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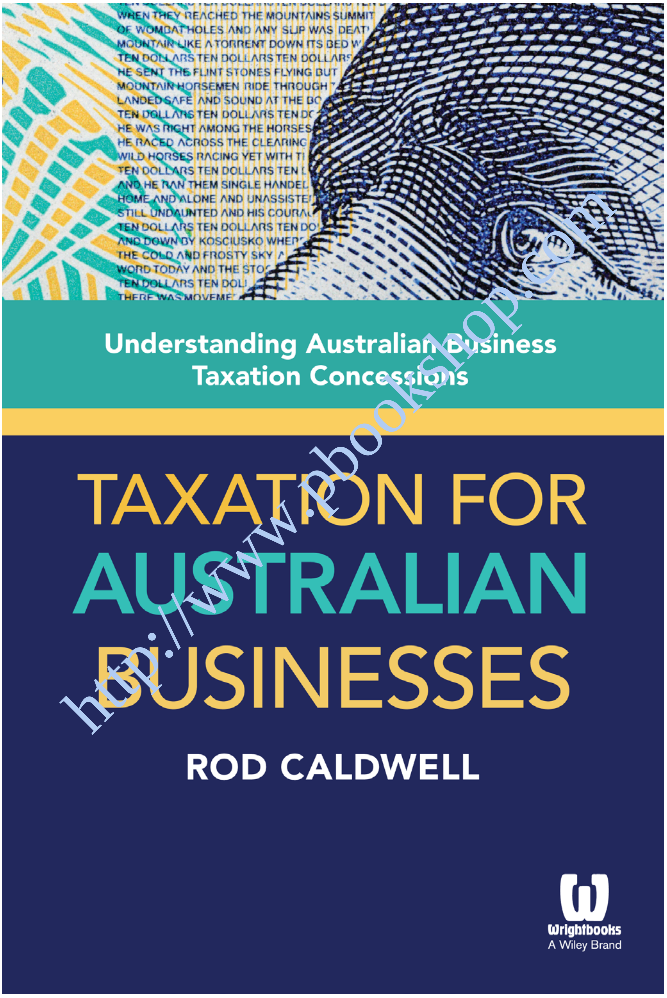

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Preface

While I was reading the local newspaper the other day two articles caught my attention. In one an ex-Glory football player and accountant had misappropriated money from his business in order to fund a gambling debt, and as a consequence of this he had not paid the correct amount of tax on his earnings. He was subsequently sentenced to seven years imprisonment for tax fraud, a victimless crime. In another article, a clandestine drug lab exploded, injuring the offender and a child living at the same residence. He received only five years for his efforts.

The moral to this story is that our society views crimes against the state as far more serious than crimes against the individual, even an innocent toddler. So beware the Tax Man!

In this text I will introduce you to taxation as it affects small to medium-sized businesses. Generally we are talking about businesses with a turnover under $25 million, which covers about 70 per cent of all businesses in Australia. We will also discuss the small business concessions that can be accessed by micro businesses—that is, businesses with a turnover under $2 million; the capital gains tax concessions that apply to micro and small businesses with less than $6 million in net assets; and the fringe benefits tax parking exemption that applies to business with an income of less than $10 million. Businesses with turnovers in excess of $10 million, usually referred to as Small to Medium enterprises, cannot access any taxation concessions, while those with turnovers in excess of $25 million, generally referred to as large businesses, are outside the scope of this text.

This book is not intended to supplant your tax accountant. Unfortunately our tax laws are so complex—some would say stupidly so—that the services of a tax accountant are almost mandatory for all small businesses in Australia. What I will do is empower you so you will be able to keep your records in a tax-compliant fashion, minimising the work your accountant has to do on your behalf. Accountants charge in six-minute billing units and the fewer your job requires, the less you have to pay.

One of the problems facing tax authors is that the tax rates quoted in any printed text are usually out of date by the time the book hits the shelves. The reason for this is political: our politicians cannot seem to stop themselves constantly fiddling with the tax regime to suit their own political agenda.

As an example, the small business asset write-off limit (which we discuss in chapter 4, on capital allowances) was $1000 up to the 2013 tax year, $6500 for the 2013 tax year and up to 31 December 2013, and was proposed (but is so far not legislated) to return to $1000 from 1 January 2014. This sort of tinkering makes keeping a book like this completely up to date an impossible task.

For this reason, although I have included the tax rates that were current at the time of writing, I will also publish the latest tax rates under the 'Update' link on the website for this book at www.tpabusiness.com.au, where I also maintain an errata page that will explain how the changes affect particular sections of the book itself. In this way your information will always be up to date, irrespective of when the book was published.

Additional resources for this and my other texts, including an introductory video for each chapter in this book, are available on my website. I am also happy to answer any questions you may have in relation to any of my texts at rod@tpabusiness.com.au.

Rod Caldwell
August 2014

CHAPTER 1

A general discussion of taxation

Key areas we will cover in this chapter

- Introduction — what this book covers
- Am I in business?
- Small business concessions
- The Big 4 — income tax, CGT, FBT and GST
- State-based taxation
- Private use of business assets
- Bookkeeping and recording systems

Defined terms we will introduce

Micro business: used to mean a small business with a turnover under $2 million

Small business: used in this text to mean a business with a turnover in excess of $2 million but under $25 million

Small to medium business (SME): used to mean a business with a turnover in excess of $10 million but under $25 million

Large proprietary (private) company (as defined by ASIC): a Pty Ltd company that satisfies any two of the following: revenue > $25m; assets > $12m; and employs over 50 staff

Small business concessions: a set of tax concessions available to micro businesses with a turnover under $2 million

'Turnover': the aggregate total of all income made by the business from the provisions of goods or services, including your total sales, fees and commissions

Simplified tax system: now replaced by the small business tax concessions

Income tax: a tax on net income, on a sliding scale for individuals (progressive), fixed for companies (flat)

CGT (capital gains tax): a tax on profits made from the disposal of an asset

FBT (fringe benefits tax): a tax on benefits provided to business owners and employees

GST (goods and services tax): a flat tax on the provision of most goods and services (basic foodstuff and financial services are among the exemptions)

BAS (Business Activity Statement): a form part filled, sent to businesses by the Tax Office, usually quarterly, used as a method of payment for a number of taxes: Income Tax, FBT, withholding and the GST.

IAS (Income Activity Statement): a form part filled by the Tax Office, sent to businesses not registered for the GST. It serves the same purpose as the BAS but without the GST component

Payroll tax: a state-based tax on your total payroll. There is a minimum threshold (different for each state) under which no tax is payable.

Duties: the new term for state-based stamp duties, usually levied on the purchase of property, motor vehicles and insurance, which differ between states

Is it really worth staying in business? Australian businesses feel so overwhelmed by paperwork that many consider giving up, while the 'experts' say that the trick to getting on top of your tax obligations is to become educated and informed. The objective of this book is to give you the knowledge and the tools that will allow you to maintain your day-to-day accounting records in such a way that your tax requirements are met with as little additional work as possible.

In the book I will discuss the process of keeping your accounting records in order so that you will comply with the taxation provisions, rather than comply with general accounting concepts, today known as the International Financial Reporting Standards or IFRS. What is the difference? Historically the tax acts have been written with little or no regard to generally accepted accounting principles! Fortunately these principles are of little use to small businesses, provided that the method used by the business to account for its business activities gives a true and fair view of the entity's financial position.

To make the book easier to read, I will as far as possible use plain English, as distinct from the jargon often favoured by accountants. For example, I use *depreciation* rather than the more technically correct term *decline in value*. I do not say 'you may deduct an amount to the extent that is used to produce your assessable income' but rather use the term *business expense*.

Is this book for you?

The text assumes that you are a small to medium-sized business with a turnover of up to $25 million, operating as an individual or partnership, as a private company (Pty Ltd) or as a trustee of a family trust. These different tax structures are discussed in depth in later chapters.

Further, I will also assume that you may be eligible to use the taxation concessions for small business (previously called the *simplified tax system*); that is, you deal with the Australian Taxation Office (Tax Office) on a cash basis for both income tax and the GST. However, as you will read a little later on, the bar to entry to these concessions is set fairly low, therefore I will also be discussing the tax positions of small businesses that are ineligible to access these concessions. Small businesses that can take advantage of these concessions because they have an annual turnover under $2 million I will refer to as *micro businesses*, and those with a turnover above $2 million that cannot access these concessions I will refer to as *small businesses*.

I should highlight a point of confusion here. There is no fixed definition of a small business; rather, wherever this term is used it is defined for that purpose. Small businesses with a turnover under $2 million are often called micro businesses; those with a turnover between $2 million and $10 million and with net assets under $6 million are defined as small; those between $10 million and $25 million are defined as small to medium (SME); while those with a turnover of over $25 million that satisfy the 'large proprietary' definition are referred to as large. It has also been proposed that large private companies will have additional reporting requirements placed on them by ASIC that will take them outside the scope of this text.

There are many concessions available to micro businesses. My principal objective is to help you to keep you records in such a manner that you take full advantage of these concessions and, further, that your accountant does not need to spend time reworking them to meet the taxation requirements. This will help to reduce your accounting fees while increasing your knowledge and understanding of the tax accounting requirements of your business.

Conservative advice

The advice given in this book tends to be on the conservative side. By this I mean that some tax accountants can be more aggressive in their approach to accounting for tax purposes. If you use this book as a 'bookkeeping guide', then you will be on a very solid footing for tax, including GST, FBT and income tax. It is not intended to completely replace the professional advice of your accountant or financial advisor. Rather, it serves as a guide that will empower you when it comes time to deal with these professionals or, if you wish, empower you to DIY.

One fact that is not generally understood by the small business community, however, is that in dealing with the Tax Office, a tax agent acts on your behalf. It is as though his actions are your actions. If the agent makes excessive claims to reduce your tax bill, those claims are your claims. The Tax Office will come to your door for an explanation and give you the bill (possibly with interest and up to 200 per cent penalties). You will not be able to hide behind your tax agent and will be held 100 per cent responsible.

The moral of this is that it is better to be a little conservative and be able to sleep at night rather than make suspect claims and be forever waiting for the knock at the door!

Am I in business?

What a silly question, of course I'm in business . . . well, maybe not?

A business, sometimes called an enterprise for tax purposes, is usually thought of as any money-making activity you undertake. However, the

Tax Office has a number of rules to determine if you are 'in business' for tax purposes. The purpose of the restrictions, as far as the Tax Office is concerned, is twofold. They are intended, firstly, to prevent you from claiming business losses against other income and, secondly, to prevent normal salary and wages being 'alienated'—that is, passed through a business structure to other family members in order to reduce your tax burden.

The general rule is: if you intend to make a profit, other than profit incidental to a hobby activity, then you are in business. The courts have tried to come to terms with this concept but have failed to establish any absolute rules. Owning one goat may be a business activity while owning six cattle may not. It all depends on your real intention when you set out on this activity. Its scale, planning, business structure and profit-making purpose are all factors that will contribute to determining whether or not you are 'in business' for taxation purposes.

If you run at a loss, but have a reasonable expectation of profit, you may be in business, but if there is no reasonable expectation of profit, the Tax Office would not consider you to be in business. In these cases, you may need to seek a professional opinion as to whether or not you can claim your losses against your other income, such as against your salary or wages from other activities.

Another test is that you must be involved in an 'active' business. Owning a rental property is not normally considered to be a business activity, neither is owning a share portfolio or other 'passive' investments. However, you can usually deduct your excess expenses associated with these activities from other income, normally wages or salaries. This is referred to as *negative gearing*.

This book, however, is aimed at 'true' business activities that are actively undertaken by the owners, such as managing a small deli, operating as a home-based contractor or running a small shop, rather than at loss-making hobbies or passive investments.

Whether or not you are in business, you will need to keep accurate business records. 'Hobby' businesses tend to develop into full-grown businesses. Passive investments, such as investment properties that allow negative gearing, require full business records. Apart from those activities that could be considered a true hobby, and especially if you run at a profit, the best course of action is to assume that you are in business until you are challenged. In this way you will not fall foul of withholding tax issues. As always, the first rule is if you are in any doubt, seek professional assistance.

Rental properties

A person who simply co-owns an investment property or several investment properties is usually regarded as an investor who is not carrying on a rental property business, either alone or with the other co-owners. This is because of the limited scope of the rental property activities and the limited degree to which a co-owner actively participates in rental property activities.

Non-commercial losses

So you pass all of these 'tests' but, like most small businesses, in the first few years you tend to run at a loss. Are these losses deductible against your other income, such as your salary from your day job? Unfortunately the quick answer is no!

There is another test that relates to small, loss-making ventures. If you are an individual, or in partnership, and your gross income for the year is less than $40 000, any loss you make on that activity will *probably* have to be carried forward until you make a profit. That is, you cannot deduct your losses from the business activity against other income such as your wages. When you eventually make a profit you can then deduct your carry forward losses from that profit. Exemptions to the requirement include a business that has more than $500 000 in real property under management or $100 000 worth of assets (excluding motor vehicles), or that has made a profit in three of the last five years (that profits test again!).

You must 'defer' the losses, and you are allowed to claim them only from future profits made from that enterprise. The good news is that if your income is from passive investment, such as a rental property or shares, then this test does not apply to you and you can, under normal circumstances, deduct your losses from other income—so-called negative gearing.

Am I a contractor? Am I in the business of contracting?

If I am employed then I am an 'employee' and am not 'in business'. But what if I leave my employer on Friday and am rehired as a contractor on Monday—am I now in the business of contracting?

The basic answer to this proposition is that from the viewpoint of the Tax Office, you are still an employee and are not in business. You are receiving personal services income and will declare it as such in your individual tax return. This book does not apply to contractors in this situation.

If you are looking at this question from *the employer's perspective*, then even though your 'contractor' provides you with an ABN tax invoice, you may still have to provide that employee with superannuation guarantee payment, if they are still an employee for superannuation purposes, even though they are not an employee for income tax withholding purposes.

But what if you are a 'brickie' who supplies your own equipment and contracts out to a number of builders, or a franchise courier who works for only the one company but supplies your own vehicle and so on? These classes of contractor are in business and this book applies to you. So what's the difference? Where does the Tax Office draw the line?

This book applies to you if your income is not received as a reward for personal effort or skills—that is, you're not in an employee-type situation—or if the majority (more than 75 per cent) of your income falls into one of the following categories:

- You obtain your income from the production of a result, for example delivering a software package rather than programming services.
- You are required to provide your own equipment and tools of trade, as in the case of a bricklaying contractor.
- You are responsible for any defects in the result. You warrant the job and must fix any problems at your own expense.

Or if no more than 80 per cent of your income comes from one client and:

- you have two or more clients who are unrelated to each other, and you advertise your services to the public at large, or

- you employ persons to do at least 20 per cent of your principal work (this does not include such tasks as your bookkeeping but is work related to your main income source), or
- you work from your own business premises rather than those of your employer.

Provided that you pass one of the above tests, you are 'in business'. If you are unsure, *seek professional assistance* to determine your exact position.

TFN, ABN, GST, PAYG withholding

Australian tax language is full of acronyms, many of which you will come across on a daily basis. Wherever I use these I will first define their meaning. We will start with the most common of all, the TFN.

TFN (tax file number)

If you are an individual in business you use your own tax file number for dealing with the Tax Office. If you operate through a partnership or company, however, then you will need a separate tax file number (TFN) for your business. Companies (MyCompany Pty Ltd) are first registered with (created by) the Australian Securities and Investments Commission (ASIC) and are given an Australian Company Number (ACN).

ABN (Australian business number)

Every business must register for an ABN. Without this you cannot give a tax invoice and any business purchaser of your goods or services will be required to withhold 49 per cent of the invoice amount. This will not affect a hobby business selling to the public through a market stall, say, but it will affect a business such as a school cleaning service.

Registering for the goods and services tax (GST)

If you have, or expect to have, an annual turnover in excess of $75 000 you must register for the GST. However, if you are under this amount you may still find it useful to register. There are a number of reasons for this, some of which are tax related (for example, you export goods) and some are for appearance's sake — that is, if you are not registered then you reveal yourself to be a small player and less 'worthy'. Also, some companies will not deal with an entity that is not registered for GST as they cannot claim back the GST credits for goods or services purchased from an unregistered entity.

All businesses, whether registered for the GST or not, are required to fill in a quarterly BAS unless specifically exempted, but there are ways of simplifying this task. The GST will be discussed in detail in chapter 9.

PAYG withholding

Withholding taxes are those amounts payable by others that you withhold from their payment. The most common form of withholding is the income tax deductions that you withhold from your staff wages. If you are going to employ any staff or pay wages, you must also register for PAYG withholding. You can do this at the same time as you get your ABN number.

How do I register?

The business entry point website at www.business.gov.au has a link to registration for small businesses that will lead you through the process.

- If your business is a partnership or company you will need a TFN.
- You will also need an ABN for the business.
- If you qualify for the GST, or wish to do so, you will need to register for the GST.
- If you wish to employ staff you will need to register for withholding tax.

The 'Big 4'

This book focuses primarily on four taxes:

- income tax
- capital gains tax (CGT)
- fringe benefits tax (FBT)
- goods and services tax (GST).

Unlike in other countries, in Australia the capital gains tax is covered by the *Income Tax Assessment Act* but the *Fringe Benefits Tax Assessment Act* is a separate although closely aligned piece of legislation. The *GST Act* stands completely alone, independent of the other taxing statutes. This fragmented system can lead to problems.

As an example, cash accounting under the GST applies to all sales and purchases, including sales and purchases of your business assets, whereas cash accounting under income tax applies only to income and expenses and not to assets. For example, if you purchase a computer system you can claim the GST the moment you pay for it; however, you can claim 'depreciation' of the asset only once it is installed and ready for use. This is despite the fact that you are using 'cash' as your method of accounting for both the GST and income tax. See page 50 for further information on cash accounting.

Wherever such inconsistencies in approach arise, we will attempt to advise you of the problem and lead you through the accounting maze that results.

Income tax

You pay income tax on your net business 'profit'—your taxable income—on an annual basis. The term *net* means there are some income and expense items that are neither included in your taxable income nor allowed as a taxation deduction. The best example of this is the private use deductions that will be discussed in chapter 7.

The percentage of tax you pay as an individual is based on a sliding scale that increases with your taxable income. This is referred to as a progressive taxation system, as distinct from a flat rate system. It is designed to give tax relief to low income earners, but as a result loads the burden of tax onto the higher income individuals. Companies, on the other hand, pay a flat rate of tax from their first dollar earned.

How you pay depends on your business structure:

- Individuals in business as sole traders include their business details in their own personal tax return (business items section). *You then pay income tax at individual rates based on your total income.*

- A partnership will submit an annual partnership tax return that explains to the Tax Office how the business's taxable income is to be split between the partners, although you do not pay any tax on the partnership income at this time. Each individual partner then includes their proportion of the business income in their personal tax return. *You then pay income tax at individual rates based on your total income.*
- A company will pay a flat rate of 28.5 per cent on their taxable income when they lodge their company tax return. You pass this income and tax on to yourself as a shareholder along with the 'franked dividend' (see chapter 10) and include the gross (pre-tax) dividend in your personal tax return along with the tax 'credit'. *You then pay income tax at individual rates based on your total income less any deductions*. This is a uniquely Australian system.

A little maths will tell you that, on the whole, whichever structure you use, your final income tax bill will be the same.

Some special income tax rules apply to some industries. For example, those engaged in primary production get special consideration, artists have special income averaging rules and prospectors have very generous capital allowance rules.

Income tax is paid at the individual level for sole traders and partnerships and at the business level for companies. It is paid as an estimate on your IAS/BAS each quarter and is not a deductible expense to your business. Each year you must complete an annual income tax return on which you will receive a credit for the tax paid, and this will form the basis of the tax estimate for the next 12 months.

Fringe benefits tax (FBT)

Fringe benefits tax is payable only where an employee receives personal enjoyment from company assets or obtains a personal benefit from company funds. Owners of companies also fall into the category of 'employees'. Individuals in business and partners are not 'employed' by their businesses and therefore have no FBT liabilities.

As fringe benefits is a tax on employee benefits it is discussed in full in chapter 7, which examines the concept of 'personal use' as well as salaries and wages.

You report your fringe benefits amounts to the Tax Office in an annual return due in March each year. The Tax Office will then include one-quarter of this amount on your BAS for the following year. The next year's FBT return will be the amount you owe less the estimates paid on your quarterly BAS.

As FBT is a tax on salary perks, it is deductible to the business and should be included with the other salary expenses. If any employee receives more than $1000 per year in FBT it must be shown on their annual payment summary.

Goods and services tax (GST)

The GST applies only to taxpayers who have registered for it. You must register if your business income exceeds $75 000, although you may register if it is under this amount and you need to issue tax-inclusive invoices to your clients. Only tax-inclusive invoices can be used to claim a tax credit.

The GST is payable on the difference between the GST you collect and the GST you pay. All income and all expenses of the business are included, with two exceptions:

- If your invoice does not include an amount of GST (because the supplier is not registered or the goods are not taxable), then you cannot claim a tax credit on the purchase.
- If there is a private use component in the payment, you can only claim the GST credit on the business use. The same applies to income items such as a trade-in or the sale of a business asset used partly for private purposes.

Basically the GST applies to *every* transaction that your business undertakes, both buying and selling, expense and income. Among the very few exceptions are basic foodstuffs, exported goods that are exempt and financial transactions by the bank, such as interest and some government charges.

Some special GST rules apply to some businesses. For example, taxi owners must register for the GST irrespective of turnover, deli owners have a special method of calculating their GST liability, and special rules also apply to vendors of second-hand goods.

Chapter 9 discusses this complex topic more fully.

Withholding taxes

These are the tax amounts owed by others to the Tax Office that you withhold from their payments. The most obvious is the income tax payable by your employees that you withhold from their salary. In the case of suppliers who cannot provide you with a tax invoice stating their ABN number, the amount of withholding is the top marginal rate of 49 per cent, which is the primary reason you do not deal with anyone who cannot give you a tax invoice.

Withholding taxes are discussed in more detail in chapter 11, on employing staff.

Withholding taxes are paid on your quarterly BAS, or your monthly IAS if your withholding amounts exceed \$25 000 per annum. They are the actual amounts withheld, not estimates, and are expenses deductible from your business income. Salary and wage tax instalment deductions are debited to the individuals wages account and will appear on their payslips and their annual payment summary.

Paying your tax bills (PAYG)

A Business Activity Statement, or BAS, is normally required each quarter. On your quarterly BAS you will pay:

- your actual net GST for the quarter
- if you have employees, the actual amount withheld as income tax payable from their wages
- your estimated income tax liability for the quarter (sole traders and companies)
- your FBT estimate for the quarter if your previous FBT annual payments exceeded \$3000
- a number of specialty taxes such as wine equalisation, luxury car and fuel tax credits that are beyond the scope of this text.

You pay the total amount of all of these applicable taxes as one quarterly payment.

Each quarter you will be sent a pre-printed BAS with your name and address details already filled in. You simply complete the payment details and post it with your cheque or use one of the other payment options available. If you are not registered for the GST but are required to pay PAYG, then you will be sent a similar quarterly return but it will be called an Instalment Activity Statement (IAS) and it will not include the GST component.

When you lodge your annual income tax and fringe benefits return the Tax Office will estimate the amount of your tax liabilities for the next year. Each quarter it will send out a pre-printed BAS with the estimate already included. The first BAS will contain the options available, both for income tax and for the GST.

For income tax, payment may be based on either a fixed estimate or a percentage of annual turnover. It is recommended that you accept the Tax Office estimate method as this does not require you to complete your accounting procedures for the quarter before payment.

For the GST you also have three options:

- Each quarter you work out your GST liability and pay that amount. This method is used by the vast majority of GST-registered small businesses.
- You estimate your GST quarterly and report annually. But there are penalties for getting the estimate wrong, so why would you use this method?
- You pay the Tax Office estimate quarterly and report annually.

As there are significant penalties associated with the two estimate options, it is highly recommended that you calculate and pay your GST quarterly and be done with it! However, make sure you lodge your BAS within 14 days of the end of the quarter or again you will be penalised. We'll discuss this further in chapter 9.

Particular arrangements for each business structure

The above analysis is a *generalisation* of the procedures. Each class of business, whether sole trader, partnership or company, will have slightly different arrangements.

Individuals in business as sole traders

For an individual in business, the Tax Office will make no distinction between you and your business, but it is very unwise for *you* to fail to make this distinction. The best approach is to register a business name with the local state authority and then set up a business bank account in this name. Keep your business records completely separate from your personal account.

Before you can register a business name or set up a business bank account, however, you will need to obtain an Australian Business Number (ABN) and register for the GST, if applicable, and also PAYG, again if applicable.

The Tax Office we send you either a BAS or an IAS (depending on whether or not you register for the GST), and it will cover both your private and business income. If you receive a large amount of interest privately, the IAS will reflect this even though it is nothing to do with your business. Usually for small business in this category the IAS/BAS reflects your business earnings, but be aware that other amounts could be included.

In business as a partnership

For partnerships you will receive a BAS only if you register the partnership for the GST (the partnership must also register for an ABN and a TFN). The partnership does not pay any income tax and therefore the BAS will have a nil amount in the income tax box. Income tax is paid at partner level based on your proportion of the partnership income. Therefore you as an individual will also receive a quarterly IAS to account for your income tax on the partnership income.

For companies

You will register the company for an ABN and a TFN. A company pays GST, FBT and income tax, therefore it will get a quarterly BAS that will include the GST, income tax and withholding (PAYG) from staff wages.

Annual returns

There are a number of annual returns you may have to fill in. If you are an individual in business, then there is your annual income tax return. This is the same as any individual but with the addition of 'business items'. You will get a credit for the income tax paid on your quarterly BAS and either receive a refund or need to pay the difference.

If you are in partnership then you will need to fill in a partnership return. No tax is payable on this return. Its main purpose is to set out the percentage of the partnership income to be included in each individual partner's tax return. It is this amount of the partnership income, together with other untaxed amounts, that will form the estimate on the IAS that you, as an individual, will be required to pay each quarter. If the annual estimate is low enough, you may elect to make just one annual payment. The Tax Office will notify you if your estimated liability falls within this category.

If your business is a company, then the company must fill in an annual income tax return and pay 28.5 per cent of the taxable income (tax profit). The taxable income can then be passed on, along with the tax paid, to the shareholders in proportion to their holdings and returned on their individual tax returns. You must note this 'distribution' in your records and also keep a record of the taxable profit (income), income tax paid and distributions made. This is referred to as a *franking account*. Other annual returns required by a company include FBT (31 March) and ASIC (anniversary of date of registration).

Capital gains tax (CGT)

There is surprisingly little to say about small business and CGT. Capital gains tax applies when you sell an asset. You either make a gain or suffer a loss on the sale. The gain, minus any CGT losses for the year and any previous CGT losses, is included in your income.

For small business taxpayers, however, any asset that is subject to depreciation is not subject to capital gains tax. Therefore, the assets to which CGT may apply are very limited.

If you own shares or other investments through the business, then CGT may apply if you dispose of them. The 50 per cent general exception applies to individuals and partnerships, but not to companies as such.

There are also special concessions available for micro businesses, usually aimed at providing retirement income for the business owners. The concessions are, in summary:

- an additional 50 per cent reduction (over and above the general 50 per cent) if the asset sold is an *active business asset* (but not a depreciating asset)

- small business rollover defers the capital gain on a depreciating asset that is sold and replaced with a like asset
- a small business retirement exemption where the proceeds of the sale are paid into a superannuation fund (age 55 and $500 000 conditions apply)
- an exemption for business assets owned over 15 years when the business owner is over 55 and retiring.

Generally it is only on the sale of your business that these exemptions may apply.

Small businesses should be aware that you may still be eligible for the CGT concessions (if you have net assets of $6 million or less) and the FBT car parking exemption (if your total ordinary income plus statutory income is less than $10 million). This is more fully explained in chapters 6 and 7, which are devoted to the CGT and FBT taxes and how they apply to both micro and small businesses.

The golden rule is, if you sell an asset, apart from anything that is a depreciable asset or trading stock, then you should seek professional advice.

State-based taxation

All the taxes reviewed above are collected by the federal government. There is also a raft of state-based taxation regimes. The two that are most common are payroll tax and stamp duty. These differ from state to state, so we can make only a general comment on each.

Payroll tax

Payroll tax applies only to businesses with fairly large payrolls. Each state has a different threshold and taxing rate. For example, in NSW your payroll must exceed $750 000 before you are subject to the tax at a flat 5.45 per cent; in Queensland it is $1 100 000 and 4.75 per cent. Of course, these rates were current at the time of writing and are subject to change.

State duties (stamp duty)

State-based 'duties' apply to the value of contracts that pass legal ownership in certain specified goods or services, usually land (including leases and mortgages), motor vehicles, insurance and trusts, although each state authority has its own list of dutiable items and rates. Failure to pay these duties, evidenced in the past by the attachment of revenue stamps to the contract, makes the contract unenforceable at law.

Getting information

You should consult your own state tax authorities to determine if any state taxes and duties apply in your situation. Most of them have publications for small businesses operating within their state.

The business entry point 'Taxation' at www.business.gov.au has links to all state taxation offices.

Small business concessions

Small business tax concessions apply to micro businesses that have an 'aggregate' turnover of less than $2 million. There is no longer an asset test applying to these provisions, but you must actually be in business, not just in the start-up phase.

You do not have to notify the Tax Office if you wish to use these concessions, but you must note in your accounting records that this is what you are basing your tax calculations on. This would apply especially to the depreciation method you adopt. More on this topic later!

Your turnover is the total of all income made by the business from the provision of goods or services—your total sales, fees and commissions. By aggregate turnover the Tax Office means the total turnover of all your business ventures; this is proportioned for those businesses that have started partway through the year.

These 'concessions' are contingent on the following conditions:

- You must account for your income tax liability on a cash basis. This means you can also elect to treat your GST liability on a cash basis. (This book assumes that you have made that choice.) Small businesses in excess of $2 million in turnover must account for their income tax and GST liabilities on an accrual basis—that is, based on a legal liability rather than on a funds transfer.

- If you purchase any asset costing less than $1000, you can write it off as an immediate expense, a low-cost asset. Small businesses in excess of $2 million in turnover must account for assets that cost less than $1000 in a 'Low Value Pool' at a rate of 37.5 per cent per year. *Note:* This book reflects the current Liberal government's stated intention to reduce this low-cost asset concession from $5000 for cars and utes and $6500 for other assets, to under $1000. This was to be effective 1 January 2014, but is yet to be legislated. Please refer to my website www.tpabusiness.com.au for the latest on this change.
- All other assets generally have the one depreciation rate of 30 per cent. Small businesses in excess of $2 million in turnover must assess each asset, or class of assets, according to the asset's effective life.
- You do not have to account for stock variations provided they do not move by more than $5000 per year. Small businesses in excess of $2 million in turnover must account for the difference between the opening and closing stock levels for each income year.
- You do not have to account for any capital gains tax consequence of selling a depreciating asset. Other taxpayers must treat any private use component under the CGT rules.
- You can claim pre-paid expenses (up to 12 months ahead) as an immediate deduction. Small businesses in excess of $2 million in turnover must apportion pre-payments over the period to which they relate.
- You must account for any income received in advance when you receive it. Small businesses in excess of $2 million in turnover must apportion their income over the period to which it relates.

Private use of business assets

There is not a business owner in Australia who has not at some time used their company credit card for a private purchase or taken stock off the shelf for their own use. There is nothing illegal or wrong with this; in fact, it is common practice. It becomes a problem only if the private use is not handled correctly in the accounts, with the correct adjustments made to reflect the correct amounts of GST and income tax that you pay.

The other private use problem relates to employee ‘perks’. How do we handle the company paying for an employee’s golf club membership out of company funds?

One main area we will not address here is the private use issues with motor vehicles. This is a major topic in its own right, and I will leave the discussion of the private use of business motor vehicles and the FBT implications thereof to chapter 8.

First let’s summarise how we deal with the private use issue before we look at the issue in more depth:

- If you spend business funds for private purposes, add them to your equity (drawings) account, including the private portion of the GST credit.
- If you are *really* using a business asset for private use—that is, your use is not *incidental*—then you can claim only the business use portion of the asset for GST and use the business portion for depreciation purposes.
- If you take stock off the shelf, adjust the inventory and GST against your drawings account at the cost of purchase, not the selling price.
- Business owners’ private use is subject to FBT only if the business is an incorporated company (Pty Ltd); in other cases you are required to account for the private use as stated above.
- For employees, if you give them any private use of company assets, including paying for private expenses, then you are subject to FBT! Far better to give them an allowance or a reimbursement rather than run the risk of FBT.

What is ‘private use’?

It is normal in a business enterprise for some of the business assets (such as motor vehicles or mobile phones) to be used partly for private purposes. It is also normal practice for the business to pay some of the owner’s private accounts (for example the home telephone, electricity and newspapers).

How do we account for these expenses and how are they taxed?

This is a complex issue that is at the heart of most problems you will face in accounting for your business income and expenses. There are two classes of persons we need to discuss separately under this heading: these are the business owners and the employees of the business.

Private use by the business owners

Private use falls into two categories. You can use business funds to purchase private goods (to buy your morning newspaper, say), and you can use business assets for private purposes, such as the business computer your son uses to do his homework. It should be noted here that the term *owner* also includes your family members. In tax parlance, these are known as associates.

Owner's private expenses paid out of business funds

If you use business funds to make a purchase that is for private use, including assets for 100 per cent private use, you cannot claim the 'private portion' of the expense as an income tax deduction, nor can you claim a GST credit for the private portion. For example, Jenny has a hairdressing business and is registered for GST. She obtains her own personal hairdressing products (shampoos, brushes and so on) by making a separate order with her supplier. These acquisitions are all of a private nature and cannot be creditable acquisitions, and nor are they business expenses. These expenses would be debited against her drawings account at the cost of the goods to the business, not the selling price.

Owner's private use of assets, with the exception of cars, can be handled in a number of ways, but in this book it is treated as a shared resource, recording only the business portion into your accounts with the private portion being debited to the drawings (suspense) account. Chapter 4 discusses this in more detail.

Calculating the private use percentage (business use percentage in tax terms)

The Courts have decided a number of 'private use' cases, usually on their particular merits without stating a general principle. It is for you to decide what is private and what is business use, and usually it is not as easy as the above example.

Let us say that you run a small publishing business from your home. You buy a computer for this business. Being in your home it will probably be used for private purposes as well, but to what extent? Perhaps your son likes to play computer games and uses the computer for this purpose. Is this private use? The Tax Office would say definitely yes! I would say it depends . . .

If the computer is available at all times for business use—that is, he plays games only when the machine is not in use, and he is required to give up the machine at any time it is required for business, then I would call this is *incidental use*, not private use. There are no tax consequences of incidental use of business assets. If your son did his homework on the machine and gets preferential use between 6 pm and 9 pm each night, then this would be a private use and subject to tax treatment.

This is only the personal opinion of the author, but I believe that a *right to use* must be present before a private use component can be established—for example, a motor vehicle used to travel to and from work. The employee has a right to use, therefore this is a private use.

There are no legal rules that direct how you are to determine your private use percentage. Generally you should try to determine the private use by a direct calculation (number of hours used privately versus number of hours used for business purposes, or number of kilometres travelled for private purposes versus total kilometres). These calculations should be done over a test period, say six weeks, and the written (diary) results held as proof of your private use percentage. You can also attempt to estimate usage, such as percentage of floor area used, but the direct method is preferred.

Once established, the business use percentage for each asset is used to determine the proportion of the depreciation expense that you can claim as a business deduction and the amount of the GST credit you can claim on purchase or replacement.

Tax Office estimates

For some industries, the Tax Office has estimated the amount that it would be reasonable to include in your private income for goods taken from the trading stock of small businesses for use by the family.

As an example, a baker would include $1310 for each adult in the family and $655 for each child in their business income to account for the goods taken from inventory for private use. Other examples are included in table 5.1 (see p. 95).

To account for this private use you would make a journal entry, usually on an annual basis, deducting (Cr) the amounts from purchases and adding them (Dr) to your drawings account. *Note:* these estimates do not include GST.

You do not have to use these amounts, but if you decide to account for private use by another method, you must keep detailed records of any goods taken.

Drawings account (suspense account)

For companies, the balance of the drawings account (more correctly called a suspense account) should be converted into salary each quarter. For other business structures, such as individuals or partnerships, the owner's drawings account is offset with the business taxable income at year's end.

Accounting for private use

As an example, let us assume that you pay the household electricity account through the 'home-based' business cheque account. The business occupies 20 per cent of the property area, therefore the private use proportion is 80 per cent. The electricity account is $110, including $10 GST.

Only the business portion is claimable for both GST and income tax, therefore you would allocate the private portion to the drawings account:

Dr	Electricity	$20	business use proportion	
Dr	GST account	$2	GST on business use proportion	
Dr	Drawings	$88	Private use including GST	
Cr	Bank			$110

On the other side of this example, if you pay the electricity account out of private funds then how do you claim the business portion? Again, it is against the drawings account:

Dr	Electricity	\$20	business use proportion
Dr	GST account	\$2	GST on business use proportion
Cr	Drawings	\$22	Paid from private funds

If you are a sole trader, the drawings form part of the profit you made on the business; for partnerships they form part of the profit distribution; for companies they form part of the owner's salary. Please note that technically a private company (Pty Ltd) cannot have an owner's drawings account as the business is an entity unto itself, but in the small business world a drawings account is used as above. It is technically a suspense account to be cleared before year's end.

Note that the Tax Office uses an alternate term, the *business use percentage*. This is because the business use is deductible whereas the personal use is not. If one-third of an asset is for private use, then two-thirds is for business use. The tools on our website, www.tpabusiness.com.au, apply the term *business use* to be consistent with the Tax Office terminology.

Private use by your employees

The next set of problems concerns private expenditure of business funds or private use of business assets by employees. All employees' private use is handled under the fringe benefits tax rules *irrespective* of the business structure.

The main contenders here are motor vehicles, union fees, laptop computers, mobile phones, protective clothing (overalls), home phones and superannuation. I have deliberately mixed these up because the first thing to realise is that not all expenses are treated the same.

- As an employer you can provide your employees with one laptop computer each per year without the need to account for any private use of that item. In tax parlance, it is FBT exempt. Superannuation is also FBT exempt. There are no FBT tax implications of providing superannuation for your employees.

- If your employee would get a tax deduction if they paid for the item, then there is no FBT implication under the *otherwise deductible rule*—union fees fall within this category.
- If you provide items for which there is no private use—as in the case of protective clothing—then there are no FBT implications.

In all other cases you must account for the private use. Please refer to the section on fringe benefits tax that deals with this topic at some depth.

Bookkeeping and recording systems

If you are contemplating starting a business, then you must also consider the method you will adopt to account for your income and expenses. The days of the shoe box of receipts to be sorted by your accountant at year's end are well and truly over. Today each and every business, no matter how small, needs to use a computerised accounting system from day 1. You should also note that the Tax Office can fine you for failing to keep adequate records. Fortunately they must give you a warning for your first offence.

Computer systems

There are three levels of choices available to you: the basic cashbook systems (often a spread sheet adaptation); entry-level accounting systems such as MYOB or Quicken; and the more advanced systems such as Attaché or Sybiz.

As MYOB has over 70 per cent of the small business market, I would recommend that this be your starting point. The examples in this book are from MYOB Accounting. The availability of training by independent educators and TAFE is an added bonus. If your business is too complex for these entry-level systems, then there are over a hundred more advanced accounting packages to look at. Your accountant should have access to CPA Australia's annual accounting software guide, which lists all the most common accounting programs and their features.

If you have only one or two employees, the Tax Office website contains a basic salary calculator that you could use. It may save you the cost of an additional payroll package and the training involved with its use. Alternatively, both MYOB and Quicken have payroll add-ons.

In-house bookkeeper, contract bookkeeper or do your own thing?

In today's business world approximately one-third of all businesses fail within the first year. One reason for this is failure to keep control over their expenditure. You must take control of your own accounting. This does not mean that you can't seek assistance from bookkeeping services, but you must retain ultimate responsibility.

'Doing the books' involves a number of stages, including recording the income and expenses, the month-end processing, monthly and quarterly production of the tax and financial reports, and finally the annual processing and rollover. If the first element, the recording, is wrong then all other processes that depend on this will be incorrect.

You have three options to make sure that everything is correctly recorded:

- Do it yourself, with assistance from your own accountant or bookkeeper (now must be a Registered BAS Agent).
- Do the basic recording yourself and have someone, on a monthly or quarterly basis, double check your work and provide any advice needed.
- Employ a full bookkeeping service, either at your premises or as a remote data entry, to undertake the work.

Which option you choose really depends on the complexity of your business and the availability of advice. One point to keep in mind is that bookkeepers are now required to be registered with the Tax Office and therefore the costs associated with this kind of service are escalating. Doing your own books is the only sure way of keeping these costs under control.

With the appropriate assistance, you should not have any difficulty in recording your own accounting data, provided of course you are using a product such as MYOB and have undertaken the necessary training.

About the author

Rod Caldwell is a tax accountant with postgraduate qualifications in taxation. He spent 20 years with the Australian Taxation Office, where he was a tax advisor in a centre of excellence, recognised by CPA Australia as a tax specialist and awarded Fellow status. He left the Tax Office in 2005 to try his hand at teaching. Rod has lectured and tutored in taxation and management accounting at a number of Australian universities, including Monash University, University of Western Australia and Edith Cowan University, as well as teaching business studies at diploma and advanced diploma levels at a number of TAFE colleges in Western Australia. His first book was published by Wrightbooks in 2004. He currently has four books in print and another due to be released later in 2014.

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Taxation for Australian Businesses is essential reading for all existing business owners, or those contemplating starting a new business in Australia. In this book, tax expert and accounting specialist Rod Caldwell discusses the Australian tax system and legislation and shows business owners how to structure their business in the most tax-effective way.

In this guide, learn how to:

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- claim the capital gains tax concessions available to your business
- find out your obligations as an employer
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Taxation for Australian Businesses empowers business owners, helps reduce their accountancy fees, and ensures they are compliant with the latest tax laws.

ROD CALDWELL worked as a tax accountant for the Australian Taxation Office (ATO) for 20 years before becoming a tertiary level lecturer in taxation and management accounting. Rod has written three other books on Australian business accounting and tax law. Visit his website at **www.tpabusiness.com.au**

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