Tax time 2012: Best year-end strategies for SME owners

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Michael Laurence
www.smartcompany.com.au

Astute SME owners will carefully coordinate their personal and business end-of-year tax strategies to make the most of changing tax-saving opportunities and to sidestep a range of looming tax traps.

From a personal perspective, there are compelling reasons for many super fund members to maximise their concessional contributions before July. However, beware of the mounting risk of overshooting the contribution cap in a rush to contribute.

And the depressed state of the property and share markets is an extra incentive to consider transferring selected assets into the name of lower-taxed spouses and self-managed super funds (SMSFs). This is because less capital gains tax (CGT) and stamp duty are payable than when prices are high.

Further, a significant increase in the tax-free threshold from 2012-13 will encourage more investors to make arrangements now to split income with their spouses who may have little or no other income.

From an SME tax perspective, business owners should immediately check their eligibility for the small business tax regime. Perhaps there is still time to take action before the end of the financial year if necessary to fall back within the turnover small business threshold.

And business owners should consider deferring the purchase of assets, including new motor vehicles, because much large immediate deductions are available from July.

Finally, SME owners should pay close attention to the classic end-of-year tax strategies of deferring income where possible until July 1 while maximising deductions by June 30.

Here are our best personal and business end-of-year tax strategies for SME owners:

Maximise super contributions

Strategy: Super fund members have a powerful incentive to maximise super contributions before July 1. Don't overlook that 2011-12 is the final financial year before the standard cap for concession contributions by members over 50 is halved from $50,000 to the indexed $25,000 that applies to other fund members.

Detail: Concessional contributions comprise salary-sacrificed and compulsory contributions as well as personally-deductible contributions by the self-employed and non-employed investors. (The Government is considering keeping the cap at $50,000 for members over 50 with less than $500,000 in super.)

Sydney tax and superannuation lawyer Robert Richards, principal of Robert Richards & Associates, suspects that many fund members don't realise how much they are throwing away in tax breaks by failing to take full advantage of the contribution caps. For top marginal taxpayers, a $50,000 deduction for a concessional contribution is worth $15,750 in their hands (after allowing for the 15% contributions tax).

And for super fund members under 50, it's worth contributing as much as possible into super as non-concessional (after-tax) contributions within the higher annual caps applying to these contributions because of the highly-concessional taxation of super.

"Most people don't think about maximising their super contributions until it's too late," says Richards. "They tend to concentrate on paying off their mortgages and paying school fees – waiting until they are in their fifties before worrying about super. But the contribution caps make it then very hard to catch up."

Avoid excess contributions

Strategy: Don't make the mistake of thinking that only a few people overshoot their concessional contributions or non-concessional contributions caps. Far from it!

For 2009-10, the ATO issued a breathtaking 45,350 assessments for excess contributions. And the numbers of excess contributions could rise sharply in 2011-12 given that many fund members are likely to contribute as much as possible before the halving from July of the standard concessional cap for members over 50.

Detail: The tax costs for making excess contributions can be enormous. Excess non-concessional contributions are taxed at 46.5% while excess concessional contributions are taxed at 31.5% – plus the standard 15% contributions tax.

This means that contributions that overshoot both caps are taxed at a jaw-dropping 93%.

Certainly, this is the first financial year when members who exceed their concessional contributions cap by up to $10,000 can request a refund of the excess. But don't let this lure you into a false sense of security – once used, this escape route is lost forever.

And the escape clause won't help if you overshoot the cap by a huge amount; perhaps through no fault of your own.

Take care with negative gearing

Strategy: Avoid the trap of rushing headlong into negatively-geared shares or property in an effort to make up for lost tax breaks with the imminent halving to $25,000 of the standard concessional contributions cap for members over 50.

Understand the possible opportunities with negative gearing but don't overlook the extra risks involved. (***SmartCompany*** examined this issue late last month.)

Detail: It is, however, understandable that many taxpayers will now hunt for new tax breaks. The halving of these caps means that super fund members with a marginal tax rate of 46.5% will lose tax savings of up to $7,875 a year from 2012-13 while those with a 38.5% marginal rate will lose up to $5,875 a year.

You may consider that the depressed state of the residential property market and the fact that some commentators regard the highly volatile sharemarket as cheap means that negative gearing is worth considering.

But never overlook the risks involved – while gearing magnifies potential capital gains, it also magnifies potential capital losses.

Understand extra incentive to split income

Strategy: Minimise tax by earning as much investment income in the name of a lower-earning, lower-taxed spouse, says Richards. And understand that, depending upon your family's circumstances, there may be a much stronger incentive to split income from July 1.

The tax-free threshold will more than triple to $18,200 from 2012-13. This may provide an excellent income-splitting opportunity if your spouse earns a low-income or has no income.

Detail: A standard income-splitting strategy is to hold as many investments as feasible in the name of a lower-earning spouse. This means that less tax is payable on income – if an investment is not negatively geared – and less CGT is payable when an investment is eventually sold.

Transfer property or shares to save tax

Strategy: Richards suggests that SME owners and investors consider taking advantage of low property and share prices to transfer assets from their names to a lower-earning spouse or to their concessionally taxed self-managed super fund.

Detail: Some investors may choose to take transfer assets to a spouse or SMSF when prices are depressed because less CGT and stamp duty are payable than when prices were higher. However, the feasibility of this strategy depends on the circumstances.

Obviously, it is usually more tax-effective to hold a negatively-geared investment in the name of the higher income-earner. But it could be a different issue when an investment's income is enough to at least meet the interest payments on the investment loan.

The investments could be transferred or contributed to your SMSF. However, there are a couple of key points to keep in mind: the annual contribution caps and the bar on super funds from acquiring residential property from their members.

Check eligibility for small business tax regime

Strategy: Small business owners should regularly check the eligibility of their enterprise for this regime – and, if possible, make adjustments to fall within the threshold.

Detail: Small business entities (individuals, partnerships, companies or trusts) with a turnover of less than $2 million are eligible for a range of tax benefits including simplified depreciation, CGT concessions/exemptions, accounting on a cash (rather than accrual) basis, and simplified depreciation rules allowing an immediate tax deduction for assets costing less than $1,000.

Significantly from 2012-13, the value of assets that small businesses can instantly write-off rises from $1,000 to $6,500. And also small businesses can claim an accelerated initial deduction of $5,000 for motor vehicles acquired from July 2012. (See next strategy about deferring asset purchases until next year if appropriate.)

The CGT concessions/exemptions, for instance, may markedly reduce or even eliminate tax on multi-million dollar capital gains from the sale of a small business.

Basically, an eligible small business is entitled to CGT exemptions, discounts or rollover relief on the sale of "active" assets. The special small business CGT concessions are in addition to the 50 per cent general CGT discount applying to individuals, trusts and super funds.

"Active" assets include goodwill, trademarks and business premises but do not extend to passive assets such as its investment portfolio.

If your business is at risk of exceeding the $2-million turnover threshold in 2011-12, strategies to consider include deferring collection of income until the new financial year.

If your business does not have a turnover below $2 million, you may still be eligible for the small business CGT concessions if certain net assets do not exceed $6 million.

As Richards explains, the net market value of the vendor's business assets, personal bank accounts, personal investment portfolios and personal investment properties – as well as those of their business partners, spouses, children under 18 or any entities or people under their control – count towards the $6-million threshold.

Astute business owners can adopt a number of strategies to try to stay longer within the $6-million threshold by putting money into assets that do not count towards the limit.

Such strategies, says Richards, include: upgrading your family home, buying a holiday home, helping your children pay the deposit on their first homes, making extra-large super contributions, buying a luxury car or boat, or taking an overseas holiday. None of these count towards the $6-million threshold.

Defer purchase of small business assets

Strategy: Sue Prestney, a principal and family business specialist with accountants and business advisers MGI in Melbourne, suggests that "it may be very worthwhile" for some small businesses to defer the purchase of assets until July.

Detail: From July, 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 acquired from July 2012. (See previous strategy.)

Watch private company loans

Strategy: Immediately take steps to try to ensure you don't get caught having to pay tax on deemed dividends.

Under tax law, loans and advances to private company shareholders or their associates are deemed as taxable unfranked dividends – unless formal loan agreements are in place, with interest and capital payments meeting minimum standards.

The intention of the measure is to stop profits of private companies being distributed to shareholders as tax-free "loans".

Detail: Paul Banister, a tax partner with accountants Grant Thornton in Brisbane, says a company could do *one* of the following by the time its 2011-12 tax return is due to stop their shareholders or their associates facing deemed dividends:

- Make sure the money is repaid.
- Declare a dividend and treat the amount as income. (In this case, the dividend would be franked if applicable.)
- Enter into a complying loan agreement.

But what should a private company do regarding loans to shareholders or their associates from past financial years that are undocumented and insufficient payments have been made?

Banister says the company should ensure that a complying loan agreement is in place, and bring interest and capital payments up-to-date. And then the shareholder should ask the tax commissioner to exercise his discretion to provide relief from the deemed-dividend provisions.

Watch for tax trap with use of company assets

Strategy: Understand that use of private company assets by shareholders or their associates for less than market value is caught under the deemed dividend provisions in tax law.

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 paid for the use.

Detail: Sue Prestney suggests that SME owners gain advice about whether it is feasible to transfer the asset involved out of the company. "Every situation is different."

The asset could be transferred to a shareholder in lieu of a cash dividend. Perhaps the shareholder lent money to the company and the transfer of the asset could be treated as a repayment. Depending upon the circumstances, the transfer of the asset to the shareholder might be at little cost, no cost or too costly to contemplate.

Prestney explains that if a company transfers the asset out of the company before the end of the financial year, there could still be deemed dividends for previous private use.

Be aware of unpaid trust distributions – one

Strategy: SME owners should know that unpaid trust distributions (known as unpaid present entitlements) of an associated private company beneficiary could be treated as deemed dividends.

Detail: Sue Prestney says that under a 2009-10 ruling, the tax commissioner regards such unpaid distributions as a kin to a loan from the company to the trust. In Tax Office speak, there has been the "provision of financial accommodation". (The tax ruling applies to unpaid distributions from December 16, 2009.)

Prestney suggests a way for trusts to deal with this issue is to have a sub-trust arrangement whereby the money representing the unpaid distribution or entitlement is held by the trust for the sole benefit of the company.

Alternatively, but not preferably, a complying loan agreement could be entered into by the time the tax return is due, providing for minimum interest and capital payments.

Be aware of unpaid trust distributions – two

Strategy: Understand the tax risk if a trust's taxable income differs from its distributable income. In short, your trust could be liable for tax even if it has no income to distribute.

Detail: Paul Banister explains that a trust's taxable income includes grossed-up dividends (allowing for franking credits), capital gains and certain deemed income from investments in foreign structures.

A trustee that doesn't have any distributable income can have its taxable income subject to the highest marginal tax rate of 46.5% (without the benefit of the standard CGT discount).

Further, Banister says trustees should ensure that distributions are made in accordance with their trust deed.

Contribute business sale proceeds to super

Strategy: Take advantage of a special opportunity to make extra-large super contributions by contributing certain proceeds from the sale of your small business.

Detail: Non-concessional contributions using proceeds from the disposal of small business assets that quality for certain CGT exemptions (the 15-year ownership or the retirement exemptions) do not count towards the standard contribution caps if within a lifetime limit. The indexed limit for 2011-12 is $1.205 million.

Pay dividends from cashed-up companies

Strategy: Small business owners could arrange for their private companies to pay fully franked dividends by June 30 to adult shareholders outside the paid workforce. In turn, such shareholders – who might include the owner's spouse – could contribute the money to super as a deductible personal concessional) contribution. (It is, of course, vital from a tax perspective to stay within the contribution caps.)

This strategy is intended to extract money from a cashed-up private company in a highly tax-effective way.

Detail: As mentioned earlier, eligible super fund members – including the self-employed and non-employee investors – can claim deductions for their concessional contributions. And depending upon their circumstances, the non-working shareholders might receive a refund of the franking credits from their dividends.

Consider delaying private company dividends

Strategy: As an alternative to the previous strategy, Richards says some private companies choose to delay the payment of dividends until after June 30 if it suits the tax circumstances of their shareholders.

Detail: For example, a soon-to-be-retired shareholder may be planning to take a superannuation pension early in the new financial year. The tax-free treatment of a super fund's assets backing a pension means the person can earn high dividends from shares held outside super without paying extra tax – beyond absorbing their franking credits. Much depends on the size of an individual's non-superannuation income.

Don't overlook classic strategies for small business

Strategy: A fundamental end-of-year tax strategy for small business is to defer as much income and capital gains as possible until after June 30 and to accelerate deductions in this tax year where possible.

Detail: Ways to defer tax include delaying the issuing of invoices and postponing asset sales (if justifiable for non-tax reasons and provided payment of the invoices and asset sales are not put in jeopardy).

Eddie Chung, a tax partner with accountants BDO in Queensland, says some taxpayers who defer CGT by delaying asset sales until next financial year enter a put-and-call option. If exercised, the option obliges other parties to buy within a certain time – therefore not putting the transaction at risk.

Chung says taxpayers should have a commercial justification for delaying a sale, which may include uncertainty about the availability of finance in the short-term. As Richards warns, the tax commissioner may apply the anti-avoidance provisions if a taxpayer’s dominant motive for delaying a sale was to save tax.

Ways to accelerate deductions include prepaying such expenses as loan interest and insurance premiums for up to 12 months in advance, and carrying-out last minute maintenance to business or investment properties.

Write-off bad debts

Strategy: Check through your list of debts and decide whether you should write any off, suggest Richards.

Detail: Under the accruals method of reporting income, bad debts are generally deductible. However, bad debts must be written-off in the same income year as the deduction is claimed.

Offset CGT with super contributions

Strategy: If you are selling an investment for a capital profit this financial year, consider maximising your concessional super contributions before July 1, suggests Richards.

Detail: As discussed, eligible super fund members – including the self-employed and non-employee investors – can claim deductions for their concessional contributions. In turn, the deductions may offset the CGT payable on the capital gain.

Make sure your SMSF pays minimum pension

Strategy: Understand that if your SMSF doesn’t pay the minimum superannuation pension, assets backing the pension payment could lose their tax exemption.

Detail: For 2011-12, the minimum pension payable ranges from 3% to 10.5%, depending upon age.