



MARSHALL MICHAEL CHARTERED ACCOUNTANTS

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Employers: Beware “left- field” FBT liabilities

It is generally understood that for fringe benefits tax (FBT) to apply, the benefits paid are usually in respect of an employment relationship.

About this newsletter

Welcome to the Marshall Michael client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes affecting you. Should you require further information on any of the topics covered, please contact us via the details below.

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Where some businesses have tripped up in the past – however is where this relationship is not clear cut – that is, where non-cash components of remuneration are sourced not directly from you as an employer, but from an associate, a related company or from a third-party provider. Certain family arrangements may also (but not necessarily) trigger FBT.

The arranger provisions

The FBT law provides that an employer can be liable for FBT even if benefits are provided to staff by third parties or by an “associate” of your business. In other words, there could still be an FBT liability even if provided indirectly.

For example, arrangements to which these provisions might apply would normally include employees who receive goods directly from your suppliers.

For a liability to arise, it is generally accepted that you must have been party to the arrangement or had been knowingly facilitating the provision of the benefit. In some cases, allowing an employee to receive a benefit in these circumstances may be sufficient to result in it being considered an arrangement for FBT purposes.

Arranger provisions and meal entertainment

It is not necessarily the case that you would be held liable for FBT for meal entertainment where you merely allow an employee to, for example, go out to lunch with a client where the client provides the meal, or to attend a function provided by a third party.

Where you need to be careful however is where it could be inferred that you “entered into an arrangement” with a third party that includes providing such a benefit to your staff member, such that:

- the meal entertainment was provided under an agreement between you the employer and the third party, or
- you knowingly participated in the provision or receipt of such entertainment — for example putting in for drinks at a function organised by the third party, or making premises available, or
- your business promoted or participated in a scheme under which the meal entertainment was provided by the third party (such as by encouraging sales staff to participate in a product promotion organised by the third party).

If you are unsure of whether the arrangement is caught under the arranger provisions, please contact this office for further details.



FBT changes for work related laptops, tablets, etc

For the current FBT year, an FBT exemption applies in respect of eligible work-related items (such as a portable electronic device, an item of computer software, and a tool of trade). However, in respect of a work-related portable electronic device (for example a laptop computer or a tablet), the exemption generally does not apply to multiple items provided by an employer to an employee in the one FBT year where those multiple items have “substantially identical functions”.

But in the upcoming FBT year (that is, from 1 April 2016), the law has been changed to allow an FBT exemption for small businesses with an aggregated annual turnover of less than \$2 million that provide employees with more than one qualifying work related portable electronic device, even where the items have substantially similar functions.

According to the government, the proposed change will remove confusion where there is a function overlap between different products — such as between a tablet or laptop. Businesses which do not satisfy the meaning of small business are still governed by the old rules.

CASE STUDY

Stephanie is employed by an accountancy practice that provides taxation advice to cricketers. The cricketers often arrange free tickets for Stephanie and her partner to attend matches and corporate functions that precede them on match days. The partners of the accounting practice encourage her to take up these offers as they provide an opportunity for business networking.

It is likely that a benefit has been provided, by a third party, which arises in respect of Stephanie's employment. This would generally make the benefit subject to the FBT provisions, resulting in her employer having an FBT liability.

Specifically “outside” the FBT net

The ATO has ruled out a number of specific examples of benefits under family arrangements that it deems to be outside the scope of FBT law.

These include:

- a birthday present given to a child who works in a business run by the parents
- a wedding gift given by parents to an adult child who had some years earlier worked after school in the family business
- an interest-free or concessional loan given to such a child for the purpose of buying a matrimonial home
- the value of meals and accommodation provided to children of a primary producer in the family home where they work on the family farm
- the rental value of a farm homestead occupied by a family whose private company conducts the farming business in which they work and holds the title to the homestead
- the value of accommodation provided free in the family home to a child apprenticed to his/her parent as a motor mechanic, and
- the administration costs of an employer in providing fringe benefits.



FURTHER “LEFT FIELD” FBT FACTS

Here are some other FBT fun facts that you may find useful.

- Shopping centre car parks that provide free parking for an initial period (the first two hours, for example), and thereafter charge a fee based on time (to discourage all-day parking), are not considered by the ATO to be “commercial parking stations” for the purpose of determining if there is a car parking fringe benefit.
- Where a mobile phone or similar item is treated as an exempt work-related item and the monthly call costs are exempt, the exemption will typically extend to internet data usage fees.
- Where a loan is made in respect of employment to an employee who is also a shareholder of a private company, there is no loan fringe benefit if the loan amount (or residual un-paid balance) is deemed to be a dividend made to the borrower under tax law. Ask this office for more details. ■

Rental properties: ATO focus on “initial repairs”

The ATO is focusing on claims that investment property owners make for repairs to rental residences that it deems to in fact be “improvements”.

The scenario where investment properties have work done on them often happens shortly after the property is purchased, and has led to the term “initial repair” being commonly used when discussing the tax implications of such property works.

Keep in mind that generally such costs are on capital account, and therefore not specifically deductible under rules that allow for a particular deduction for repairs and maintenance costs. Instead, a deduction may be claimed for depreciation under the uniform capital allowance provisions or the capital works provisions.

The following scenario from the ATO illustrates this:

A taxpayer recently claimed repairs and maintenance for a newly acquired rental property, which was significantly improved upon purchase. The taxpayer provided an invoice from an interior developer for the “refurbishment” of the property.

Further documentation detailed the scope of the refurbishment, which included completely stripping the property and replacing old fixtures and fittings with new. The large repairs and maintenance claim was disallowed because initial repairs and improvements to a property are not deductible.

The ATO has asked some taxpayers for evidence that such costs are not initial repairs if they disclose repairs and maintenance costs in their tax return.

Repairs vs improvements

The ATO has issued guidance that sets out considerations in deciding whether or not an expense is an “improvement”:

- whether or not the thing replaced or renewed was a major and important part of the structure of the property
- whether the work performed did more than meet the need for restoration of “efficiency of function”, bearing in mind that “repair” involves a restoration of a thing to a condition it formerly had without changing its character
- whether the thing was replaced with a new and better one, and
- whether the new thing has considerable advantages over the old one, including the advantage that it reduces the likelihood of repair bills in the future.

If the answer to some or all of the above considerations is “yes”, then the expenditure would likely be an improvement, and therefore not deductible. However, it may pay to check with this office if you have any doubts.

An example from the ATO’s guidance that distinguishes between a repair and improvement is as follows (and would have similar application to rental property owners):

Mary Fabrica owns a factory in which the bitumen floor laid on a gravel base needs repairing. She replaces it with a new floor consisting of an underlay of concrete topped with granolith (a paving stone of crushed granite and cement).

The new floor, from a functional efficiency (rather than an appearance) point of view, is not superior in quality to the old floor. The new floor performs precisely the same function as the old and is no more satisfactory. In fact, the new floor is more expensive to repair than the old.

Because the new floor is not a substantial improvement, it is a repair and its cost is most likely deductible.

Distinguishing between repairs or improvements can be tricky – contact this office for further information. ■



When can your SMSF's benefits be paid?

The money put aside in your self-managed superannuation fund (SMSF) is of course intended to be kept to fund the retirement of you and your fellow fund members. This is the over-riding obligation of you as trustee to adhere to the "sole purpose" test.

Accessing the money in an SMSF to pay benefits is generally only allowed when you reach what's called your "preservation age" and meet one of the specified conditions of release – for example, you turn 65.

YOUR PRESERVATION AGE

Your preservation age depends on when you were born (see table on page 5). It is determined by legislation, and will increase steadily so that by the year 2024 it will be set at age 60 for everyone born on or after July 1, 1964.

Significantly, the goalposts regarding preservation age only recently moved back by one year. Preservation age has been set at 55 years for anyone born before July 1, 1960 for years now. But from July 1 last year, this age has been increased by one year – in other words, if you thought you were approaching the preservation age milestone in the current financial year then you will have to wait another year to reach it.

The term "preservation" means that money in superannuation must remain in the fund until one of the specified conditions of release are met (more below). Super benefits are allocated to three preservation categories:

- preserved
- restricted non-preserved, and
- unrestricted non-preserved benefits.

Preserved and restricted non-preserved benefits must be retained in superannuation until a condition of release is met. The latter has a release condition dealing with ceasing "gainful employment", but it's a fine distinction and you should check with this office for more.

These two categories basically transform into unrestricted non-preserved benefits when a condition of release is met. Unrestricted non-preserved benefits can be accessed immediately, with no conditions of release having to be met.

Unrestricted non-preserved benefits are generally from certain amounts that were accumulated before July 1, 1999, when the legislation to preserve superannuation savings came in.

CASHING OF BENEFITS

Getting money from an SMSF is known as "cashing of benefits" and can be paid as a lump sum or by starting a pension. Note that there are restrictions about which form of payment can be made. When you can apply for the cashing of benefits depends on both preservation conditions and meeting a condition of release.

The law spells out in some instances the form that cashing of benefits must take, known as "cashing restrictions", and your SMSF's trust deed might also stipulate rules for paying benefits.

All forms of payments are "voluntary" cashing of benefits in that the member, once eligible, can decide to cash benefits. One exception however is the death of a member when benefits must be "compulsorily" cashed out.

CONDITIONS OF RELEASE

The most common conditions of release for paying out benefits are:

- **Retirement:** Actual retirement depends on your age and, for those less than 60 years of age, future employment intentions. A retiree can't access their preserved benefits before they reach preservation age.
- **Transition to retirement (attaining preservation age):** If you are under age 65 and have reached preservation age, but remain gainfully employed on a full-time or part-time basis, you could access some benefits as a “non-commutable income stream” (meaning it cannot be withdrawn as a lump sum). Ask us if you'd like to know more about these income streams.
- **Attaining age 65:** If you reach age 65, you may cash your benefits at any time. There are no cashing restrictions — but it's not compulsory to cash out benefits merely because you reach a certain age.

There are a number of other circumstances in which benefits can be released, such as incapacity, severe financial hardship, a temporary resident leaving Australia, terminal illness or injury.

- **Incapacity:** If, due to ill health, you have to cease gainful employment and are unlikely to regain work for which you are qualified, benefits may be cashed with no restrictions. If the end of gainful employment is due to a temporary state of health and is not a permanent condition, temporary incapacity benefits may be paid as a non-commutable income stream. This is generally up to the level of income received before the temporary incapacity, and includes salary support insurance or sick leave payments.
- **Severe financial hardship:** Releasing benefits on these grounds depends on being able to show that you cannot meet living expenses and have been on

government income support for either 26 weeks (if before reaching preservation age) or 39 weeks (having reached preservation age). There are also restrictions on payment amounts, and advice is recommended.

- **Compassionate grounds:** Until recently, the Australian Prudential Regulation Authority (APRA) had the discretion to release benefits on compassionate grounds, but the role has now been taken over by the Department of Human Services. Early release is generally done for things like treating life threatening illness, palliative care or other medical support, or to prevent foreclosure on the family home. The amount is determined by the government, and must be made as a lump sum.
- **Temporary resident leaving the country:** Eligible temporary resident visa holders who permanently leave Australia can apply to the ATO to have accumulated superannuation benefits paid out. Ask this office for more details.
- **Terminal illness:** On confirmation of diagnosis of a terminal medical condition, all benefits can be deemed unrestricted non-preserved and can be cashed out. Prescribed certification from medical practitioners will be required.

PENALTIES FOR IMPROPER EARLY ACCESS

Setting up or using an SMSF to gain improper early access to superannuation benefits is illegal and this area has become a focus for the ATO given the increasing number of SMSFs and the apparent variance of trustee knowledge in the area of withdrawing benefits. If a benefit is unlawfully released, the ATO may apply significant penalties to trustees, to the SMSF itself, as well as the recipient of the early released payments. ■

YOUR PRESERVATION AGE

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 - 30 June 1961	56
1 July 1961 - 30 June 1962	57
1 July 1962 - 30 June 1963	58
1 July 1963 - 30 June 1964	59
After 30 June 1964	60



Get your “personal service income” affairs in order for 2016

It is not uncommon for professional people who provide services to set up a separate entity to run their business, be it a trust, partnership or incorporated company.

The allure of course is the lower tax rate that these entities can secure, rather than at the top marginal rate of 47% (or 49% with the Temporary Budget Deficit Repair levy) that an individual would generally wear.

Running a business through such a structure can also lead to a wider range of deductions being available, depending on circumstances. To stop taxpayers dodging their full share of tax, the tax law however has in place a set of rules.

The PSI rules

The measure comes under the banner of “personal services income” (PSI), which broadly defines such income as “a reward for an individual’s personal efforts or skills”. This excludes the sale of goods, as with a retailer or manufacturer, or only using a physical asset like a truck or tractor to generate that income.

As PSI is income produced mainly from personal skills or efforts, you can derive PSI in a wide variety of industries, trades or professions. However, some common examples include construction workers (such as tradies), financial professionals, information technology consultants, engineers and medical practitioners.

The PSI rules operate as an integrity measure to prevent individuals using an entity to direct their income to a lower taxed environment (such as a company) and to access a larger suite of general deductions.

So if, for example, your business structure is assessed to be contrived (an assessment that is based on a series of tests), then income your business earns will be treated as being earned by you as a contractor individually, and taxed at your personal rate rather than taxed to the entity.

Therefore, the tax issues that come with PSI are often misunderstood and can trap the unwary if the ATO’s auditors come calling.

The ATO’s PSI tool

To make things easier, and to help with your tax planning for the year ahead, ask this office about accessing the ATO’s recently developed online “decision tool” to assist you to work out whether you will or have earned PSI, and if the PSI rules will apply to that income.

We can probably help you with a lot of the information required. To answer the questions in the PSI decision tool you may need:

- details of contracts or written agreements with your business’s customers during the income year
- invoices from work performed during the income year
- records of payments to any employees or subcontractors.

What this PSI tool gives you

After answering a series of questions, the tool will provide you with a report that gives you:

- guidance on whether your income is PSI and if the PSI rules apply to you
- a summary of the responses you have provided
- information about what your result means for your tax obligations.

Once done you can save or print a copy of the report, which we can keep for you with your other tax records. We can discuss the outcomes with you to help you plan your tax affairs.

The ATO says that in most cases you will be able to rely on the result provided by the tool, but in our experience, depending on your circumstances, it could be better to apply for a “personal services business (PSB) determination”.

Ask this office if you need help or advice. ■



Going from sole trader to company

Whether you've been in business for years or you're just starting out, choosing the right structure for your business is important. It is a consideration that is not only important from the start, but as your business grows and develops.

The business structure that you build your business on can determine:

- how much tax you pay
- your responsibility as a business owner
- your potential personal liability
- your asset protection, and
- ongoing costs and volume of paper work for your business.

When you first started in your venture, it would probably have seemed an achievement just to get it off the ground, and maybe you're proud of the fact that you're still in business and are making a go of it (or have your fingers firmly crossed!).

Changing business structures may be one of your lower priorities, and it's easy to stay with the status quo. But the fact is that depending on your circumstances there may be benefits to changing your business structure.

As the best decisions are based on clear facts, here are the basic differences between operating as a sole trader or a company:

KEY TAX DIFFERENCES

One of the basic differences that any business owner migrating their enterprise from sole trader status to that of a company is that the money that drives your business along is no longer coming from, or going to, your own hip pocket. Money will still come in the door, but will not be your own personal funds anymore.

Also as a company you will be required to lodge two tax returns. One will be your own personal return, as you usually would, and the other a company tax return — as both you and the company will be liable for tax. The tax rates that apply however will likely be different.

Tax rates and other key taxation differences are summed up in the table on the following page.

KEY TAX SIMILARITIES

There are some similarities of course. Your business tax rates may change due to structure, but your obligations for tax and superannuation are not based on structure. Therefore you may still need to register for pay-as-you-go (PAYG) instalments, and if there are employees you'll also have to pay the superannuation guarantee, withhold tax and issue PAYG withholding statements.

And whether your business is operated as a sole trader or company, you are



A director or secretary of a company must comply with a variety of obligations under the Corporations Act.

required to register for GST if the business's annual turnover is greater than \$75,000. Payroll tax of course depends on whether there are employees, but the rates and thresholds are set by each state government. Ask this office if you have any questions.

LIABILITIES

As a sole trader you are personally liable for all aspects of your business, including debts. So if things go bad and you have to liquidate assets to cover losses, your own personal assets may be liquidated. That means the things you've worked hard for — the family home and car, for instance — are potentially vulnerable in a dire situation.

A company is a separate legal entity (it exists under the law in its own right) and therefore has a degree of asset protection as the company is responsible for the company's liabilities. The company can enter into contracts, borrow money and buy and sell its own assets. So the business's debts, for example, will be met by the company, not you personally.

But, very importantly, you as company director are charged under regulations with ensuring the company meets all of its legal obligations — including taking care of debts and other financial matters, regulatory and reporting issues, looking after tax and super obligations such as PAYG withholding and super guarantee.

Failure to do so will attract not only severe penalties but in the worst instances, jail time. And as company director, you will be held personally liable, so any personal asset protection can be compromised.

MONEY MATTERS

As a sole trader, you can take money out of the business bank account as personal drawings. Your money is the business's money and vice versa. A separate bank account is not compulsory, although this could be a handy idea just to keep track of the business's finances.

But with a company, money earned by the business belongs to the business and a separate bank account is mandatory. As a director, the company may pay you a salary or "director fees", but you cannot simply put your hand in the till at random.

Sole traders cannot "retain profits". In the hands of the sole trader, profits are income that is taxed at the sole trader's personal marginal rate. Generally however, a company can decide to retain profits rather than distribute them to shareholders. The company can then use the retained profits to grow the business. The retained profits are taxed as income of the company.

You can also receive dividends from shares in the company or a loan. An important consideration with taking one of these forms of payment will be what is known as "Division 7A". This is basically an integrity measure to prevent the recipients from withdrawing funds from the company and avoiding tax (ask this office for more information if you're unsure).

If you are interested in transitioning from a sole trader structure to a company structure, make sure you are aware of all that is involved. Feel free to ask this office for help and advice. ■

	Sole trader	Company
What is the tax-free threshold?	\$18,200 for sole traders (individuals) in the 2015-16 income year.	There is no tax-free threshold for companies.
What are the income tax rates?	Sole traders pay tax at their individual income rates.	This is 30%. However, from the 2015-16 income year onwards the company tax rate for small businesses with an aggregate turnover of less than \$2 million is 28.5%.
What type of tax returns need to be lodged?	An individual tax return each year. Business income and expenses go in your individual tax return using a separate business schedule – you do not need to lodge a separate return for your business.	A separate company tax return needs to be lodged. You must also lodge your own personal return as an individual for income you earn via wages, shares, dividends or loans received from the company or any other sources of income.

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