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conrad carlile client newsletter

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“YOUR SUCCESS. OUR KNOWLEDGE”

As the end of another year quickly approaches, the team at Conrad Carlile would like to sincerely thank you for your ongoing support throughout the year. We would also like to take this opportunity to wish you and your families a very happy and safe festive season.

Please note the office will be closed over the Christmas period from 5.00pm Thursday 23rd December until 8.30am Monday 10th January 2011.

We trust you enjoy the last edition of our 2010 newsletter and we look forward to working with you in the New Year.

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A Warning for Small Business: Benchmarks and Recordkeeping

The Australian Taxation Office has recently issued over 100 small business benchmarks. For clients in small business, this means that the quality of your recordkeeping is about to come under scrutiny from the ATO. Therefore we advise clients to review your record keeping systems and talk to your accountant as to whether your arrangements are adequate.

The benchmarks have been developed by the ATO with the aim of encouraging small business to correctly report earnings, particularly for those businesses who receive significant portions of their income as cash. The benchmarks are based on industry data, and show an expected range of income, an expected proportion of cash sales, and expected cost of goods sold, materials, labour, rent and motor vehicle expenses. For example, input benchmarks for tradespeople will show an expected range of income, based upon the labour and materials used. If your business is outside this expected range, you are likely to be targeted in an audit from the ATO.

The ATO is expecting to issue 100,000 letters to taxpayers who fall outside the benchmarks. These letters ask for an explanation, and if the tax office is not happy with the explanation received, audits will be conducted. **If the business records are found to be inadequate, the ATO may apply the industry benchmark, and issue a new assessment for income based on the benchmark.** Consequently, it is crucial for small businesses to keep good records, as you need to be able to demonstrate that all income has been recorded, and also explain why your business may possibly genuinely fall outside of industry averages.

Business categories include:

- Building and construction trade services
- Education, training, recreation and support services
- Food services
- Health care and personal services
- Manufacturing
- Professional, scientific and technical services
- Retail trade
- Transport, postal and warehousing



We recommend that all small business clients review their business performance against the benchmark for their industry. Copies of the benchmarks are available on the ATO website or from our office. Alternatively, please ask for an analysis on your business.

Consider the Implications of Capital Gains Tax BEFORE Selling Your Business

Are you aware that the majority of small business owners won't pay capital gains tax on the sale of the business or business premises?

The small business capital gains tax (CGT) concessions are very favourable for small business owners, however, only a small minority of business owners are aware they exist.

The best case scenario for a husband and wife is that they can sell their business after they reach age 55, make a capital gain of up to \$4,000,000 and not pay any capital gains tax. Their assets, other than superannuation and their home, must be worth less than \$6,000,000 for the CGT exemptions to apply.

This is a complex area of tax law, but if you can tick all of the boxes then the first concession available is the general discount, whereby, the capital gain is reduced by 50% so long as the asset has been held for more than 12 months, and the capital gain will ultimately flow to an individual. This part is well known, and it applies to other non-business assets such as investment properties and shares.



Business owners are then eligible for an additional 50% reduction in the capital gain (reducing the taxable gain from 50% to 25%) under the small business active asset CGT concession. If the remaining gain is less than \$500,000 and you are aged over 55, and haven't fully utilised this concession, then the remaining gain is tax free. If you are less than 55 years of age, the remaining amount can either be rolled over into the purchase of another business asset or deposited into your superannuation fund.

To explain the \$4,000,000 example: the husband and wife each have a gain of \$2,000,000. This is reduced by \$1,000,000 by the general discount exemption, followed by a \$500,000 reduction by accessing the small business active asset exemption. Being 55 or older, the remaining \$500,000 is tax-free.

As mentioned above, if you are less than 55 years of age, there are a number of alternatives:

- The 15 year exemption;
- The replacement asset exemption; or
- Depositing your taxable gain into your superannuation fund.

The downside of these concessions is that there are a number of exclusions and hidden traps that could result in business owners not qualifying for all exemptions. It is very important for all small business owners to talk to your accountant years before selling the business to ensure the business is operating in a structure that allows access to the CGT concessions.

Finally, it is critical that a small business owner discuss with their accountant at the time of the sale of the business, the CGT concessions that are applicable to the business owners.

Making Succession Successful

Who gets the farm? It is a tough and sensitive discussion to have, particularly if there are a number of children in the family and the farm may not support every family member.

Challenges similar to this result in farming families often avoiding a discussion about succession planning, rather than working out a solution that considers the future of all family members, as well as how best to protect and enhance the farm's value.

Rather than avoid having a discussion about succession planning, there are a number of different strategies farming families can implement so that when the time arrives, assets are fairly distributed.

A well-articulated succession plan also means when a family member leaves the farm or dies, the stress the family faces at the time may be greatly reduced.

If we use the Smith family as an example: there are three children in the family, a boy and two girls.

Billy Smith, the son, has been working the farm full-time for 10 years, while daughters, Sarah and Jane, have worked in the city during the same period.

The family owns a farm valued at \$1,000,000. There is a loan of \$400,000 attached to the farm and the family owns no off-farm assets.

This is a complex situation which raises many questions:

1. Does the family want to keep the farm family-owned for the long term?
2. With so much equity in the property, how will the parents fund their retirement?
3. How will the asset be ultimately split, especially considering that Billy has put much effort into the farm?
4. If Sarah and Jane wish to liquidate their share of the farm, how will this be funded?

These are some of the questions that succession planning can address.

During succession planning, a key consideration will be how the farm's revenue is to be split between the three siblings.

Another factor to be considered is whether Billy could borrow enough to pay out his sisters, assuming he wants to stay on the farm.



A key element of succession planning is the development of an appropriate retirement income strategy for the senior members of the family. In the case of the Smith family, superannuation would underpin the parents' financial future. In good years, a larger proportion of the farm's revenue can be contributed to their superannuation fund, which not only assists to support them in retirement, but also takes advantage of the tax benefits of the current superannuation system.

An alternative option would be to use some of the farm's proceeds to establish off-farm investments to help support the parents in retirement. These assets may also be able to form the basis of the daughters' inheritance, leaving the farm as the son's inheritance.

A third option is life insurance. If the parents have a life insurance policy, on their death the payout from this policy could be apportioned so that each child receives an equitable share of the estate. In this situation, it is essential a well documented will, supported by a binding nomination, is in place.

Confronting succession planning is a daunting and emotional task for a farming family. However, with a well-thought-out succession plan in place, the farm can often remain in the family, wealth can be transferred across generations, and all members of the family can be treated equitably.

In the end, succession planning can make a difficult process much easier to bear.

Superannuation Update

When is the Right Time to Start a Superannuation Pension?

One of the most common misconceptions is that it is best to wait until age 60 to commence a superannuation pension as this is the time at which the pension is tax-free.

Aside from drawing income tax effectively, the biggest advantage of commencing a superannuation pension is that no tax will be payable on earnings from assets held within the fund which support the pension.

No capital gains tax within pension phase

Any unrealised capital gains on existing investments within your fund are eliminated if the assets are converted into pension phase. Furthermore, within pension phase, assets can be bought and sold without any capital gains tax consequences.

Franking credits within pension phase

With the fund in pension phase, the member is entitled to receive franking credits on Australian share dividends in cash at the end of the financial year. Franking credits represent tax paid by Australian companies on dividends paid out to shareholders. Given that the company has paid 30% tax on profits and the superannuation fund tax rate whilst in pension phase is nil, the entire 30% company tax paid is refundable to the fund.

Example: For a fund with a \$100,000 share portfolio yielding a 4% fully franked dividend of \$4,000 per annum.

The fund will receive franking credits of $\$4,000 * 30/70 = \$1,714$

The franking credit refund of \$1,714 effectively produces an additional yield of 1.7% per annum.

Should I start a pension soon after attaining preservation age of 55?

1. Member with a large tax-free component – there are two reasons to commence a pension as soon as practicable after reaching age 55 particularly if a large amount of your superannuation entitlement is a tax-free component:
 - a) Even if you are under age 60 you may pay little to no tax on pension income;
 - b) The way in which the proportioning rules work for pensions is such that when investment returns are positive, the earlier a tax-free component is locked into a pension the better.
2. Member with minimal other taxable income – for a member below 60 years of age who is receiving predominantly pension income and limited other taxable income the main concern is having to pay income tax on the pension drawn. A tax rebate of 15% is available to taxpayers in this scenario, and the rebate would negate normal income tax that would be payable.
3. Member with significant other taxable income – for a member below 60 years of age who is receiving a pension and a significant amount of other non-pension income such as wages and/or business income, income tax could be a concern. The member could reduce the amount of tax payable by making deductible contributions to superannuation by way of salary sacrifice or concessional (deductible) contributions (if substantially self-employed). This removes some of the tax downside of starting a pension and encourages commencing a pension as soon as practicable.

Should I defer commencing a pension until age 60?

It may not be beneficial to start a pension until age 60 if the following circumstances apply:

1. Member with a high taxable income, fully utilising concessional contributions – the member should not necessarily start a pension in this scenario, especially if their superannuation balance consists mostly or entirely of a taxable component. The pension will be taxed at the 46.5% marginal rate less the 15% tax offset.
2. Member with a low taxable income within the fund – there may be cause to consider not drawing a pension if the fund has very little taxable income from investments. For example, your superannuation fund may have a low taxable income where the fund has large deductions which reduce the taxable income such as capital allowances, depreciation and interest on borrowings.

If you have any questions relating to commencing a superannuation pension, you should consult your accountant. This is a complex area of tax law and all scenarios need to be considered prior to implementation so that you can maximise the benefits.



Team Profile



Daryl Keller has been a member of the Conrad Carlile team for two years. He began part time while studying and now works full time as an accountant. Daryl graduated from the University of Queensland earlier this year with a Bachelor of Business (Accounting), having previously completed a Bachelor of Arts.

Daryl grew up on a farm in Patrick Estate, and currently resides in Gatton with his young family. He enjoys spending time with his wife and two children. Daryl values customer satisfaction, and always endeavours to provide a quality service to our clients.

The information in this newsletter is general commentary only and should not be considered advice. You should not act solely on the basis of the material contained in this newsletter. We recommend that you seek our formal advice prior to acting. Liability limited by a scheme approved under Professional Standards Legislation.