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Accounting for small business

The Little Report – Summer 2011

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Superannuation Guarantee Charge and Contractors

Last year I presented an article outlining the concept of Contractors being 'deemed employees' for the purposes of Superannuation Liability. In essence the Superannuation Guarantee Act 1992 defines a person as an employee if they are an employee under Common Law.

The meaning of 'employees' is, however, expanded if the contract is wholly or principally for 'labour' In that case the person is 'deemed an employee'.

The Australian Taxation Office had been involved in a number of cases arguing those deemed 'employees and those deemed 'contractors'.

The case of *Roy Morgan Research Pty Ltd v Commissioner of Taxation & Anor* went before the full Federal Court to make a determination. In that case, the full Federal Court decided that certain individuals engaged by the taxpayer were in fact employees for the purposes of the *Superannuation Guarantee Act 1992* (Cwlth).

This reinforces the need for companies to reconsider their position where they have engaged contractors.

Borrowing in a SMSF

In 2007, legislation was enacted to enable Self Managed Super Funds (SMSFs) to borrow funds to make investments for the retirement of the member/s of the fund. Examples include investments in management funds, shares and direct property (real estate).

When borrowing in SMSFs there are significant rules to be followed including the establishment of a 'bare' trustee. Banks are restricted with respect to the types of loans that can be made to SMSF Trustees and they often require personal guarantees by members of the fund.

In undertaking a borrowing of this nature in your SMSF, you must be aware that because of the complexities involved, it can be a lengthy process.

You will need to ensure the steps required to be undertaken are well planned and coordinated. A solicitor will need to be involved in the preparation of documentation and, in the case of direct property, a solicitor should be engaged to act and assist in purchasing the property.

For property, banks may require a deposit of around 40 per cent to 50 per cent of the total sum and a personal guarantee from members of the fund. Careful consideration needs to be given if you are contemplating such an arrangement.

Those over the age of 45 should take particular care as there could be equity difficulties if the asset is not paid off before the member's pension commences. Alternatively, members who are around 40 years of age may find this a good strategic opportunity to acquire assets and have them paid off before commencing their pension. New real estate also provides the opportunity for capital allowance and depreciation which may assist in the tax effectiveness of the investment within the SMSF.

Personal Services Income

The Australian Taxation Office continues to run cases to contest aspects of the Personal Services Income regime.

One aspect was recently challenged in the case *Park vs Commission of Taxation* (2011) AATA567. In that case the taxpayer, an I.T. Specialist who provided their services through a Company Structure, claimed that the Personal Services Income rules did not apply because the results test was satisfied by the Company.

In this case it was identified that the services were provided through a labour hire firm with the taxpayer being required to submit weekly timesheets for approval. It was found that there was no evidence that their company was engaged to produce a result even though the Contractor was contracted to work on substantial projects.

As such the Tribunal found that the taxpayer did not conduct a personal services business during the relevant years as the 'results test' was not satisfied. The income was therefore attributed to the applicant and a penalty applied.

This reinforces further the ATO's focus on the Personal Services Income regime. It also confirmed the Administrative Appeals Tribunal felt a 25 per cent penalty was appropriate.

This area is complex and if taxpayers do get it wrong the penalties can be very significant. Please contact me if you feel that your circumstances need to be reviewed.

FBT and the New Car Fringe Benefits Legislation

Since the introduction of the new car fringe benefits legislation on 1 May 2011, it is worth revisiting the method chosen for calculating the car fringe benefits tax (FBT).

Previously, if you used the 'statutory formula method' for calculating FBT then a sliding scale percentage was used. In this instance, the more kilometres the car travelled, the lower the percentage applied.

Under the May 1 changes, a flat 20 per cent applies to all car fringe benefits provided after 7:30pm on that date. The rate is phased in gradually from 2011 to 2014. This is outlined in the table below:

Total kms travelled in FBT year	Old Rate	From	From	From	From
		1 May 2011	1 April 2012	1 April 2013	1 April 2014
Less than 15,000	26%	20%	20%	20%	20%
15,000 to 24,999	20%	20%	20%	20%	20%
25,000 to 40,000	11%	14%	17%	20%	20%
Over 40,000	7%	10%	13%	17%	20%

There are some circumstances, however, where the old rates will still apply. One such example would be where there is a pre-existing commitment (Eg: A lease entered into prior to 1 May 2011).

Should the terms of the agreement be varied or changed after that date it may be considered a new agreement. If so, the new rules would apply.

For cars travelling less than 15,000kms per year the FBT rate has actually been reduced and for those travelling between 15,000km to 24,999km there is no difference.

The rate has increased, however, for those travelling more than 25,000km. For drivers using their cars for business purposes that fall into this category, it may be worth moving from the 'statutory formula method' to the 'operating cost method' to calculate FBT.

In order to rely upon the 'operating cost method' a log book must be prepared and kept.

A logbook must be maintained for a continuous period of 12 weeks and contain the following information:

- The date the journey began and ended (multiple journeys are treated as a single entry)
- The odometer reading of the car at the start and end of the journey
- The number of kilometres travelled by the car, and
- The purpose of the travel.

The odometer readings of the car must be recorded at the start and end of the FBT year. If you complete a logbook within 12 weeks of the end of the FBT year it can be used for the preceding year, thereby, giving you the option to choose your FBT method for the FBT year ending 31 March 2012.

Christmas Fringe Benefits

It is that time of year – Christmas party planning is in full swing and employers may be considering gifts for staff and their families. The key is to ensure that your Christmas cheer does not leave you with a Fringe Benefits Tax (FBT) hangover.

Christmas Parties

The general position is that if a Christmas party is not held on your premises and the cost per employee is less than \$300 per head (\$150 per head if partners attend), it is classed as a minor benefit and no FBT is payable. The function is, however, classed as 'entertainment' and as such no GST or tax deduction will be claimable.

If the function is held on your premises on a work day for employees and it includes a light meal but no alcohol then no FBT is payable and GST and a tax deduction can be claimed.

If however, the function is held on your premises on a work day with the employees' families and alcohol is supplied (with the cost per employee being less than \$300 per head), no FBT will be payable but no GST or tax deduction can be claimed either.

If this style of function exceeds a cost of \$300 per employee then FBT is payable on the family portion and a tax deduction is claimable only for the portion for which FBT is payable.

Gifts

Gifts to employees may be provided at the same time as the Christmas party without being included in the \$300 minor benefit cost allowed for the party. So long as the gifts are less than \$300 and are not classified as 'entertainment' (Eg: Concert tickets) then no FBT is payable and GST and a tax deduction can be claimed on these items.

With this information in mind, you can enjoy a tax effective Christmas party season!

Liquidate or De-Register a Company

Deregistering a company can be a cheap, effective way of winding up a business.

When deregistering a company, there are several income tax issues to consider. Firstly, ensure that there are cash funds available to pay all dividend payments and secondly, ensure there are sufficient franking credits available to avoid the dividends becoming unfranked. Alternatively the company can elect to pay a franking deficit tax.

The Capital Gains Tax (CGT) implication of deregistering a company is another key issue to consider. On cancellation of shares, shareholder interest in the company does provide a CGT Event C2. Various actions can 'trigger' various CGT provisions. Event C2 is one such provision. This effectively enables a Capital Gain loss to be calculated. Other issues can also arise when shareholders receive dividends but then realise a capital loss as a consequence of the cancellation of the shares.

Alternatively, when winding up a solvent company you can consider a Members Voluntary Liquidation. Significantly, this provides an alternative scenario in relation to distributions as they are treated as the liquidator's distributions. In broad terms it allows certain amounts to be distributed as capital instead of dividends for tax purposes and this can deal with pre CGT items or capital gains concessionally treated under Small Business Capital Gains Tax Concessions.

Similar to deregistration, the end result of a liquidation process after any distributions have been made is for the shares to be cancelled. This triggers a CGT Event G1 and/or C1 and these arrangements are concessional and can adjust the cost base of the share.

In conclusion where there are significant CGT issues arising from exempt capital profit reserves, or CGT Concessions available to shareholders, the Members Voluntarily Liquidation is often preferable.

It is most important to have adequate planning to determine the optimum path to follow.

SMEs Set Their Sights on Sustainability

The Chartered Accountants of Canada, American Institute of CPA and Chartered Institute of Management Accountants recently released a Report entitled 'SME's set their sights on Sustainability'. The Report issued in September 2011 makes interesting reading and questions whether the drive for sustainability is an evolution or a revolution.

The report states that, 'there are many ways to interpret the term 'sustainability', but whether it means environmental performance, corporate citizenship, long-term business prospects, or all three it is a growing priority for businesses of all sizes'. The authors undertook a study on how small companies can implement sustainable business practices for the benefit of the environment, their communities, the customers and the bottom line.

They identified the 'key elements to implementing Sustainable Business Practice in SMEs'. Broadly, they were:

- Strategy and Planning
 - Taking a broad view of sustainability
 - Defining in detail what sustainability means to the company, and
 - Engaging all stakeholders.
- Execution and Alignment
 - Remembering you are not alone
 - Establishing responsibility and communicating widely
 - Taking it step by step, and
 - 'Walking the talk'.
- Profit, Performance and Reporting
 - Tying sustainability to profit
 - Measuring, monitoring and reviewing, and
 - Investing in the future.

For those that are interested in setting their business sights on sustainability, I recommend that you read and consider this report. The full report is available online at www.aicpa.org

Staff Loyalty

Retaining staff continues to be a prime source of worry for small business owners.

Consider the following strategies to retain loyal staff:

- Recognise employees doing the 'right things' - small gestures can help retain staff in the long term
- Encourage staff to voice their ideas
- Provide structured plans for the career progression of talented staff

Salary increases are only a small aspect of staff loyalty. Taking the small steps outlined above can go a long way to improving staff retention rates.

Success Breeds Success

An adage many will be familiar with is 'success breeds success'. This statement is however, not always true.

Success can create a positive momentum. A successful company such as Microsoft will become a desirable place to work for that very reason and, as such, the best and brightest applicants will obtain placements.

Conversely, success can also often breed failure, particularly in organisations with strong cultures. Companies that have experienced tremendous success begin to believe in their own invulnerability and become arrogant. They lose their competitive edge and are overtaken by more aggressively focused competitors.

Motorola, the once dominant mobile phone manufacturer has lost market share and dominance to Sony Ericsson and now Apple with the iPhone.

Ensure that success in your business does not blind you to the continued need to evolve and respond to change, strive for continued excellence and the need to maintain humility and moderation.

Interns as a Source of Labour

When cash flows are tight small businesses can occasionally find paying their employees difficult. One solution may be to use interns or university students during holiday periods.

While the intern may not receive a large wage, they obtain relevant practical work experience and the small business obtains the intern's valuable skills at a lower cost than they otherwise would.

To be an effective strategy, ensure the intern is kept motivated. Boring, repetitive administrative work will quickly drive interns away.

Additionally, the mutually beneficial arrangement may lead to long term employment on the conclusion of an intern's studies.

It is also possible to engage an overseas student as an intern. This is part of their study and they are not allowed to be paid – so for the business operator they are a free source of labour. Obviously, you need to have meaningful work for them to do so that the arrangement is mutually beneficial, but some businesses that have done this can't wait to get another student intern. I have contact with a business that organises such placements for students from the United States and I would be happy to introduce clients who may be interested in putting on a student intern.

How Best to Handle Redundancies

With talk of another economic downturn, 2012 may be a year when businesses shed staff. To avoid this becoming a more harrowing experience for the staff being made redundant employers should:

- Plan and execute the redundancies with precision
- Avoid making decisions at sensitive times such as holiday periods (Eg: Christmas Eve)
- Consider the time it will take employees to start receiving government assistance
- Carefully script the announcement and deliver the news quickly and succinctly
- Give employees an opportunity to discuss the situation after the initial panic has gone
- Discuss the exit process
- Avoid saying 'I know how you feel'
- Avoid saying 'I'll see what I can do'
- Engage a Career Outplacement Consultant
 - Outplacement Consultants will also be able to advise the employee on how to tell their family and how to put together their resume in order to find their next job. This helps turn the situation into a positive opportunity.

Making staff redundant is rarely easy for a manager. By putting proper processes in place, you can reduce the consequences of the negative situation.

Source: BRW

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