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Client Information Bulletin

An Overview of the Budget

The Federal Budget for 2002/2003 was handed down on the 14th May 2002

The following is a brief description of the proposed key initiatives..

Reduction of the Superannuation Surcharge

Effective from 1st July 2002 the superannuation surcharge will be reduced by 1.5% to 13.5%, with an additional reduction of 1.5% in the 2004 and 2005 financial years to a maximum of 10.5%.

Tax Deduction Threshold for Superannuation Lifted for the Self-Employed:

Effective from 1 July 2002, the amount of the fully tax deductible threshold for self-employed persons will be increased from \$3,000 to \$5,000. Contributions in excess of this amount will remain 75% tax deductible and will still be limited to the age based limits.

Reducing Tax on Excessive ETP's:

The Government has exempted the excessive part of a cash employer ETP from the termination payments surcharge. Effective from the 1 July 2002 the Government proposes to make the effective tax rate on the excessive component of a superannuation fund ETP no higher than 48.5%.

Baby Bonus:

Effective from 1 July 2002, the recipients of the Baby Bonus will be eligible to contribute the Baby Bonus, and any other amount, to superannuation.

The bonus applies to a first child born on or after 1 July 2001 for up to five years. The bonus is in the form of a tax refund of up to \$2,500 (based on taxable income of \$60,000 or more), and a minimum annual benefit of \$500 (for income of \$25,000 or less).

Child Superannuation:

Effective from 1 July 2002, parents, grandparents and other relations or friends will be able to contribute to superannuation on behalf of a child. The contributions are limited to up to \$3,000 per child per 3 year period. These contributions will be non-deductible and not eligible for the Government co-contribution. The contributions will be classified as undeducted contributions and subject to the standard preservation rules.

Extending Superannuation Contribution Rules for those aged between 70 and 75:

Effective from 1 July 2002, a person under the age of 75 will be able to make personal contributions to superannuation provided they are gainfully employed at least 10 hours per week.

However the superannuation guarantee requirements will not be extended to persons aged over 70, and employers will only be entitled to a tax deduction for contributions for persons aged over 70 if the contribution is a mandated contribution under an industrial award obligation.

Government Matching of Superannuation Contributions:

Effective from 1 July 2002 the current \$100 tax offset available to employees with lower income will be replaced with a co-contribution from the Government. The Government will match every \$1 of personal contribution into superannuation with a \$1 of Government contribution, to a maximum of \$1,000.

The maximum co-contribution will apply to those with income levels up to \$20,000 and will be reduced by 8 cents in every dollar over this income threshold. Persons will receive no co-contribution with an income level exceeding \$32,500.

Splitting Contributions between Couples:

From 1 July 2003 members of an accumulation fund will be able to split both personal and employer contributions with their spouse. Splitting contributions will allow couples to access two Reasonable Benefit Limits (RBL's) and two post June 83 tax-free thresholds, thus enabling more tax effective income streams in retirement.

Tightening Eligibility for Disability Support Pension (DSP):

The eligibility to DSP will be restricted to those whose incapacity prevents them from working for 15 hours a week compared to the current 30 hours. There will be increased funding to help disabled people to find work but if unsuccessful they will have to claim Newstart.

Medical Expenses Offset Threshold Increased:

For the 2002/03 income year, the threshold above which the 20% offset becomes payable will be increased from \$1,250 to \$1,500.

Simplified Tax System?

Small business owners should carefully consider all the issues before deciding whether to take part in the new Simplified Tax System. The Australian Tax Office's Simplified Tax System is an alternative tax system that aims to simplify depreciation, accounting practices and trading stock rules for small businesses. Participation is optional.

It is available for businesses with a turnover of less than \$1 million that have depreciable assets below \$3 million. The ATO claims the new system could help small businesses reduce their paperwork, and potentially pay less tax. However, the scheme may also require restructuring of the enterprise's business systems, changing to cash accounting system instead of an accrual system, and changing depreciation methods.

Also once a business grows above the \$1 million threshold, it faces the prospect of changing the systems back again. The simplified Tax System comes into effect on July 1. The system uses cash accounting rather than accruals, which means tax is not paid on income until it is received. There are two other components to the system: simplified depreciation and simplified trading stock rules. All three components must be used. Small businesses that choose to become part of the Simplified Tax System will not need to conduct stock takes except in certain circumstances. Under the system, assets that cost less than \$1,000

are written off immediately. The system was introduced to help small business align GST payments with income tax payments. Please seek advice from this office before making a decision.

Superannuation

Spouse Contributions – An Overview

A person can generally contribute to a complying super fund for a spouse regardless of:

- Whether either spouse is working and
- The age of the contributing spouse

A 'spouse' includes a person who lives with the contributor on a bona fide domestic basis as the husband or wife (and does not include a person who lives separately and apart from the contributor on a permanent basis).

The contributions must be for the purpose of obtaining benefits for the spouse or the dependants of the spouse in the event of their death.

There is no limit to the amount of contribution and there is no need to demonstrate that your spouse has worked either presently or in the past (unless over 65 years of age).

If the contributing spouse is contributing as employer of the receiving spouse and is entitled to a deduction for the contribution then the normal work tests apply (eg the 10 hours /2 years test for non-compulsory contributions generally applies).

Where the receiving spouse is over 65 but under 70 years of age a contribution can be made if the receiving spouse is gainfully employed for at least 10 hours in the week the contribution is made, or the contributions are pursuant to an award. Contributions cannot be made if the receiving spouse is 70 years of age and over.

A Tax Rebate is available if:

- Both the contributing spouse and the receiving spouse are Australian residents at the time the contribution is made.
- The rebate applies to a maximum of \$3,000 of contributions and the maximum rebate is 18% (ie \$540).
- Subject to those limits the rebate is the lesser of 18% of:
 - *total eligible spouse contributions for the year, or
 - *\$3,000 – (receiving spouse's assessable income and reportable fringe benefits - \$10,800)

No Rebate is available if:

- the receiving spouse's assessable income and reportable fringe benefits exceed \$13,800.
- the contributing spouse is the employer of the receiving spouse and will receive a tax deduction for the contributions.

Attractive Tax Features of Spouse Contributions

- No Tax on withdrawal – Spouse contributions (other than in employer/employee situations) do not attract tax deductions. They are therefore classified as undeducted contributions and so attract no tax when they're eventually withdrawn from the superannuation system
- Tax Rebate – As shown above, spouse contributions may attract a tax rebate where the receiving spouse's income is below certain levels. In these cases the tax concessions compare reasonably well with deductible but fully surchargeable contributions.
- Better use of RBLs – Both spouses' RBLs is better utilized. This can mean fuller usage of the concessional tax treatment of super

fund earnings, and a greater chance of avoiding excess benefits that attract a harsher tax treatment.

- Better use of low tax threshold – To the extent that benefits are taken in a lump sum form, there may be full or fuller usage of post 1983 low tax rate threshold
- Income Splitting – To the extent that benefits are taken in pension form, more comprehensive income splitting may be possible, resulting in better use of each spouse's lower marginal tax rates in retirement.
- Tax efficient estate planning – Superannuation can be a tax efficient way to insure a person's life, and spouse contributions can be an effective way of funding the premiums.

Year End Tax Planning

With the end of the tax year (30 June) rapidly approaching, now is the time to implement year-end tax saving strategies. Correct structuring of salaries, bonuses, superannuation, dividend levels, negative gearing, prepayments, etc can be of great benefit when carried out prior to 30th June.

1. Accelerate Deductions

Due to prepayment rules, only small businesses (turnover under \$1 million and depreciable assets under \$3 million) can prepay business expenses and receive a full deduction this year. You can prepay expenses by ensuring that a cheque is drawn for the expense in June, rather than July or August. The tax laws only allow prepayment of expenses up to 13 months in advance. Even so, this is still an excellent way to legally delay

payment of tax for a year, particularly for those businesses classified as "small business".

To improve the chances of deductibility, the prepayment should be a condition of the contract or arrangement that requires or allows that advance payment. Check the terms of the contract before any prepayment is made.

Some examples of this are:

- Interest can be prepaid on a business or investment loan.
- Prepay business rent of premises or certain lease rentals on business assets.
- Repairs to vehicles and equipment can be carried out in June, rather than in July.
- Business travel and conference costs.
- Other general business expenses such as property maintenance, stationery and insurance.

2. Deferring Taxable Income

Check the items of income that are possible to delay into the next tax year. Some specific points:

- Where income will be derived by a minor who is nearing the age of 18, income deferred into the following year will attract the much lower adult rates of tax.
- Where income in the next tax year is likely to be substantially less and the applicable tax rate much lower; eg in the case of a downturn in business, extended holidays, retirement, etc.

- The deferring income strategy can also be utilized for personal exertion income. Salary and wages and other payments for services rendered are generally taxed when they are received. This is so whether the payment is for current or past services. This means that back pay, retrospective increases, lump sum workers' compensation arrears, bonuses, directors fees, holiday pay and the like are all assessable in the year they are received. This can work to the advantage of the taxpayer, e.g. receive a bonus or commission on 1 July rather than 30 June.

3. Superannuation

Must be paid before 30 June to claim Tax Deduction. A business is able to pay its June Superannuation Guarantee contribution by 28 July quite legitimately but it won't be tax deductible in June.

You also need to consider the superannuation surcharge. Super funds are currently taxed 15 percent on most superannuation contributions. However, if your adjusted taxable income (including superannuation contributions and fringe benefits) exceeds \$85,242, the superannuation surcharge may also apply. For each thousand dollars received over that amount, the surcharge rate on the super contribution climbs by one per cent up to a maximum of 15 per cent.

4. Farm Management Deposits

The Farm Management Deposits scheme system should allow primary producers to plan their taxation affairs to perfection. That is reduce taxable income when in the top marginal tax bracket (above \$60,000) and defer the income to a year when taxable income falls into

the lower marginal tax brackets. Interest on amounts borrowed to fund the tax deductible deposits should also be tax deductible. Deposits are fully tax deductible in the year of deposit. The deposit must be made prior to 30 June to be effective in this tax year. Amounts are taxable in the year of withdrawal.

5. Offset Capital Gains Against Capital Losses

This is an area that has caught many investors out. Capital losses realized in a tax year can only be offset against capital gains, made in the same year or future years. Capital losses cannot be offset against ordinary income, although they can be carried forward to future years. Therefore you must ensure that capital losses are realized before or in the same year as the capital gain. If you have a realized capital gain in the current year, and are sitting on unrealized capital losses, you must give serious consideration to realizing the loss to offset the gain in the same year.

6. Bad Debts

Write off before 30th June to gain a tax deduction in the 2002 year.

7. Stock on Hand

Review stock levels, write down obsolete and damaged stock, and look at the most advantageous method of valuation i.e. cost or market selling value.

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.