Winter 2004

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ESTATE PLANNING CONSIDERATIONS

It is important to remember that Estate planning not only relates to the arrangements on death, but also the possibility of incapacity.

Testamentary Trusts

Have you considered the possibility of a Testamentary Trust being established under your will?

It can be an extremely effective means for providing financial security for children and grandchildren. The benefits include:

1. Tax planning opportunities, in that distributions can be made to children, that will be taxed at the normal adult marginal rates of tax, rather than the penalty rates normally applying to minors.

2. Asset Protection, in that assets can be protected from creditors if the trust is appropriately structured.

3. Suitable to provide for beneficiaries with disabilities.

When incorporating a Testamentary Trust into your will, you will need to consider whether the Trust will be discretionary or provide fixed entitlements and which of your assets are appropriate to form part of the trust.

Power of Attorney

A Power of Attorney allows a person to act on your behalf, including making financial transactions in the event of your incapacity.

Although a spouse is quite often the most appropriate person to appoint as your Power of Attorney, you should take the possibility of a joint accident into account. The appointment of a trusted family member or professional advisor may be appropriate.

Your appointed Power of Attorney should be made aware of their legal obligations in that they must exercise their power in an honest and diligent manner and must maintain proper records and accounts.

2004 / 2005 FEDERAL BUDGET

The Treasurer delivered the 2004/2005 Federal Budget in May. A number of significant reforms were announced including: -

1. Personal income tax cuts, in the form of increases in the two highest personal income tax thresholds at both 1 July 2004 and 1 July 2005.

2. An increase in the Medicare Levy low-income thresholds from 1 July 2003.

3. Simplification of the foreign income tax exemption from 1 July 2005, in that certain categories of leave will be considered to be part

of the continued foreign service period.

4. Changes to the Family Tax Benefit (FTB) system to increase the Part A and Part B amounts for the 2003/2004-income year and make the income tests/taper rates more concessional from July 2004.

5. Introduction of a Maternity Payment Allowance and Baby Bonus. The payment will be a lump sum of $3,000 on the birth of each child born after 1 July 2004, increasing to $4,000 for births after 1 July 2006 and $5,000 for births after 1 July 2008.

6. Proposals for further reductions in the superannuation surcharge rate to 12.5% in 2004/2005, 10% in 2005/2006 and to 7.5% for 2006/2007 and following years.

New Tax Rates from 1 July 2004		New Tax Rates from 1 July 2005	
Taxable Income	Tax Rate	Taxable Income	Tax Rate
$0-6,000	Nil	$0-6,000	Nil
$6,001 $21,600	17%	$6,001 $21,600	17%
$21,601 $58,000	30%	$21,601 $63,000	30%
$58,001 $70,000	42%	$63,001 $80,000	42%
$70,001+	42%	$80,001+	47%

SOME GST RELIEF FOR SMALL BUSINESS ON THE HORIZON

The Government has announced a proposal to reduce the GST compliance cost for small business. The proposed concessions (which must first receive the unanimous support of the States and Territories, although the Government will fully compensate them for revenue loss in this regard) include:

1. Small business and non-profit organizations registered for GST on a voluntary basis can report and pay GST annually;
2. Small businesses with an annual turnover of $2m or less can apportion private / business use of assets on an annual basis, rather than quarterly or monthly; and
3. Entities wishing to continue using the GST instalment option will not need to keep making an annual election to use this method.

YEAR END TAX PLANNING

With the end of another financial year just around the corner it is time to consider year-end tax planning opportunities. Year-end tax planning does not necessarily mean that you need to enter into complex, sophisticated arrangements. Consider the following: -

1. Timing and derivation of income. Possibilities include:

   - Delaying billing of work in progress;
   - Deferring sales until the next financial year;
   - Making use of any CGT roll-over relief on disposal of assets;
   - Timing of lodgment of insurance claims and final payment arrangements; and
   - Timing of dividend payments by companies.

2. Timing of expenses.
   - Bad debts need to be written off by 30 June, in order to be deductible;
   - Prepayment of expenses, including rent, interest, repairs, insurance, stationary, bonuses.
     Note that the prepayment rules should be carefully considered, as prepayments are generally fully deductible, only for non-business individuals and small businesses (i.e. turnover under $1 million and depreciable assets under $3 million).
   - Superannuation contributions need to be paid by 30 June (even though they are not yet due under the Superannuation Guarantee requirements) to be deductible this year.

3. Stock on Hand.
   - Assess the most appropriate valuation for closing stock for tax purposes (i.e. cost, market selling value or replacement value);
   - Consider scrapping of obsolete stock prior to 30 June to obtain a deduction;
   - It is recommended that a physical stocktake is undertaken.

4. Capital Gains.
   - You may be able to realise capital losses prior to 30 June, which can then be offset against any capital gains incurred during the income year;
   - Note that capital losses cannot be offset against ordinary income (only capital gains).

BANKRUPTCY and FAMILY LAW

The Attorney-General Philip Ruddock has released exposure draft legislation targeted at high income earners using bankruptcy and family law schemes in order to avoid the payment of tax.

The legislation proposes to make a number of changes to both the Bankruptcy Act and the Family Law Act, with the objectives of: -

- Improving the ability of bankruptcy trustees to recover assets from bankrupts who do not own assets personally but who have funded the acquisition of assets by third parties whilst retaining the use and benefit of

those assets (e.g. assets held by spouses);
- Provide a more effective means of collecting income contributions from bankrupts who do not receive their income as a salary or a wage (by ensuring that the bankrupt operates a bank account into which all income must be deposited);
- Preventing the misuse of financial agreements as a means of avoiding payment to creditors; and
- Addressing longstanding issues concerning the interaction between family law and bankruptcy.

GOVERNMENT CO-CONTRIBUTION SUPERANNUATION SCHEME

Have you considered making a personal superannuation contribution this financial year, in order to receive a co-contribution by the government?

Broadly, in order to be eligible you must:

- Have made a personal contribution to your superannuation fund;
- Have earned less than $40,000 in gross income for the year (individual taxable income, not household income, but note this figure will generally include any reportable fringe benefits);
- Be employed full-time, part-time or on a casual basis (not self-employed)
- Be entitled to receive superannuation contributions from your employer;
- Be under 71 years of age; and
- Be a permanent resident of Australia.

Your eligibility for this scheme is an important consideration now, as we approach the end of the first year of this scheme, (it commenced on 1st July 2003, replacing the previous tax offset for personal super contributions).

If your total income is $27,500 or less, the Government will match your superannuation contributions up to $1,000 per year, on a dollar for dollar basis.
Where your income is more than $27,500 but less than $40,000 a year, the co-contribution is adjusted under a sliding scale (e.g. if total income is $32,000 the co-contribution made by the Government will be $640).

Note also that in the May Federal Budget, the Government has announced proposed changes to make the scheme applicable for more Australians (e.g. increasing the maximum income threshold to $58,000 per annum).

FAMILY TRUSTS

Does your trust have a 'family trust election' (FTE) in place? If not, this election should be considered at the time of lodging the trust's 2004 tax return.

It has been estimated that up to half of the trusts in Australia have not appropriately addressed the issue of making a FTE for tax purposes. As both taxpayers and advisors have been focused on numerous tax reform measures since the FTE rules were introduced and coupled with the fact that there has been little guidance available on the implications of making such elections, this election (which is one of the few that needs to actually be lodged together with the trust tax returns) may have been innocently overlooked.

The Government has been understanding on this issue, and the Australian Taxation Office has released a Practice Statement, advising that it will allow a one-off opportunity for trusts to make FTE's in the 2004 tax returns, dating back to the time that the election should have been first made.

It is likely that you should have a FTE in place if: -

- The trust has incurred income losses;
- The trust has an interest in a company deriving income losses; or
- The trust holds shares acquired after 31st December 1997.

Note that there are a number of implications and potential disadvantages associated with making a FTE. Therefore you may need to discuss this issue in detail with us, prior to the finalisation of the 2004 Tax Return for your trust.

RENTAL PROPERTIES

Investors in rental properties are reminded that there continues to be an ATO focus on income and expenses being declared in respect of these investments by taxpayers.

As a result of the ATO audit program, there is a degree of concern that there is still a high degree of non-compliance, particularly in relation to the correct declaration of capital gains, and the over claiming of expenses.

Some issues to keep in mind:

- A distinction needs to be made between repairs and maintenance expenditure. Repairs and maintenance essentially make good the wear and tear of the use of the property by tenants and is fully deductible. Capital expenditure is generally improvements or replacements of an entire asset that is part of the property (e.g. an entire fence) and will be depreciable over a number of years.

- Deductions may need to be pro-rated if the property was used for private purposes during the year (e.g. used as a holiday house) or was not available for rent for any part of the year;
- If the property has been both your primary residence, and a rental property during the period of ownership, the rules associated with the primary residence exemption for CGT (which can be complicated) will need to be carefully considered on disposal of the property;
- If you carry out any substantial renovations or property development, the activities may constitute the carrying on of a profit making scheme for tax purposes, which can result in any gains on disposal being considered ordinary income rather than capital gains (meaning you will lose the benefit of the 50% CGT discount);
- Take care with deductions being claimed for interest expenses. If new loans are drawn against a property, the use of those new funds will generally need to be for investment purposes in order for the interest component to be tax deductible against the income of that new investment.

Disclaimer: The contents of this publication are general in nature and we accept no responsibility for persons acting on information contained herein without first consulting us.