, is that you need to show you are actually ‘out-of-pocket’, and that the expense has been incurred to run your business. Here then are some tax deductions you may be able to claim:

**Advertising and sponsorship**

Costs to push your brand and garner publicity for your business are deductible and can be claimed, as can advertising or sponsorship to sell ‘trading stock’ and to hire staff. Take care to ensure that the costs incurred do not fall within the definition of ‘entertainment’, which is not usually deductible.

**Bad debts**

A debt that is unpaid and deemed to be a ‘bad’ debt is an allowable deduction as long as it was included as assessable income in the present or even a previous income year, and that it is written off as bad (uncollectable) in the same year that a deduction is claimed.

**Borrowed money**

Expenses incurred in order to get the borrowed funds can be claimed as a deduction, the proviso being that the money must be used to produce assessable income. These expenses can include legal costs, registration fees, valuation costs, fees to guarantee an overdraft and any commissions paid. But you may have to spread the deductions over more than one year, depending on the extent of the expenses, to cover for example the period of the loan. These deductions are quite separate from the interest actually incurred on the borrowed funds, which is also deductible if the borrowed money is used to produce income.

**Business travel**

You need to record and document all particulars, but travel for business purposes can usually be claimed. So keep all receipts and your itinerary or diary, and of course airline tickets. Note the nature of the travel, its purpose, and where, when and for how long (and look out for any personal activities that are mixed in as these expenses are non-deductible).

**Car expense deductions**

You can claim a full deduction for any expenses your company incurs while running a vehicle, either leased or owned, provided the vehicle is used only for business purposes. If your business operates as a sole trader or
partnership, you can claim certain proportions of deductions for vehicle expenses, but they are subject to substantiation rules.

**Fringe benefits**
You can generally claim a deduction for any costs involved with providing a fringe benefit to an employee.

**Home work claims**
If your work is done from home, or partly home-based, you can usually claim deductions for expenses such as interest, telephone, insurance and a portion of running expenses like heating, lighting or cleaning.

**Insurance**
Workers compensation insurance premiums are deductible, as are insurance costs for fire, business-use cars, public liability, theft and loss of profits.

**Plant and equipment (depreciating assets)**
Larger items like cars or even buildings can be claimed over time as depreciating assets. And you may also be able to claim (over a five year period) certain capital costs in setting up or ceasing a business, as long as an outright deduction is not able to be claimed for that expenditure.

**Repairs, replacement, maintenance**
A deduction is available for the upkeep of machinery, tools or premises used to produce assessable income (provided they are not ‘capital’ costs). These deductions include things like painting, plumbing and electrical maintenance, upkeep to windows and fences, guttering and machinery maintenance. Generally it means fixing defects, not totally replacing an item, and does not include improvements or work done immediately after acquiring an asset.

**Superannuation contributions**
You can claim a deduction for a contribution made to your own super fund if self-employed, although care must be exercised if you also have some earnings from employment upon which super contributions have been paid by the employer. Contributions to an employee’s fund should also be deductible. Employers legally have to contribute to employees’ super anyway under the superannuation guarantee laws.

**Salary and wages**
Operating as a trust or a company means you can claim a deduction for salary paid to employees or to yourself provided the salary is in respect of duties connected with the business. Partnerships can’t claim for salary paid to a partner, but a deduction is available for salary paid to other employees. Sole traders can’t claim for salary paid to themselves (and you can’t claim for amounts taken from the business for private purposes).

**Tax management expenses**
Managing your business tax affairs can cost, and you can claim these as deductions. This includes paying a bookkeeper, having a tax agent prepare and lodge tax returns and activity statements, attending to a tax audit or the costs of appealing or objecting to an assessment.
**Telephones**

For a telephone you use for business only, you can claim for calls and rental, but not installation. If the phone is used for both business and private calls, you're able to claim all business calls and a proportional part of the rental. An itemised phone account will guide this, but you can also base the claim on using a representative fourweek period to get an average rate for the whole year.

**Theft**

Losses incurred by theft or stealing by an employee may be allowable deductions.

**For further information please contact:**

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