AUTOMOTIVE UPDATE

AUTOMOTIVE TAX PLANNING 2017

WITH THE END OF FINANCIAL YEAR JUST AROUND THE CORNER, BDO AUTOMOTIVE TAKE THIS OPPORTUNITY TO REMIND YOU ABOUT A NUMBER OF TAX MATTERS THAT YOU SHOULD CONSIDER BEFORE 30 JUNE.

CHANGE IN COMPANY TAX RATE

Companies that fit the small business entity definition (broadly, entities with an aggregated annual turnover of less than $10 million) are subject to a company tax rate of 27.5% for the 2017 financial year. Those entities that do not meet the definition (for e.g. those with turnover of more than $10 million) continue to be subject to a tax rate of 30% for the current financial year.

The 27.5% tax rate will apply to companies as follows:

YEAR ENDED 30 JUNE	TURNOVER
2017	$10 million
2018	$25 million
2019	$50 million

EFFECT ON COMPANY FRANKING CREDITS

Under the current law, where a dividend is paid to a shareholder, franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution. However, the methodology to calculate maximum franking may differ due to the change in corporate tax rate. Please note that the increased gap between the corporate tax and the top marginal individual tax rate will mean an increase in the top up tax when the company profits are ultimately distributed to shareholders. Hence, thought must be given to the tax profiles of the shareholders when considering annual dividend strategies.

OVER-FRANKED DIVIDENDS

The franking credit rate for the year ended 30 June 2017 will be 27.5% where the company's aggregate turnover for the previous year (2016) was < $10 million. Therefore dividends paid by these companies after 30 June 2016 have a maximum franking credit per cent age of 27.5%. If the company has made a franked distribution, and issued a dividend statement after 30 June 2016 using the 30% franking rate, the dividend will be over franked and result in a loss of franking credits.

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TRAPPED FRANKING CREDITS

Where the company pays a franked dividend based on profits of a previous year, where the company's tax rate was higher than the year it is paying the dividend, there is the possibility of franking credits being trapped in the company. This being the difference between the previous year's tax rate (e.g. 30%) and the current year's tax rate (e.g. 27.5%).

HIGHER TOP-UP TAX

Shareholders in companies that pay 27.5% franked dividends will have to pay a higher top-up tax because the franking offset they receive will be lower than if the dividend was franked at 30%.

Generally, this means the company tax cut is clawed back by the government when dividends are paid to resident shareholders.

For example, a company has $100 profit and pays 30% tax, and pays the $70 balance as franked dividend to the shareholder. If the shareholder's marginal tax rate is 47%, they will pay tax on the $70 franked dividend of $17 (after franking offset) leaving the shareholder with $53 after tax.

However, if the company tax at 27.5% tax on the $100 income it can pay a $72.5 franked dividend franked at 27.5%, in which case the shareholder pays $19.50 on the $72.50 franked dividend leaving the shareholder with the same $53 after tax.

TRUST DISTRIBUTION

Under the current tax law, a trust must have distributed its annual income to beneficiaries on, or before, 30 June each year. Any undistributed income will be taxed in the hands of the trustee at the highest marginal tax rate.

Effective the year ended 30 June 2012, the Australian Taxation Office withdrew the previous concession of allowing trust distributions to be made within two months after the end of the income year in order to avoid the trustee being taxed.

Accordingly, it is critical for a trustee to have considered the income of the trust and made a resolution to distribute the income to beneficiaries on or before 30 June each year to properly discharge the fiduciary duties of their trustee role.

DIVISION 7A LOAN AND UNPAID PRESENT ENTITLEMENT

If your group has any Division 7A loans and/or unpaid present entitlement (under a sub-trust arrangement or otherwise), the minimum repayment requirement will need to be satisfied each year.

Under the Division 7A rules, any loan owed by a shareholder, or an associate of a shareholder, to a private company may give rise to a deemed dividend, unless the loan is put on a commercial footing under a written loan agreement. These rules also apply to any loan owed by a shareholder, or an associate of a shareholder of a private company to which a trust has previously made a trust distribution that has remained unpaid as an unpaid present entitlement (UPE).

Further, the Commissioner of Taxation is also of the view that a UPE may be caught by the Division 7A rules unless it is converted to a compliant Division 7A loan or treated as a sub-trust.

TRADING STOCK – DEMONSTRATOR, USED AND PARTS

The tax legislation provides that closing trading stock can be valued at the end of every year using one of the following three methods:

- Cost
- Market selling value
- Replacement value.

Usually, the most tax effective outcome is that which provides the lowest value.

For used and demonstrator vehicles the most tax effective method is usually replacement value which is ascertained by way of an independent valuation using either a:

- 'Suitably qualified arms length' (TR93/209), 'truly independent' (IT2648) valuer
- Recognised industry guide, for example Red Book (not permitted for Demonstrators).

Care should be taken to ensure that the valuations meet the strict requirements of the tax legislation outlined above, as the deduction derived from this valuation normally represents the largest single tax adjustment.

Note that it is not necessary to 'book' the adjustment through the accounting records, and in fact we recommend that you don't. Your accountant can include the deduction for tax purposes only.

For parts and accessories the most tax effective method is again achieved through valuation at replacement value. Our view is that replacement value equates to cost, for parts less than 12 months old, and nil for parts with no movement greater than 12 months.

Remember to have your Parts Manager print the aged stock report on 30 June, normally in conjunction with the physical stocktake, as many DMS's cannot subsequently produce an accurate report to reflect the aged stock as at 30 June.

BAD DEBTS

A tax deduction is available for a bad debt if:

- The amount has previously been included in assessable income
- Reasonable action has been taken to seek recovery, and
- The debt is physically written off by year end.

Remember to claim back GST previously remitted in respect of that sale. Have you forgotten to claim back any GST on debts previously written off?

DEFER SALES/REVENUE

Industry practice is to bring forward the sale of vehicles to an earlier month, at least in an accounting sense, despite not having delivered the vehicle by the end of the month. Motivations include the manufacturer incentives for achieving targets and/or the Sales Managers' motivation to increase their bonus. Recognise that this practice also 'brings forward' the income tax, GST and LCT liabilities to the earlier year where it occurs in June.

BRING FORWARD EXPENDITURE

Consider bringing forward certain tax deductible expenses before year end and access the available tax deductions.

Under the general deductibility rules, you are entitled to a tax deduction as soon as the expense has been incurred, regardless of when the physical payment is actually made. For example, a tax deduction would be available when you purchase workshop or office supplies before year end regardless of which period they are paid.

Notwithstanding the above, it should be noted that expenditure for services may not be immediately tax-deductible even where incurred. The rules governing prepayment for services are discussed below.

PREPAYMENTS

Generally, the tax deduction for a prepayment for service (as opposed to physical items such as workshop supplies) will need to be spread over the 'eligible service period' associated with the expenditure.

For instance, if a $12,000 insurance premium paid at the end of May and relating to the 12 months following will entitle you to a tax deduction of just $1,000 for that year. The remaining $11,000 will need to be claimed in the following year.

However, there are a few exceptions relevant to dealers which may give rise to an immediate deduction on the full prepayment amount:

i The expenditure is less than $1,000 (GST exclusive)
ii The expenditure is required by law (e.g. Workcover)
iii The expenditure is incurred under a contract of service (wages for example).

ACCRUED EXPENSES

Identify all expenses to which you have definitively committed (i.e. the expenses have been incurred) at year end, even though they may not have been physically paid for until later. These expenses may be tax deductible and you should consider recording them as 'accrued expenses' in the accounts so that they can be identified by your accountant. Some of the expenses that are commonly accrued include:

- Advertising
- Bank charges
- Commissions/bonuses
- Electricity
- Fringe Benefits Tax (FBT)
- Interest
- Payroll tax
- Rent
- Telephone
- Salaries and wages.

BUILDING DEPRECIATION

Engaging a quantity surveyor who prepares Capital Allowance (building depreciation) and Tax Depreciation Reports (plant and equipment depreciation) may significantly maximise the deductions available.

Of significance is that the quantity surveyor will seek to identify items of plant and equipment that can be separately depreciated at rates higher than 2.5 %.

The quantity surveyors' reports may provide higher deductions regardless of whether the facilities are recently constructed, purchased or have been owned for some time.

FIXED ASSETS AND DEPRECIATION

Assets that have little or no resale value may be scrapped by year end.

This will also enable you to claim their tax written down value as a tax deduction.

Depreciation is calculated with reference to the effective life of each asset for which the ATO provides guidance. It can be calculated using a number of methods as follows:

- Diminishing value – provides a greater deduction in the earlier years
- Prime cost – or straight line, provides an equal depreciation for each year.

Assets which cost less than $1,000 can be allocated to a low value pool and depreciated at 18.75 % in the first year acquired and 37.50 % for subsequent years.

HIGHER INSTANT ASSET WRITE-OFF FOR SMALL BUSINESS EXTENDED FOR 12 MONTHS

Last year's Budget introduced a number of welcome Small Business Entity (SBE) concessions including a more generous instant asset write-off for SBEs, and changes to the simplified depreciation regime with a view to improving cash flow for the small end of town. This concession raised the instant write-off threshold from $1,000 to $20,000 with an end date pencilled in for 30 June 2017.

The Government has indicated it will extend the SBE instant asset write-off concession on assets costing less than $20,000 by 12 months until 30 June 2018. This concession extends to small business simplified depreciation pools to allow eligible taxpayers to write-off the pool balance where the total written down value is less than $20,000.

The concession applies to entities which have turnover of $10 m or less for the year ended 30 June 2017.

FRINGE BENEFITS TAX

The Fringe Benefits Tax (FBT) regime contains a number of exemptions for benefits that may be provided FBT exempt to employees while the cost of providing such benefits continues to be 100 % tax deductible to the employer. These include:

- Mobile phones
- Personal digital assistant
- Protective clothing
- Briefcase
- Calculator
- Tools of trade
- Laptop computer
- An employee's subscription to a professional journal
- An employee's airport lounge membership
- An employee's membership for a corporate credit card.

To qualify for the FBT exempt treatment, the relevant item provided must be used by the employee primarily for work related purposes and only one of each item may be provided to each employee in a given FBT year. A full tax deduction is available for these benefits provided to employees subject to the qualifications above.

The FBT rate for the year ended 31 March 2018 will also drop to 47%, down from 49% in line with the drop in top marginal rate.

SHOULD YOU VARY THE PAYG INSTALMENTS?

Your current instalments are based on the taxable income you achieved in the 2016 financial year. Compare your 2017 financial year result to that of the previous, consider the instalments you have made for the previous three quarters, any significant tax adjustments (for example the used and demonstrator valuations) and consider if it would be prudent to vary the June quarter instalment down.

Note that the ATO can potentially apply general interest charges where variations result in actual tax paid of less than 85 % of actual tax payable.

LOW INCOME SUPER CONTRIBUTION (LISC)

If you earn less than $37,000 a year, and your employer (or you) makes concessional (before-tax) super contributions on your behalf, then you will receive a refund of the 15% contributions tax that was deducted from the contribution. The refund will be capped at $500 and paid directly to your superannuation account by the federal government. From 1 July 2017 the Low Income Super Contribution (LISC), will be renamed the Low Income Superannuation Tax Offset (LISTO).

SUPER GUARANTEE CHANGES

The rate for superannuation contributions by employers on behalf of their employees under the SGC for the year ended 30 June 2017 is 9.5%.

The rate will remain at 9.5% until 30 June 2021, and then progressively increase over subsequent income tax years to 12%.

Tax deductions for the superannuation contributions will only be available in the 2017 tax year if the contribution is received by superannuation fund before 30 June 2017.

SUPERANNUATION

Superannuation contributions

Given the low tax environment under which complying superannuation funds operate, there are specific contribution limits that govern both the maximum and minimum amount of superannuation contributions that can be made to superannuation funds.

Maximum superannuation contributions

Concessional contributions
Making concessional contributions on behalf of employees (including directors) may be tax-effective, especially for those employees who are close to retirement age and are eligible to utilise the transition to retirement strategy

Generally, an employee may reduce their individual tax liability by having some of their remuneration paid directly by their employer to their complying superannuation fund as a concessional contribution, which will attract a contribution tax at 15% in the hands of the superannuation fund, as opposed to tax at the employee's marginal tax rate.

For the year ending 30 June 2017 if your reportable income (including fringe reportable fringe benefits) plus super contribution ("your income") is greater than $300,000 a surcharge of $15% (total of 30%) will apply to that part of the contribution that takes your income over $300,000. From 1 July 2017 the threshold has been reduced from $300,000 to $250,000.

Self-employed or substantially self-employed persons (i.e. persons who generally have less than 10% of their adjusted taxable income derived from employment) may also make concessional contributions for themselves, which may be claimed as a tax-deduction to offset the assessable income they derive as an individual.

The annual concessional contribution cap for the year ending 30 June 2017 is $30,000 per person. An increased cap of $35,000 applies to individuals who are 49 years old or over on 30 June 2016. This $35,000 cap will be available to individuals who were 49 years old and over on 30 June 2016 and the general concessional contribution cap was $30,000 for those under 49 years of age.

The contribution cap applies to concessional contributions made on behalf of an individual from all sources. It is very important to ensure that the contribution cap is not breached as penalties may apply to any excess contribution made.

Importantly, to secure a tax deduction for the concessional contribution made for the year ending 30 June 2017, the contribution must be physically received by the relevant complying superannuation fund on or before 30 June 2017.

Where the superannuation fund uses a clearing house facility, you should allow up to one week for the contribution to be processed and recorded as having been received by the superannuation fund.

From 1 July 2017 the concessional contribution cap will be $25,000.

Non-concessional contributions
Individuals may contribute up to $180,000 in non-concessional contributions for the year ending 30 June 2017. The 'bring-forward option' continues to be available, which allows individuals under 65 years old to make a lump sum contribution of $540,000 for a three- year period. Once the $540,000 has been made, no further non-concessional contributions can be made until that three-year period has expired.

Effective 1 July 2017, the non-concessional (post-tax) contributions cap will be reduced from $180,000 to $100,000 per annum with a three-year bring forward period for individuals under 65 years of age (i.e. $300,000 over three years). Individuals with a balance of more than $1.6 million in super will no longer be eligible to make non-concessional contributions.

Individuals should check with their advisors and superannuation fund/s before making any further NCC this financial year.

Minimum superannuation contributions

Employers are required to provide a minimum level of superannuation guarantee support for each of their employees, subject to certain exemptions (e.g. part-time employees under 18 years old, employees earning wages of less than $450 per month).

The minimum rate of compulsory superannuation guarantee contributions for the year ending 30 June 2017 is 9.5% of the relevant employee's ordinary time earnings, which must be paid on a quarterly basis within 28 days after the end of the quarter. Otherwise, a non- deductible penalty known as the Superannuation Guarantee Charge will be imposed.

However, the superannuation guarantee requirement is capped at the 'maximum contribution base' of $51,620 per quarter (or $206,480 per year) for the year ending 30 June 2017. If the relevant employee's ordinary time earnings exceed $51,620 in any given quarter in the year ending 30 June 2017, the employer is only obliged to pay the maximum superannuation guarantee contribution of $51,620 x 9.5% = $4,903.90 for that quarter.

Notwithstanding that the payment due date for superannuation guarantee contributions for the quarter ending 30 June 2017 is 28 July 2017, we still recommend that the contributions be paid on or before 30 June 2017 to ensure that the relevant employer entity will secure a tax deduction for the contribution for the income year ending 30 June 2016.

From 1 July 2017, the maximum superannuation contribution base will increase to $52,760 per quarter ($211,010 annualised).

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