MEDICAL AND DENTAL
ACCOUNTING

THE HEALTH WEALTH SPECIALISTS

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INTRODUCTION

Welcome to our final newsletter for 2007; one we hope will bring you Christmas cheer or at least interesting Christmas reading!

We wish all our clients the best for the holiday season and trust that 2008 will be a happy, healthy, successful and prosperous year for all.

The topics covered in this edition of our newsletter are:

1. Christmas Parties and Fringe Benefits Tax (FBT)
2. Super Funds Can Now Borrow to Invest
3. Superannuation Trustees penalized
4. Paying your Employees' Superannuation Guarantee Late
5. ATO Compliance Program 2007/08 – Could You Be a Target?
6. New Childcare Rebate Rules for 2007/08.
7. Estate Planning and Testamentary Trusts – Protect Your Assets

1. Christmas Parties and FBT

In a timely move, the ATO has updated its advice on the FBT and tax deductibility issues concerning Christmas parties and related benefits. This follows the recent increase of the minor benefit exemption from $100 to $300.

The main points are as follows:

Exempt benefits – minor benefits

The ATO now considers that the minor benefits threshold of less than $300 applies to each benefit provided, not to the total value of all associated benefits. The cost of a Christmas party may be exempt if the cost is less than $300 per employee. Benefits provided to associates (i.e. wives, partners, other family members) may also be exempt minor benefits if the cost of the party for each associate is less than $300.

Gifts for employees

If the value of the gift is less than $300 it will be an exempt minor benefit and no FBT will be payable.

Where a gift is given at a Christmas party the gifts are “associated benefits”. However each benefit must be considered separately to check if they are less than $300. If both the cost of the Christmas party and the gift are less than $300 in value, they will both be exempt benefits.

Christmas parties held on business premises

If you have a Christmas party for your current employees on your business premises or worksite on a working day, the cost will be an exempt benefit. The cost of wives and partners attending is a taxable fringe benefit, unless the minor benefit exemption applies.

Christmas party held off business premises

The costs of holding a Christmas party off business premises (e.g. at a restaurant) for employees and their associates will give rise to a taxable fringe benefit. This is unless the benefits come within the $300 minor benefits exemption.

Tax deductibility

The cost of providing a Christmas party is only tax deductible if it is subject to FBT. Therefore any costs that are exempt from FBT, such as exempt minor benefits, cannot be claimed as a tax deduction.

The costs of entertaining clients are not subject to FBT and are therefore non-deductible for tax.

2. Super Funds Can Now Borrow To Invest

Recent amendments to superannuation legislation have opened the door to a number of investment opportunities for self managed superannuation funds (“SMSFs”).

Subject to some limited exceptions, super funds have generally been prohibited from borrowing in order to invest. However the new laws, which took effect from 24 September 2007, have provided an express exception to the superannuation borrowing restriction. The explanatory material accompanying the new legislation describes the exception as permitting investment in instalment warrants. However, the laws themselves do not expressly refer to instalment warrants and may possibly apply to a range of other investments by SMSFs.

In simple terms a superannuation fund trustee can now borrow to acquire a beneficial interest in an asset that is held on trust. The law is not exactly clear on what type of trust that it must be but it must enable an instalment type process for the super fund acquisition of the asset. What is required is a set of legal relationships that creates a Debt Instalment Trust ("DIT") that enables a superannuation fund to acquire an asset.

Broadly a trustee will not be prohibited from borrowing money if each of the following requirements are met:

- The money is to be used for acquiring an asset.

- The trustee would not be prohibited from investing in that asset directly.

- The asset is held on trust so that the super fund's trustee acquires a beneficial interest in the asset.

- The super fund's trustee has a right to acquire legal ownership of the asset by making one or more payments (i.e. installment payments).

- The lender's rights against the super fund's trustee for a default on the borrowing (e.g. interest) are limited in recourse to the underlying asset only.

Of significance to many is that the asset may be any asset (e.g. real property, works of art or listed securities) that a fund may invest in directly. The existing investment restrictions such as investing for a sole retirement purpose, or against an in-house asset or acquiring assets from a related party of the fund, continue to apply to the DIT arrangement.

It is also worth mentioning that there does not appear to be any limitation on who the lender may be. Conceivably the superannuation fund member could be the lender to his or her own superannuation fund. Thus a member may be able to get more of their wealth working for them in their superannuation fund, more than the recent superannuation caps allow.

Despite the potentially broad application of the new rules care is needed when assessing whether or not a financial product or arrangement is covered by the new exception. Whether an arrangement constitutes a borrowing and whether that borrowing satisfies the new exception depends on the detailed terms and conditions of the arrangement. Expert advice should be sought.

The new laws took effect from 24 September 2007.

Superannuation trustees penalized

Well it had to happen. Ever since the ATO took over administration of self managed superannuation funds a few years ago from APRA, they've been warning that Phase 1 would involve education. Now, it seems, we are entering Phase 11- Penalties!

The trustees of an SMSF have been penalised $30,000 and ordered to pay $32,500 in costs for breaching the rules relating to their fund.

On 15 October 2007, the Federal Court declared that the trustees for the Axent Group SMSF had breached superannuation legislation by selling a property belonging to the fund and using the proceeds of nearly $150,000 to pay a private debt.

The couple had accessed assets in the super fund before meeting any conditions of release such as retirement or reaching preservation age.

Deputy Commissioner Raelene Vivian said this action was part of an increased compliance focus on SMSFs by the Tax Office.

"The main purpose of SMSFs is to provide for retirement. Trustees who access their superannuation without meeting a condition of release are breaking the law and risking their retirement savings. It's vital SMSF trustees make sure they understand their legal and regulatory obligations as they are legally responsible for managing their fund. SMSFs which do not comply with the legislation are at risk of prosecution, penalties an additional tax," Ms Vivian said.

4. Paying your Employees' Superannuation Guarantee Late

Employers must pay superannuation contributions, known as the Superannuation Guarantee ("SG"), on behalf of all eligible employees. This is currently 9% of the employees' earnings. Payments are due for each employee at least four times per year within 28 days after the end of each quarter.

When employers do not pay their employees superannuation contributions on time they become liable for the Superannuation Guarantee Charge ("SGC"). The
SGC includes the amount of the original contribution plus interest and an administration fee which is paid directly to the ATO. The SGC ensures that employees' super contributions are met by the employer. However the SGC is payable even if the employer paid the full amount, albeit late, to the super fund. This means that the employer has effectively paid the contributions twice.

The good news is that the Government has announced changes to superannuation which will mean that employers who make a late SG payment do not pay the same amount twice. However the employees will still be entitled to interest to compensate them for the late payment.

Until the changes become law, employers who are in these circumstances should contact the ATO to discuss their situation.

5. ATO Compliance Program 2007/08 – Could You Be a Target?

The Commissioner of Taxation, Michael D'Ascenzo, released the ATO's 2007/8 Compliance Program on 16 August 2007.

Small to medium enterprises ("SME's")

The ATO will be addressing specific issues in relation to SMEs. A small business is defined by the ATO as one with a turnover of less than $2 million while a medium business has a turnover of between $2 million and $100 million. The areas that the ATO will focus on in this group include the following:

- Losses – The ATO will look at situations where losses are artificially generated (e.g. through related party transactions) and in relation to companies where losses are recouped without taking into account a majority change in ownership or that a different business is being carried on.

- Capital gains tax issues including the application of the small business concessions which can be quite difficult to apply in practice. The ATO will also focus their attention in this area on:

- - failing to report the sale of assets;
  - avoiding CGT on overseas transactions;
  - failing to report CGT derived on the sale of assets where the proceeds have been transferred into a superannuation fund.

- Fringe Benefits Tax issues – Car fringe benefits generate over 45% of all FBT revenue. Consequently the ATO plans to review a number of businesses that provide motor vehicles to employees. This will include examining the calculation of the motor car fringe benefits (e.g. assessing the car log book required when using the Operating Cost method.).

- GST - Real estate transactions, including unreported sales and the correct application of the margin scheme. The ATO's audit activities will be facilitated by data matching by third parties.

- Extracting wealth from the business – A number of arrangements to extract income/wealth form the business will be examined. Examples are loans, payments and debts forgiven by private companies that, in effect, distribute company profits to shareholders without paying tax.

Individual Taxpayers

The ATO will also be focusing on the following areas in relation to individual taxpayers:

- Close monitoring of capital gains on the disposal of property and on distributions from managed funds.
- High income individuals (including senior company executives whose income exceeds $1 million) to identify any under-reporting of income.
- Rental properties – investigating taxpayers with unusual patterns of rental claims.
- Aggressive new financial products, for instance, where, for a relatively small cash outlay, participants create large losses by acquiring, prepaid service warrants that may be redeemable for legal and other professional services.

6. New Childcare Rebate Rules 2007/08

From 1 July 2007 the government's Child Care Benefit increased by 10% on top of annual indexation. This means an extra $16.40 per week for a family on the maximum rate with one child in long day care.

In addition, the existing Child Care Tax Rebate ("CCTR") will convert to a direct payment administered through Centrelink shortly after 30 June each year. This means that families that had insufficient tax liability to absorb their full CCTR will now receive the full rebate.

Families will still receive a rebate for out-of- pocket costs incurred in 2005/06 under the existing tax system arrangements. This means families with out-of-pocket costs for both 2005/06 and 2006/07 will receive two rebates in 2007/08; one through the tax system and one as a direct payment from Centrelink.

7. Estate Planning and Testamentary Trusts – Protect Your Assets

All clients need to consider estate planning. Effective estate planning ensures that assets are directed to the right beneficiary at the most appropriate time. Other benefits of an effective estate plan are managing the tax implications on passing assets to beneficiaries. Use of a testamentary trust may be a useful tool in achieving these objectives.

A testamentary trust is a trust created by a will. It is generally a discretionary trust where the Trustee has full discretion about who benefits, and to what extent, under the trust. A discretionary trust is generally the most flexible type of trust. A testamentary trust can be established under a will to appoint a trustee to use property for the benefit of the beneficiary in the way that the will specifies.

A testamentary trust has two significant advantages for the maker of the will and the nominated beneficiaries.

Income Splitting

The Tax Act provides that income and capital gains derived by children under 18 years of age received as a result of a will are not subject to penalty tax rates. Children who benefit under a will are taxed at the normal marginal rates. In addition:

- Each child has a tax free threshold of $6,000. Based on rates for the 2007/08 year, taxable income between $6,001 and $30,000 will be taxed at the low rate of 15%. The Medicare levy of 1.5% is also payable if the taxable income is in excess of $16,740.

- The main advantage of using a discretionary, testamentary trust to bequeath assets to beneficiaries is that any income gains, capital gains and franked dividends can be distributed among the beneficiaries each year in the most tax efficient way.

Note that tax concessions also apply to income and capital gains derived from assets acquired from the re-investment of moneys received from the original inherited assets.

Asset Protection

A person making a will wants to make sure that the assets of the estate are protected and that they remain within the family and are used to benefit family members.

A significant advantage of a testamentary trust is that there is a separation of control and benefit. The assets are owned by one party (i.e. the trustee) and the benefit of the income and capital passes to another person (i.e. the beneficiaries). A testamentary trust is therefore able to address the following concerns:

- Beneficiaries becoming bankrupt;
- Beneficiaries becoming divorced and their assets being split in the divorce;
- Spendthrift children;
- Ensuring that the surviving spouse will pass on their assets to their children upon that person's death;
- Looking after handicapped children.

The terms of the testamentary trust are set out in the will. These terms can restrict the ability of any of the beneficiaries to control the activities and investments of the trust or give them total control. The person making the will therefore needs to decide whether he/she wishes to sacrifice the independence of the beneficiary to ensure that the inherited assets are protected and used sensibly for the benefit of the family.

Consider the following example:

Laurence is an anaesthetist, He is married to Angela and they have three young children. Concerned with protecting his assets from potential risk associated with his occupation, Laurence has carefully structured his *investment and asset ownership so that his wife Angela owns most of the marital assets including the family home.*

Laurence and Angela have both made simple Wills leaving everything to each other and then equally between their children.

Laurence did not realize that the assets may still be at risk if Angela dies before him. Because Angela's Will leaves everything to Laurence personally, upon her death he will inherit all the assets previously held by Angela. The assets will once again be exposed to the liability risks arising from his occupation.

The solution to Laurence's asset protection dilemma is for Angela to prepare a Will that provides for all assets owned by her at death to pass into a testamentary trust for Laurence's benefit. In this way the assets of Angela's estate are quarantined from Laurence's personal name and are therefore protected from any claims made against him in his professional capacity.

Laurence's parents should also consider testamentary wills for any provision they intend making for him at their deaths.

Do not let your assets be exposed through inadequate asset protection and estate planning.