Your Knowledge – August 2018

Inside

Are you holding back your business?

Overcoming the biggest problems in business often comes down to the simple things. Here are a few simple things you can do to capitalise on your opportunities and reduce your risks.

"I didn't get time…" No more excuses

Most people simply don't set aside the time to do the forward planning they know they need to do. Here's a simple test: write down your goals for the business. Now ask yourself, are you doing something to achieve those goals every day or every week? If not, it's not a goal. It's just a nice thought.

Set a realistic budget

Financially mapping your business reduces your risk and removes some of the surprises that can occur. Your budget needs to be realistic – not just a percentage increase on last year.

Start with an operating budget and assess each line critically. Map your revenue to see where, how and when the

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money is coming in to create a reliable estimate of your income for the coming year. Once you have your revenue expectations in place, look at what is required to generate that income. For example, what advertising, marketing and resources will be required?

Once you are comfortable with your revenue, work up your expenditure budget. Be tough on costs. Don't forget to allow for growth and the increases that are likely to flow through.

Once your budget is complete and you have a good idea of your likely profit margins, do a couple of alternative estimates for your key revenue drivers so you understand the impact of changes to your assumptions. Once you have all this in place, track and measure it throughout the year. Where possible, your management team should be a part of this process and take responsibility for achieving the budget numbers they give you. When people don't take the steps that they knew were required to achieve the budget the gaps become obvious fairly quickly. Having a budget in place that you need to report on regularly makes you focus on what really needs to be done.

Map your cash

Even some very large businesses have failed because they ran out of cash. Understanding your cashflow needs is vital particularly for high growth business. Understanding your cash position is about understanding the timing differences: How long will it take for your customers to pay you? How much stock will you need to hold? And, what are the payment terms required by your suppliers? With your cash flow, don't forget to allow for things like tax payments, loan repayments, dividends and any capital purchases that are planned. These can be 'big ticket' items and if you don't allow for them then you will get caught out.

As part of your cash flow forecast identify your capital expenditure requirements.

Don't deal with these on a one-off basis as they arise, plan them in advance.

Expect the unexpected

Growing to death is often the result of unplanned growth opportunities. It's ironic that seizing a major sales contract or big new client can be your business's ruin but its more common than you think.

Many business operators are very good at what they do. Most have an excellent knowledge of the business they conduct and understand their products and services. Most also have an in-depth knowledge of sales performance and revenue. Few however, have a high level of financial management expertise, so when a big new opportunity presents, critical financial questions are not part of the vocabulary. As a result, there can be a sudden and unintended impact on their financial position. A rush of sales might be a great thing but it is not always counterbalanced by a rush of income and profit. Free cash and liquidity are the victims.

Take all the tax advantages you can

for small business in particular there are a range of concessions and funding you can access. Many businesses simply don't realise the opportunities available to them.

A simple example is trading stock valuations. Your trading stock is an asset that is recorded on your balance sheet. In most cases it should be tax neutral to you.
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The cost of purchasing stock is expensed in your profit and loss account and offset by the value of the stock asset, until you sell it. While the amount of stock you are carrying will impact on your cash position, because you have your funds tied up in it, there is no direct impact on your profits or taxable income until you sell that stock. However, if at 30 June some of your stock is worth less than its cost price, you have the option to value it at the lower figure and take the tax write off, rather than wait until the stock is sold. This reduction in your stock value will produce a tax saving for you.

For tax purposes, there are a number of ways of valuing stock. Once you have done your stocktake (assuming you need to do one), you can choose what method to apply depending on the stock and your circumstances. The different ways of valuing stock can produce different results. Most businesses chose to value trading stock at cost – but you have the option of valuing your stock at cost, market selling price or replacement value.

For example, if you have stock that is about to become obsolete, valuing it at cost price for tax purposes is not going to help you. In this situation you might be better off to value the stock at market selling price, particularly if it is a large quantity. The tax rules also allow you to use a value that is lower than cost, market selling price or replacement value if this is warranted because of obsolescence or other special circumstances as long as the value you elect is reasonable. Take the example of vitamins with a use by date that only has a month or two left on it. Leading up to and once the vitamins reach their use by date they are unsaleable. In this case, you would estimate how much of the stock you are likely to sell prior to the use by date and at what price. Using previous sales as a guide, if you only expect to sell 15% of the stock prior to the use by date, you would use the market value of this 15%. Other than when you sell your stock, your tax return gives you a once a year opportunity to adjust your stock values and realise any losses.

Another way businesses disadvantage themselves is not taking the Government concessions available to them. The R&D tax incentive and Export Market Development Grant are a classic case. In the case of R&D incentives, if you develop new technologies or products, you might be eligible for a 43.5% tax offset (if your business has a turnover under $20 million). The Export Market Development Grant reimburses up to 50% of eligible export promotion expenses above $5,000 provided that the total expenses are at least $15,000.

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1 July 2018 Personal income tax cuts

New personal income tax rates come into effect from 1 July 2018. The top threshold of the 32.5% personal income tax bracket will increase from $87,000 to $90,000. Dovetailing into the tax bracket change is the introduction of the Low and Middle Income Tax Offset for those with taxable incomes up to $125,333. The offset is a non-refundable tax offset that you receive when you lodge your income tax return.

If your annual taxable income is $80,000 in 2018-19, then the personal income tax changes provide an annual tax reduction of $530 per year. If your annual taxable income is $120,000, then the changes give you an annual reduction of $215.

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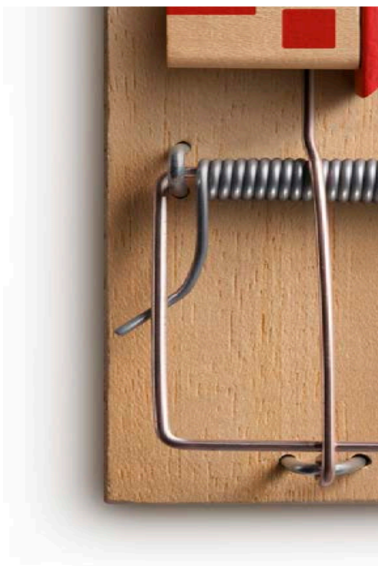

$10k limit on cash payments to business

One of the interesting approaches to tackling the black economy in the recent 2018-19 Federal Budget was the announcement of a $10,000 limit on cash payments to business.

Unrecorded and untaxed transactions that occur in the community are estimated at up to 3% of GDP or around $50 billion. We have all seen examples of the black economy in action in the form of cash payments and money not ringing through a retailer's till. This initiative targets high value transactions that are generally used to avoid tax obligations or for laundering the proceeds of a crime.

How will the new rules work?

The cash payment limit targets larger cash payments - typically made for cars, yachts and other luxury goods, agricultural crops, houses, building renovations and commodities - removing the ability of any individual or business to make a single cash transaction of $10,000 or more.

The limit would apply to all payments made to businesses with an ABN for goods or services. The impending restrictions would not apply to private sales where the seller does not have an ABN, or cash payments to financial institutions.

Transactions at or in excess of the $10,000 threshold would need to be made electronically or by cheque. Splitting the payment into smaller amounts either as cash payments or a combination of cash and electronic payments would not be allowed. There would also be restrictions to prevent payment structuring to get around the payment limit.

At present, only financial services, banks and gambling industries have obligations for cash transactions of $10,000 or more. Under the *Anti-Money Laundering and Counter-Terrorism Financing* rules, transactions of $10,000 or more must be reported to the Australian Transaction Reports and Analysis Centre (AUSTRAC) within 10 working days.

Australia will not be the first country to introduce cash payment limits; France, Spain and Italy all impose limits at varying levels and generally for much smaller amounts than $10,000. For example, France imposes a EUR 1,000 limit for goods and EUR 450 for certain services. There are some exemptions for non-residents, salaries paid in cash, and for those who do not have access to any other form of payment.

The Australian limit on cash transactions is intended to apply from 1 July 2019. The legislation enabling the measure is currently in consultation phase and is not yet law. We will keep you up to date on progress.

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Clothing deductions hung out to dry

The Australian Taxation Office is closely examining work-related clothing and laundry expense claims of taxpayers submitting their 2017-18 tax returns.

The ATO says that clothing claims are up nearly 20% over the last five years with people either making mistakes or deliberately over-claiming. Common mistakes include people claiming ineligible clothing, claiming for something without having spent the money, and not being able to explain the basis for how the claim was calculated.

“Around a quarter of all clothing and laundry claims were exactly $150, which is the threshold that requires taxpayers to keep detailed records. We are concerned that some taxpayers think they are entitled to claim $150 as a ‘standard deduction’ or a ‘safe amount’, even if they don’t meet the clothing and laundry requirements,” Assistant Commissioner Kath Anderson said.

While this particular announcement focuses on clothing related expenses, it has been clear for some time now that the ATO is paying very close attention to work related expenses in general. All claims should be supported by evidence – just in case the ATO decides your claim requires closer scrutiny. We have heard of a number of real life examples in the last year or so where the ATO has queried and challenged very small deduction amounts which could not be supported by appropriate evidence.

What can I claim?

You can only claim a deduction for the cost of buying and cleaning:

- Occupation-specific clothing - for example, the checked pants a chef wears.
- Protective clothing – fire-resistant and sun-protection clothing, safety-coloured vests, non-slip nurse's shoes, rubber boots for concreters, steel-capped boots, gloves, overalls, and heavy-duty shirts and trousers, and overalls, smocks and aprons you wear to avoid damage or soiling to your ordinary clothes during your income-earning activities, and
- Unique, distinctive uniforms – clothes that are designed and made for the employer and not publicly available - like shirts with the company logo.

If you claim a $150 on clothing and laundry expenses, just be aware that you might be asked to prove these expenses.

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Quote of the month

"If your house is burning, wouldn't you try and put out the fire?"

Imran Khan, former cricketer and Pakistan’s incoming Prime Minister.

When can you take your super?

The cash sitting in your superannuation fund can be tempting, particularly if you are short of cash. But, the reality is there are very few ways you can take advantage of your superannuation once it has been contributed to the fund – even if you change your mind.

The sole purpose test underpins access to your superannuation – that is, superannuation is for the sole purpose of providing retirement benefits to fund members, or to their dependants if a member dies before retirement. It's important to keep this in mind because it's often forgotten when people are tempted by 'too good to be true' schemes to access their super early.

The ATO recently warned against a scheme spreading through suburban Australia where scammers encourage people to access their superannuation early to pay debts, take a holiday, or provide money to family overseas in need. All the scammers need is a fee for their services and you to sign blank forms and provide identity documentation. Typically, the forms are used to roll-over your super from an industry fund, establish an SMSF, and open a bank account for the new SMSF. Once the superannuation is rolled into the SMSF, the funds are accessible to withdraw. Problem is, accessing the superannuation is illegal unless you meet the conditions. Any super that is withdrawn early is taxed at your marginal tax rate even if the money is returned to your fund later, plus you are disqualified from being a trustee of your SMSF. If you knowingly allow super benefits to be accessed illegally from your fund, penalties of up to $1.1 million and a jail term of 5 years can apply.

Generally, you can only access your super once you turn 65, when you reach preservation age and retire, or reach preservation age and choose to keep working and start a transition to retirement pension. Currently, the preservation age is 55 years old for those born before 1 July 1960. It then increases by one year, every year, up to the maximum of 60 for those born after 30 June 1964. There are some very limited circumstances where you can legally access your super early.

Treasury is in the midst of a review into the early release of superannuation. The review was sparked by a rapid increase in requests for early access to fund medical treatments such as gastric banding surgery.

"A significant proportion of recent applications appear to relate to out-of-pocket expenses associated with bariatric surgery (that is, weight loss surgery), with a smaller proportion attributable to assisted reproductive treatment (ART), also referred to as in-vitro fertilisation (IVF) treatment."

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The review however is focussed on more than medical treatments, looking at the issue broadly including whether it is appropriate to provide early access to superannuation to pay compensation to victims of crime.

Compassionate grounds

Superannuation benefits can be released on compassionate grounds to meet expenses related to medical treatment, medical transport, modifications necessary for the family home or motor vehicles due to severe disability, and palliative care. Funds may also be released on compassionate grounds to prevent foreclosure of a mortgage or exercise of a power of sale over the fund member's home (principal place of residence); or to pay for expenses with a dependant's death, funeral or burial.

Early access to super needs to be a last resort. It's up to the person applying for early access to prove to the regulator that they don't have the financial capacity to meet these expenses without access their superannuation.

In 2016-17, the Department of Human Services received 37,105 applications for early access to superannuation on compassionate grounds, with 21,258 approved. The average amount released was $13,644. The great majority (72%) of funds released were on medical grounds, 18% were released for mortgage payments.

A person seeking early release for medical treatment must provide written evidence from at least two medical practitioners - one of whom must be a specialist - certifying that the treatment or medical transport:

- is necessary to treat a life-threatening illness or injury; or alleviate acute or chronic pain; or alleviate an acute or chronic mental disturbance; and
- is not readily available to the individual or their dependant through the public health system.

At present, the Department of Human Services will respond to applicants within 28 days. The applicant then must approach their superannuation fund trustee who has ultimate discretion regarding the release of the funds. From 1 July 2018 however, the Australian Taxation Office will take over administration of early release applications, streamlining the process so applicants and superannuation funds receive the compassionate release notice electronically and simultaneously.

First home buyers

The *First Home Super Saver Scheme (FHSS)* enables first-home buyers to save for a deposit inside their superannuation account, attracting the tax incentives and some of the earnings benefits of superannuation.

Home savers can make voluntary concessional contributions (for example by salary sacrificing) or non-concessional contributions (voluntary after-tax contributions) of $15,000 a year within existing caps, up to a total of $30,000. Mandated employer contributions <u>cannot</u> be withdrawn under this scheme, it is only voluntary contributions made from 1 July 2017 that can be withdrawn.

When you die

Superannuation is not an asset of your estate so your superannuation is provided to your eligible beneficiaries - your spouse (de facto) children or a financial dependant - by the fund trustee.

Putting in place a binding death nomination however will direct your superannuation to whoever you nominate, as long as they are an eligible beneficiary. If you have nominations in place, it is essential that you keep these current. Death benefits are normally paid as a lump sum but in some circumstances can be paid as an income stream.

Just be aware that with the $1.6 million transfer balance cap in place, if your superannuation is paid as a death benefit pension to your nominated beneficiary, this could tip them over the cap. It's a good idea to get estate planning advice to manage it correctly.

Divorce and super

The *Family Law Legislation Amendment (Superannuation) Act 2001* allows superannuation to be split during a divorce either by agreement or by court order.

Before making a superannuation agreement, the parties must receive separate and independent legal advice. The agreement must be in writing and must be endorsed by a qualified legal practitioner.

Where the superannuation is split by order of the family court, the court decides on how the fund is split.

Essentially, the amount of split super is rolled into the other parties superannuation fund. The same rules apply to accessing superannuation. That is, it cannot be accessed until you turn 65 or reach perseveration age.

If you and your spouse have an SMSF, you need to continue to manage the fund. Relationship breakdown does not suspend your obligations as trustee.

What happens if you contributed too much?

If you contributed too much superannuation to your fund, you cannot simply withdraw the amount.

If you breached your contribution caps, you can apply to withdraw the amount above your cap from your fund. The excess amount is treated as personal assessable income and taxed at your marginal tax rate plus an excess concessional contributions charge. Withdrawal of the excess amounts should not occur until the ATO provides you with a release authority that then needs to be given to the superannuation fund.

If you did not breach your contribution limit but simply overcommitted to superannuation, you cannot simply withdraw the amount.

Using SMSF assets and funds

In general, the assets of an SMSF cannot be used for the personal use or enjoyment of the fund members (or their associates such as friends or family). For example, If the SMSF owns a holiday home, you cannot use it, if the fund has vintage cars, you cannot drive them, if your fund owns art, you cannot hang the art in your home or your office.

The exception to this is business real property. For example, assuming the trust deed allows for it, business owners can use their SMSF to purchase a building, then lease that building back to their business. Business real property is land and buildings used wholly and exclusively in a business.

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New minimum pay rates from 1 July 2018

New award wages and allowances come into effect from 1 July 2018. If you're an employer, it's important that you are aware of the new rates and apply them. The Fair Work Ombudsman's online Pay Calculator can help you determine the right rates to apply.

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Quote of the month

"Many of life's failures are people who did not realize how close they were to success when they gave up."

Thomas A. Edison