



A | M | S

ARTHUR M SMITH  
& ASSOCIATES

## Accountants | Business & Tax Advisors

Information Newsletter - Tax & Super

April 2016



# Business assets, personal use?

Is there a problem with using your company's assets for yourself? Assets that belong to your business but that are being used for your own benefit or enjoyment can potentially trigger a tax issue known as "Division 7A".

### About this newsletter

Keep up-to-date with the latest tax news, advice, key dates & other important information.

Email: [admin@amsmith.com.au](mailto:admin@amsmith.com.au)

Telephone: (07) 4926 2383

Shop 2/248 Musgrave St, Berserker, QLD 4701

PO Box 5409, Red Hill Rockhampton, QLD 4701

Facebook: /arthurmsmithandassociates

© Content in partnership with **Taxpayers Australia**

You have set up running your business in a company to get all the "asset protection" advantages with a corporate veil. However, being a private company with most of the directors and shareholders being family or friends, company decisions can easily be skewed to benefit individuals. This may not be intentional as many of you would think of company assets as your own. However, considering that the corporate tax rate is 30% (or 28.5% in specific circumstances), and the highest individual margin rate is 49%, you can gain some tax relief from this arbitrage. Division 7A is designed to prevent this tax mischief.

**The Division 7A net is wide, and may potentially catch many transactions that, in substance, do not involve a distribution of profits ...**

#### WHAT'S DIVISION 7A?

Division 7A treats a payment or other benefit provided by a private company to a shareholder (or their associate) as a payment for income tax purposes. This integrity measure can apply even if the recipient treats the transaction as a gift, or a loan, or the waiving of a debt.

The Division 7A net is wide, and may potentially catch many transactions that, in substance, do not involve a distribution of profits, such as using a company's assets for private enjoyment. This is especially the case since the definition of "payment" was expanded to include the provision of assets.

#### CAN THIS HAPPEN IF I USE COMPANY ASSETS FOR PERSONAL USE?

Yes it can. Real tangible company assets are usually the biggest exposure that you may have to Division 7A without realising it, and may unintentionally fall out of any discussions you may have with us.

An example would be a holiday house that is owned by a company but is used by a shareholder of that company. The value of this use, under Division 7A, can be deemed to be a dividend and form part of the shareholder's assessable income.

There are certain exemptions that can apply however – for example, if the house was being used as a main residence. Check with this office for further information.

#### WATCH OUT FOR MOTOR VEHICLES

Another fairly common example concerns the provision of motor vehicles, but they are most likely caught by fringe benefits tax (FBT) rather than Division 7A because those vehicles are typically provided to directors in their capacity as employees despite those directors being shareholders (see panel at right). This starts getting quite complex, so please talk to this office if you have motor vehicles used in this manner by shareholders, directors or employees.

One of the results from the ATO's recent ramping up of its data matching activities has been an increased triggering of both Division 7A and FBT provisions after vehicles registered to businesses were found to be used privately by, respectively, shareholders or employees. ■

#### OTHER ISSUES TO CONSIDER WHEN USING BUSINESS ASSETS

If your transactions are subject to Division 7A, you may also need to consider some other areas of tax, such as FBT, issues related to share dividends or family law.

##### Fringe benefits tax

Division 7A does not apply to payments made to shareholders or their associates in their capacity as an employee or as an associate of an employee of a private company. However, such payments may be subject to FBT.

On the other hand, Division 7A does apply to loans and debt forgiveness provided to shareholders or their associates, even where such benefits are provided in their capacity as an employee or as an associate of an employee. To avoid double taxation, such benefits are not subject to FBT.

##### Dividend imputation, franking credits

Payments and other benefits taken to be Division 7A dividends are generally unfrankable distributions unless they are provided under a family law obligation. However the ATO has a general discretion to allow a Division 7A dividend to be frankable if it arises because of an honest mistake or inadvertent omission.

##### Family law

Payments and other benefits provided by a private company to shareholders or their associates as a result of divorce or other relationship breakdowns may be treated as Division 7A dividends and are assessable income of the recipient. However such payments or other benefits are treated as frankable dividends if provided under a family law obligation, such as a court order, a maintenance agreement approved by a court under the family law act or court orders relating to a de facto marriage breakdown.

# Death benefit nominations for your SMSF

A death benefit nomination is a written direction to SMSF trustees that instructs the trustee to pay a member's entitlements to certain dependants and/or legal personal representatives (their estate) in the proportions the member wishes in the event of their death.



With so much money tied up in superannuation, and more and more of Australia's retirement savings being managed under the direction of an SMSF trust deed, it is important to make sure any fund balance left over after one's time is up goes to the intended beneficiaries of your estate.

One misconception that many people have is that their normal "last will and testament" will safely distribute their estate, including money tied up in their superannuation fund. But the payment of benefits from an SMSF upon the death of a member is done in accordance to the governing rules of the fund, not according to the terms of a will.

This is why it is important for every member of an SMSF to direct how benefits are to be paid upon their death – and the death benefit nomination is the vehicle to make sure this is done.

## Nominations come in two flavours

The nomination can be binding – that is, it leaves no discretion to the trustee about how or to whom benefits are paid – or non-binding. The latter notifies the trustee of the member's preferred beneficiaries and the division of benefits, but leaves the final decision to the trustee (unless the governing rules of the fund provide otherwise).

A fund without a valid binding nomination will end up having benefits paid out according to the trust deed, if such provisions are included there, or see the trustee being guided, as appropriate, by any non-binding nomination, the late member's will or just simply exercising their own discretion.

The reasons some SMSF members may opt for a non-binding nomination can include that they may not have made their mind up about dividing up assets after they've gone, or because they know that superannuation law dictates that benefits can only be directed to dependants or legal personal representatives anyway. Or it can often be because as fellow SMSF members are family, the member assumes their benefits will end up in appropriate hands.

Also, leaving some discretion to the trustee allows for changed circumstances to be taken into account, particularly where a nomination was made some time ago

and relationships or dependencies have changed in the intervening period. The trustee can also consider the tax implications of any particular benefit distribution when the time comes.

A binding death benefit nomination, as noted above, leaves no discretion to the trustee. Benefits must be paid out in strict accordance to the nomination, which can be used to ensure no disputes arise between feuding relatives (or to exclude wayward children or estranged children's spouses).

Also a binding nomination made for an SMSF does not have to be renewed or reconfirmed every three years (which is a legal requirement for other types of super funds). They are sometimes referred to as "non-lapsing binding nominations".

However it has become accepted wisdom among superannuation industry circles that an SMSF member/trustee should consider refreshing a death benefit nomination every few years anyway, whether it is binding or non-binding – just to be certain that their wishes are satisfied and for further peace of mind, but also so that no future beneficiaries will have any reason to dispute or call into question the late member's intentions.

However making a death benefit nomination binding potentially adds another ongoing requirement for members – to make sure the nomination is updated and continues to reflect your wishes should there be a change in family circumstances. Such changes can include the death of a dependant, the birth of a new dependant or the end of a relationship. Otherwise a binding nomination for an SMSF will remain in force until the member changes or revokes it. Changing a death benefit nomination can be done at any time by completing a new nomination expressing the changed or new intentions of the member, and giving this to the trustee. The written notice needs to be signed and dated in the presence of two witnesses who are at least age 18, neither of whom is a nominee.

Ask us for help if these death benefit nominations are on your horizon. ■

# Considering a change of structure for your small business?

The final tranche of 2015 small business budget announcements have made it into law, now expanding the tax relief available for small businesses to change the legal structure of their business. This new arrangement is designed to provide greater flexibility for small businesses to change structures without incurring an immediate CGT liability, and allowing it to defer CGT to a later point in time.

From July 1, 2016, a CGT rollover relief may apply to:

- transfers of depreciating assets, where the balancing adjustment event arising from the transfer occurs on or after July 1
- transfers of trading stock or revenue assets, where the transfer is after July 1, and
- transfers of CGT assets, where the CGT event from this transfer is after the same date.

This new law is in addition to rollovers currently available where an individual, trustee or partner transfers assets to, or creates assets in, a company in the course of incorporating a business. The optional rollover will be available where a small business entity transfers an “active asset” to another small business entity as part

of a genuine business restructure, without changing the ultimate economic ownership of the asset.

Whether a restructure is “genuine” will be determined based on all of the facts and circumstances. Relevant aspects include whether it is a bona fide commercial arrangement undertaken to enhance business efficiency, whether the transferred assets continue to be used in the business, and whether or not it is a preliminary step to, as the bill puts it, “facilitate the economic realisation of assets”.

To be eligible for the rollover, both parties to the transfer must be either:

- a “small business entity” with \$2 million or more in turnover for the year during which the transfer occurs
- an entity that has an “affiliate” that is a small business entity for that income year
- “connected” with an entity that is a small business entity for that income year, or
- a partner in a partnership that is a small business entity for that income year.

Contact this office if you require further information. ■



## Boats, planes, cars, horses ... Data matching to uncover wealth

In the old days, tax officials could be seen driving around the ‘burbs looking for signs of opulence that didn’t match your income.

Now, with everything that needs to be known available digitally, data matching can uncover income that doesn’t seem to match lifestyle in a fast and effective manner.

The ATO is now working with insurance providers to identify Australians with policies covering an expanded range of luxury assets.

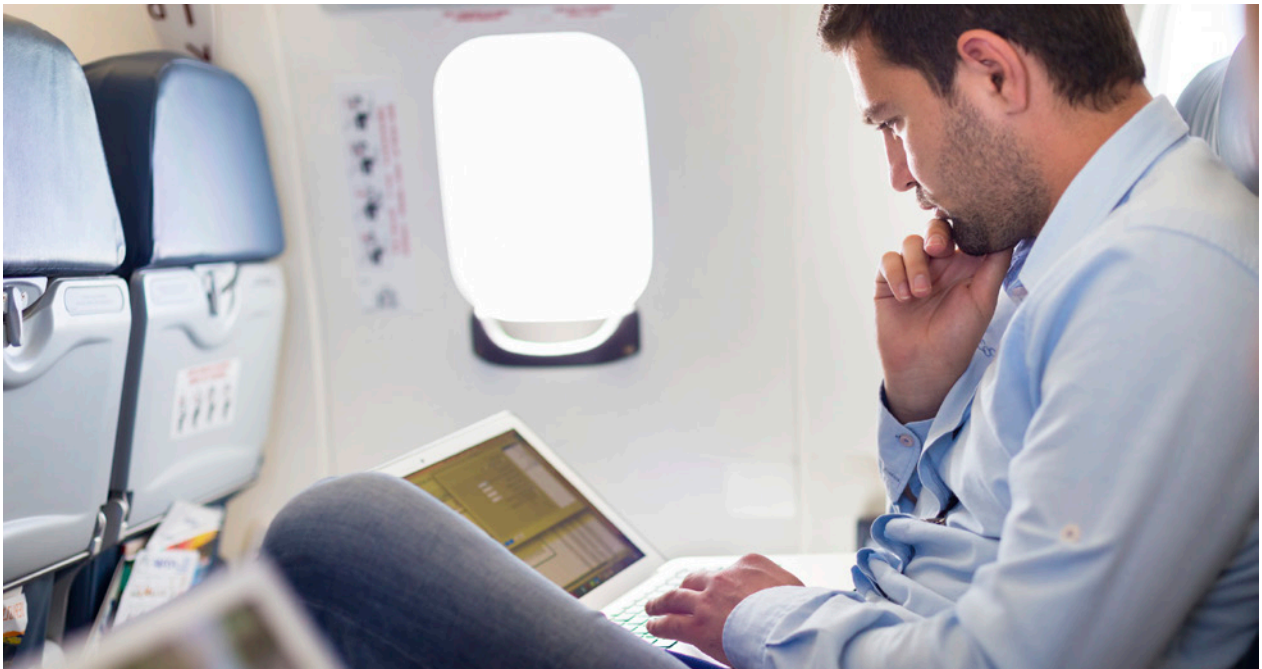
Watch out if you have insured any of these types of assets — marine, aviation, enthusiast motor vehicles, fine art and thoroughbred horses — to cover for damage or loss.

The ATO is matching the value of the insurance on these items to identify the wealthy lurking among us, and says this information will be used by it to get a more accurate estimate of the true wealth of individual taxpayers.

Starting from the beginning of this year, the ATO has commenced issuing formal notices to insurers to provide these policy details. Based on specific criteria, it expects to receive 100,000 records that may require further examination.

Please check your policies to make sure that you are insured via the correct entity, especially if you are small business entity. From our experience, many of the “please explain” may just come from administration errors and not anything mischievous.

Please contact us if you are concerned with any of your luxury assets. ■



## Work-related travel expenses: Why are they on the ATO's radar?

An area where we see individuals getting it wrong as employees is in relation to claiming work-related travel expenses.

The absence of hard and fast rules can make claiming travel expenses difficult as often the deductibility of such costs can be dependent on the nature of employment, the amount of time spent away from home and whether an allowance has been received to cover those costs. The required receipts and documentation must be sourced and maintained to make a claim.

Further, the requirements relating to the use of the Commissioner of Taxation's (the Commissioner) reasonable travel amounts without having to keep written substantiation can be confusing.

### WHY SHOULD I FOCUS ON TRAVEL EXPENSE DEDUCTIONS?

The deductibility of overnight work-related travel expenses, which includes transport, accommodation and meals, is firmly in the sight of the Commissioner recently.

Our experience indicates that the ATO has been particularly active in targeting and in some cases amending prior year assessments for excessive claims in respect of

individuals whose professions require them to frequently travel and stay away from home. Agents have had enquiries with respect to the tax affairs of clients who work as academics, fly-in, fly-out (FIFO) workers and medical practitioners.

### WHEN ARE TRAVEL COSTS ALLOWED AS A DEDUCTION?

As an employee, you are entitled to claim a deduction for travel costs, which can comprise accommodation, meals and transportation to the extent the loss or outgoing is incurred in gaining employment income and that it is not of a capital nature, a domestic nature or relates to the earning of exempt income.

As a general rule, travel costs incurred are deductible to an individual if it can be sufficiently demonstrated that the costs are incurred in the course of performing their employment duties and are not private or domestic in nature.

Accommodation costs incurred by an employee on short business trips are mostly deductible, however, the tax treatment is less clear where an employee is required to work away from their usual place of residence for an extended duration.

Whether the individual is considered to be “living away from home” (LAFH) or “travelling” (as part of their employment) is a critical consideration in determining the deductibility of travel costs.

**WHAT IS THE DISTINCTION BETWEEN “LAFH” AND “TRAVELLING”?**

When an employee is “travelling” on business on behalf of an employer, travel expenses are incidental to the proper carrying out of the employment function and do not have the character of being private or domestic expenses. Such expenditure is typically deductible.

In some cases, the employee might also receive an allowance from their employer to cover for their LAFH or travelling costs (these are particularly common with FIFO workers and certain itinerant workers).

The ATO offers the following comparisons to help determine the difference:

Living away from home allowance	Travelling allowance
This is paid where an employee has taken up temporary residence away from their usual place of residence in order to carry out duties at a new, but temporary, workplace.	This is paid because an employee is travelling in the course of performing their job.
There is a change of job location in relation to paying the allowance.	There is no change of job location in relation to paying the allowance.
Where an employee is living away from home, it is more common for that employee to be accompanied by their spouse and family.	Where an employee is travelling, they are generally not accompanied by their spouse and family.
They are paid for longer periods (more than 21 days).	They are paid for short periods.

The ATO emphasises that these indicators are guidelines only, and in the case of making a claim for a travelling expense no single indicator should be relied upon to determine the nature of an allowance.

For example, a travelling allowance might be paid to a commercial traveller, or to travelling entertainer almost continuously, whereas another claimant may receive a LAFHA for only a month.

There may be circumstances when an employee is away from their usual home base for a brief period in which it may be difficult to determine whether the employee is living away from home or travelling.

As guidance to distinguish between the type of allowances, the ATO says that as a practical general rule, where the period away does not exceed 21 days, generally the allowance will be treated as a travelling allowance rather than a LAFHA.

**HOW ARE TRAVELLING ALLOWANCES TAXED COMPARED TO LAFH ALLOWANCES?**

An allowance that satisfies the meaning of a travelling allowance would be assessed to you and deductions for travel costs incurred may be claimed against that allowance.

In contrast, a LAFH allowance, to the extent that it qualifies as a “living away from home fringe benefit” for FBT purposes, would not be assessable you. Travel expenses incurred would generally not be deductible if you are an employee and you are living away from your usual place of residence.

**WHAT RECORDS DO I NEED TO KEEP IN ORDER TO CLAIM A DEDUCTION?**

**WHAT’S THE “SUBSTANTIATION EXCEPTION”?**

All deductible travel expenses must be substantiated with written evidence and travel records (such as ticket or booking receipts and travel diaries) by you, otherwise a claim will be denied.

A “substantiation exception” is however available, which allows you to claim travel expenses without the need to keep written records if you are in receipt of a “bona fide” travel allowance.

If eligible, you can claim deductions for travel expenses up to the Commissioner’s prescribed reasonable amounts for the relevant year without having to keep written evidence.

We do however recommend that you keep all relevant receipts regardless, in order to support your claims. Also, doing this would put you more at ease in the event of an ATO audit.

This is a tricky area of the law, so please contact us if you require assistance. ■



## The “I hadn’t thought of that” business essential: Succession planning

From about five years ago, the baby boomer generation started to turn 65. A surge in Australian business owners retiring began, and continues, but the topic of succession planning, although given some emphasis by this demographic wave, remains a perennially under-addressed issue.

Often a recurring subject of the ATO’s “Building Confidence” compliance website, effective succession planning can allay many of the tax risks that stem from the fact that every small and medium sized business owner will at some stage close-up shop, retire or otherwise leave their businesses.

While on some level every business owner realises they should have a succession plan in place, and not just family businesses, it seems less common to find an entrepreneur who has done something about it. Even the seemingly straightforward assumption that you will at some stage exit your business needs to at least recognise that there should be a process to tick off all the issues.

Of course there is more than just the tax issues to consider (although CGT will figure largely) – there is super, valuing your business, finding the right person to take over, and selling or otherwise divesting yourself of something you’ve probably put a lot of blood, sweat

and tears into growing. Contemporary times may be witnessing a spike of baby boomers going through the process, but this should only cement the idea that succession planning will continue to be an important part of business life.

### NOT ENOUGH PLANNING

The ATO has found that most small business owners have not done enough planning to make a smooth exit. “We have found that leaving a business is less risky if owners have worked with their tax adviser to address the taxation issues of an exit strategy or succession plan well before leaving the business,” it says.

The fact is that when a business is sold quickly and without proper planning, items can fall through the cracks and result in obligations not being met – or result in unnecessary and costly financial consequences (including tax).

With so many issues to juggle (such as dealing with capital assets, staff, final dividends and so on) and possibly a lifetime’s achievement at stake, it can be extremely valuable to have professional advice and input to ensure careful planning – especially with the often large amounts of money involved.



**What's a sale as a "going concern"?**

A sale as a "going concern" is where all the assets and parts of the ongoing business are sold as one "package" such that the new owner can just pick up the business from where you left off

Some of the problem areas can centre around the fact that selling or passing-on a business is a one-off transaction from a commercial perspective, but issues to remember include that, from a tax perspective, what can seem like one single sale (that of the business) is actually many sales of individual assets that need to be accounted for.

As such, it is extremely important to correctly deal with the eligibility to access the four small business CGT concessions, the correct treatment of pre-CGT assets (in particular, goodwill), the restructuring or sometimes de-merging of a company before a sale, and the GST treatment when selling a going concern.

**CONSIDER REGISTRATIONS**

Not cancelling registration for certain activities can cause problems, such as GST and PAYG withholding, but also your ABN. A business activity statement will continue to be issued, for example, should you neglect to deregister for GST – and you would be penalised if you don't lodge these documents if the business is still registered, regardless of whether it is still actively trading.

ATO audits have revealed confusion over the treatment of the sale or other disposal of assets, especially over accessing the small business CGT concessions. These concessions are the 15-year exemption, retirement exemption, 50% active asset reduction and the rollover for replacement assets.

It is a pre-requisite for an asset to be "active" to gain access to these concessions, and this covers both tangible assets such as buildings, or intangible assets, which is where goodwill comes in. To be active they need to be used or held ready for use in the course of carrying on a business.

The gains from the sales of some CGT assets may not qualify for concessions

due to this issue of "use". For example, assets with a main use of just deriving rent (which is passive income for tax purposes) cannot be counted as active assets.

The general 50% discount on CGT usually applies when the asset sold had been held for 12 months or more by individuals and trusts. This concession will see only half of the capital gain included in taxable income. It is not however open to companies.

Decisions need to be taken on selling the business itself (that is, the shares in the company through which the business operates) or only the assets of the business, as there can be differing tax effects from each. Of course, if the business structure is a trust or partnership rather than a company, the tax consequences would differ yet again. We recommend getting advice about the tax consequences of your various options because of the dollars at stake.

If the business is sold as a "going concern", the sale may be eligible for a GST exemption. But there are many eligibility conditions, including that the seller needs to stay in business right up to the sale date, the buyer needs to be registered for GST and agree in writing with the seller that the "supply" of the business is as a going concern.

And any discussion of succession planning opens questions on estate planning as well. Passing on a business in your will can bring to the table considerations about making sure a business continues to be viable if being run by beneficiaries of your estate or by an executor. And if there is a self-managed super fund that owns business assets, the treatment of benefits from the super fund will need to be dealt with specifically (these are not covered by a will, but by the SMSF's trust deed).

Please talk to us should you have concerns or questions. ■

Information provided is of a general nature only, is not personal financial or investment advice, and we accept no responsibility for persons acting on information contained herein. Clients should not act solely on the basis of material contained in this document. We recommend that our formal advice be obtained before acting on the basis of the topics presented here.