

Welcome to the Christmas edition of our Newsletter. We take this opportunity to wish all of our clients a happy and safe festive season and look forward to being of service to you in the New Year.

The current economic downturn is proving to be an especially volatile time for many small businesses. With the current challenging financial environment, small businesses are having to adapt to survive.

Accordingly we list below some vital tips to survive these uncertain times.

- **Cashflow** – It is vitally important that small businesses maintain their control over their cashflow. The best way to ensure this is by keeping regular contact with your customers and clients and examining and analysing past payment history

- **Stock management** – Businesses need to be aware of the implications of having too much stock. Overstocking is a serious issue for many businesses and can lead to long-term issues

- **Foreign exchange** – Foreign exchange movements need to be monitored by small businesses that export their products. It is important for small businesses to maintain absolute control on their price margins in light of the unstable trends in exchange rates. It is necessary for businesses to have an adequate margin of forward cover in which to dilute any sudden downward movement

- **Banking relationships** – To combat these economic conditions small businesses more than ever, need to be planning and preparing their finances for the next 12-18 months even more carefully. It is vitally important that banking deadlines are met.

Despite the current “doom and gloom”, we need to keep in mind that Christmas is a magical time and we refer you to an inspirational quote: *“The joy of brightening other lives, bearing each others’ burdens, easing other’s loads and supplanting empty hearts and lives with generous gifts becomes for us the magic of Christmas”.*

Now for the current month’s update....

Legislative Developments

Capital Gains Tax Trust Cloning Exception Abolished

The Government has recently announced that it will abolish the trust cloning tax concession. This exception worked by effectively disregarding any capital gain arising when a taxpayer:

- Creates a trust over a CGT asset by declaration or settlement; or
- Transfers a CGT asset to an existing trust.

This exception generally applied in the circumstances when the new trust and the old trust had the same terms and beneficiaries. Trust cloning has been commonly used in succession planning (i.e. transferring assets to the younger generation of a family) and for asset protection purposes (i.e. segregating passive (or personal) assets from business assets).

Relevant ATO Rulings

Self Managed Super Funds

SMSFR 2008/D5 Self Managed Superannuation Funds: The meaning of ‘asset’, ‘loan’, ‘investment in’, ‘lease’ and ‘lease arrangement’ in the definition of an ‘in-house asset’ in the Superannuation Industry (Supervision) Act 1993 (SIS Act).

The SIS Act imposes a maximum limit of investments in in-house assets of 5% of total fund assets based on market value. Contravention of the rules may result in the fund becoming non compliant.

Section 71 of the SIS Act specifically defines the meaning of an in-house asset which is 'an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund...'

The Tax Office, in the above draft ruling, explains the Commissioner's interpretation of the core concepts in the definition. The core concepts include 'asset', 'loans', 'investment in', 'lease', and 'lease arrangement'. The draft ruling also provides relevant examples.

Monthly Case Update

Foreign Employment

McCabe and Commissioner of Taxation [2008] AATA 904

It was held that a taxpayer who worked overseas as a 'casual employee for much of the years in question on individual projects, did not satisfy s.23 AG of ITAA 1936 'as he was not engaged in foreign services for a period of at least 91 days in the relevant years'. As a result his foreign employment income was not exempted from Australian income tax.

This case explored the concepts present in relation to the requirement of continuous service for at least 91 days. It was held in this case that because he 'worked from contract to contract', and that between contracts he was 'unemployed', each return to Australia between the periods of overseas work constituted a break or interruption in service.

In light of this, short trips back home, for example, if you need to visit a sick relative, do not normally break the required continuous period. Your own sick days do not also break the period.

Deductibility of Legal Expenses

Romanin v The Commissioner of Taxation [2008] FCA 1532

It was held by the Federal Court in this case that a taxpayer was entitled to deductions for the legal expenses he incurred to recover income contractually due to him when his employment was terminated. This was a good result for the taxpayer.

This case explored the concept of the character of the income being recovered. The Commissioner argued that it was capital in nature as the payment was a lump sum for termination of employment. However the court was of the view that 'the payment in a lump sum of the sum which would otherwise be income received by way of regular payment, does not of itself, in my view change the character of the payment.'

In general however, legal expenses of a capital nature are not deductible. Some legal expenses are clearly of a capital nature (e.g. conveyancing costs in connection with the purchase of real estate, legal fees in connection with the purchase or establishment of a business or other capital asset for use in a business) and some are clearly of a revenue nature (e.g. legal costs of recovering business debts).

Hot Topic: Tax Implications at Christmas Time

Below are some of the rules relating to Fringe Benefits Tax and work Christmas parties and Christmas gifts to employees. This will highlight some of the tax consequences for employers this Christmas and also provide some guidance when planning for future Christmas parties and deciding on gifts for employees.

1. Gifts valued at less than \$300 each

Fringe Benefits Tax (FBT) can be avoided where an employer provides staff with non-entertainment gifts such as a bottle of wine, a voucher to a department store, or a Christmas hamper that is valued at less than \$300. These gifts will be tax deductible.

Furthermore employers that are registered for GST can also claim the GST on the gift in their Business Activity Statement.

This FBT exemption can even apply where the gift is provided in conjunction with a Christmas party and the combined cost is \$300 or more, provided the cost of each benefit is less than \$300 and the other conditions of s.58P are met.

By contrast, entertainment gifts such as tickets to sporting events or to the theatre will not be tax effective. The employer cannot claim a tax deduction for such gifts, nor can they claim the GST.

2. Christmas parties held on the employer's business premises

If a Christmas party is held on a working day on the employer's business premises and only employees attend (not spouses), the employer may not be subject to FBT. This FBT exemption is not restricted in terms of cost, and as a result, the employer can spend more than \$300 per employee and still not be subject to FBT.

3. Christmas parties where the cost per benefit is less than \$300

In general, if the cost of the Christmas party per employee is less than \$300 (GST inclusive), the employer will not be subject to FBT.

Where spouses attend, the employer does not need to combine the cost of the employee and spouse to calculate whether the \$300 limit has been exceeded. In this situation, the employer will only be subject to FBT where the cost of the benefit is at least \$300 for each of them.

In effect, employers therefore do not need to differentiate between those employees who bring their spouses and those who don't.

4. Travel costs to attend and leave the Christmas party

If the employer provides the employee with taxi travel to or from the business premises to attend the Christmas party, this is generally an exempt benefit under s.58Z of FBTAA.

However, even if this exemption is not available in the circumstances, the taxi travel may alternatively be exempt under the minor benefits exemption.

Our office will be closed for the festive season from 12 pm on Tuesday 23rd December 2008 and will reopen on Monday 12th January 2009.

Wishing you all the very best for the festive season.