Planning for June year-end tax issues

1 June 2014

For entities with a 30 June tax year end, time is running out for performing an essential pre-balance date review of the entity's tax position so as to ensure that all is in order before the end of the year. In addition, there may be specific issues that might be relevant even if you do not have a 30 June year end. Such a review may uncover issues that need to be dealt with before end of year, especially since tax is an important aspect of organisational governance.

To get you started, here is a brief list of some important issues that may be relevant year-end tax considerations for a 30 June balancing entity:

- Companies should check the balance of their franking account to determine whether the company will have sufficient franking credits to avoid a franking deficit tax liability at year end, and/or to enable the payment of franked dividends. In considering this issue, also check the application of the 'benchmark franking rule' which is designed to ensure that distributions in the same franking period are franked to the same franking percentage.
- Companies should check that carry forward tax losses and net capital losses are able to be utilised in the year. This will require the company to satisfy either the continuity of ownership test (COT) or the same business test (SBT). Widely held companies and their eligible subsidiaries should also consider the modified COT rules, and all companies will need to consider the requirement to apply the same share and same interest rule ('same share rule') when determining COT.

  Companies with losses available should ensure that there is evidence of the company's ownership structure for the purposes of satisfying the COT.

  Any company that expects to have a tax loss in the 2013-14 income year should note that changes currently before Parliament will prevent the losses from being 'carried back' to earlier income years via the refundable tax offset rules, that is, the loss carry-back offset regime will have application for the 2012-13 year only.

  Even if a company has no realised losses, it is important to note that there are loss integrity rules that apply to unrealised losses. These rules are designed to ensure that generally, upon a change in ultimate majority beneficial ownership or change in control (each determined on a same share rule basis), unrealised losses at that time may not be deducted when ultimately realised (but subject to the operation of a SBT concession).
- For debts that have been brought to account as assessable income (such as through sales on credit terms), generally a deduction may be claimed where the debt is bad and is written off as such during the year of income. It is therefore important to review the debts owed to the taxpayer and to put in place proper

procedures for writing off bad debts before the end of the year if the deduction is to be claimed this year. Integrity rules similar to the loss integrity rules (i.e. a COT and SBT) also apply to companies claiming bad debt deductions, and monitoring compliance with these rules is essential for companies making bad debt deduction claims.

When bad debts are written-off, the goods and services tax (GST) consequences should also be considered.

- The thin capitalisation (TC) rules apply to ensure that 'multinational taxpayers' cannot claim deductions (debt deductions) in respect of obtaining and maintaining their debt interests, to the extent that the taxpayer is thinly capitalised. In this context, a 'multinational taxpayer' is a non-resident, or is 'controlled' for TC purposes by non-residents, or is a resident that has certain business activities or investments outside Australia, or is an associate entity of such a resident.

  Most taxpayers will measure compliance with TC by using the safe harbour debt amount method. For entities that are not financial entities, the safe harbour is currently a debt-to-equity ratio of 3:1, but certain assets are unable to be included in this calculation, and simply taking a snap-shot of the balance sheet to determine exposure is not the recommended approach.

  Under the safe harbour method, the level of debt interests giving rise to debt deductions at any time is checked against the 'net asset' position of the taxpayer calculated under the relevant method statement prescribed in the law. The amounts to be used in this calculation are generally the amounts applicable under the accounting standards. There are some notable exceptions to this requirement including in relation to the revaluation of certain intangibles (but not goodwill).

  It is proposed that with effect from the start of tax years commencing on or after 1 July 2014, the 3:1 ratio will be changed to a 1.5:1 debt to equity ratio. The safe harbour gearing levels applicable to financial entities and authorised deposit taking institutions are to be similarly reduced. Since the TC provisions use 'average balances' in determining debt, assets, liabilities and equity, 'restructuring' carried out before 30 June 2014 (such as a reduction in debt) will affect not only the calculation of relevant TC balances for the 2014 tax year, but also the calculation of such balances for the subsequent year. With the proposed changes from as early as 1 July 2014 to the TC rules as mentioned above, fully evaluating exposure to these changes before they become law makes good business sense.

  Before any restructuring or planning is carried out to enhance an entity's TC position, make sure that all other tax implications are properly considered and taken into account.

- Review depreciating asset records with a view to enhancing the deductions able to be claimed. Planning opportunities include:

  (i) confirming that all depreciating assets and their cost have been identified

  (ii) checking that the correct decline in value (i.e. depreciation) rates are being used

  (iii) considering whether it would be beneficial to self-assess (or re-assess) the effective life of depreciating assets (other than intangible assets), and

  (iv) triggering a balancing adjustment event by scrapping unwanted depreciating assets before year end.

  Small business entities (those with 'aggregated turnover' of less than $2 million for an income year) should also note that the immediate tax write-off applicable to certain depreciating assets costing between $1000 and $6,500 will no longer apply in respect of those assets that are first used or installed ready for use on or after 1 January 2014 under amendments currently before Parliament.

- Review transactions occurring during the year that have resulted in capital gains or capital losses under the capital gains tax (CGT) rules. Where there are capital gains, review the opportunities to realise capital losses before year end to offset the capital gains. Remember that the CGT event relating to a sale under contract occurs at the time that the contract is made, and not at completion or settlement of that contract.

- Assess the most appropriate valuation of closing stock for tax purposes – that is, cost, market selling value or replacement value. You may also wish to consider using a lower value for valuing particular items of closing stock having regard to obsolescence or other special circumstances. Alternatively it may be desirable to scrap or discard unwanted stock before year end so that it is not on hand for tax purposes.

- Because deductions are not available for superannuation contributions made to 'non-complying superannuation funds', take steps to ensure that contributions are made to a 'complying superannuation fund'. Since a deduction is available only for contributions actually made during the relevant tax year, employers should ensure that contributions to superannuation funds are up to date and that remittances are made in sufficient time for there to be no argument that the contribution was not made on or before year end.

- Entities that are subject to the taxation of financial arrangement (TOFA) rules, should consider, where available, the implications of making any tax-timing election(s) – retranslation, hedging, fair value or financial reports – by year end to have it apply to all eligible financial arrangements that started to be held from the beginning of the current tax year. Because any election that is made is irrevocable, and will apply to all relevant financial arrangements that the entity subsequently starts to have, the consequences of the election should be carefully reviewed.

- Review all foreign currency exchange (forex) contracts before year end to determine whether a foreign exchange gain or loss will arise before 30 June 2014 that is to be recognised in working out the taxable income (loss) for that year. Under the forex rules, which broadly apply to transactions entered into on or after 1 July 2003, a core realisation principle applies to ensure that gains and losses are brought to account on revenue account when realised, subject to the application of any specific retranslation election that has been made. Accordingly, consider the tax effect of realising a forex gain or loss prior to year end.

If foreign tax has been paid on any assessable foreign income, entities should review whether all foreign income tax offsets will be able to be utilised, noting that unused offsets cannot be carried forward.

- The income year ended 30 June 2014 is the first time that the new transfer pricing rules (in Sub-Division 815-B of the *Income Tax Assessment Act 1997*) apply to cross-border arrangements. The rules have the effect of applying the arm's length principle by identifying the conditions that might be expected to operate in comparable circumstances between independent entities dealing wholly independently with one another. These rules also include documentation requirements that must be complied with if it is to be argued that the position adopted is reasonably arguable. The provisions also must be applied by taxpayers on a self-assessment basis, since unlike previous regimes, there is no requirement for the Commissioner of Taxation to make a determination that the provisions apply. All taxpayers with potential exposure to these rules should fully consider the implications to their activities including assessing the arm's length conditions and identifying and prioritising transactions that need documentation.

- Eligible companies should also consider opportunities to claim the research and development (R&D) tax incentive, also noting that the the rates of the refundable and non-refundable R&D offsets are proposed to reduce by 1.5 percentage points, effective from 1 July 2014 under the 2014-15 Federal Budget proposal.

All employers will need to consider their mandatory superannuation compliance obligations that will change from 1 July 2014 with the increase in the Superannuation Guarantee (SG) rate from 9.25 per cent to 9.5 per cent. Failure to contribute the correct amount may result in a liability to pay the non-deductible SG charge in respect of any shortfall.

This change in the rate follows the Federal Budget announcement that the Government is no longer going ahead with its original re-phasing of the increase to the compulsory SG rate as planned as part of its repeal of the Minerals Resource Rent Tax, but instead will further re-phase the progressive increases in the SG rate over a different period of time.

Some individuals may also be considering opportunities to maximise salary sacrificed or deductible personal superannuation contributions. For the year ended 30 June 2014, the relevant concessional contribution limit is $25,000, unless the individual is aged 60 years or over where the limit is set at $35,000. From 1 July 2014 the concessional contribution cap goes up to $30,000 for those aged under 50 years or $35,000 for those aged 50 years or over. Importantly, these caps are based on contributions actually made in the relevant financial year and not the year to which they relate for superannuation guarantee purposes so it is important to be aware of the timing of contributions made on behalf of individuals to ensure they do not exceed the relevant thresholds.

New PAYG withholding rate schedules will no doubt come into effect from 1 July 2014 incorporating the already legislated increase in the Medicare levy (i.e. increasing to 2 per cent) and, if enacted in time, the proposed Temporary Budget Repair Levy applicable to individuals with taxable income above $180,000 being taxed at an additional 2 per cent on the excess.

Before implementing any tax planning strategies, the overall facts, circumstances and commercial implications need to be appropriately taken into account, along with the possible application of the general anti-avoidance provisions (Part IVA of the *Income Tax Assessment Act 1936)*.

For further information on any tax planning issues or the application of Part IVA contact your usual PwC adviser.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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