

SAYWELLS

Chartered Accountant – Registered Tax Agent - Business Advisor

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The small business hit list: is the Tax Office targeting your business?

Last month, the Tax Office released a raft of new benchmarks for small business. Under the gentle guise of 'helping small business with their tax compliance', the benchmarks are, in reality, one of the key indicators used to identify who is likely to come under Tax Office scrutiny.

The industries benchmarked are high on the 'likely offenders' list for the cash economy and the Tax Office make it clear that "businesses reporting outside of these benchmarks are likely to attract attention."

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Crackdown on the 'hobby businesses' of the rich

A lot of successful businesses have meagre origins evolving out of the home or a personal interest. For many, these businesses are able to survive because the owners already have alternative forms of income; full time jobs, or other unrelated businesses. Even the great champagne house Veuve Clicquot evolved out of a passion for and a belief in the potential of champagne (the family were successful textile manufacturers). Prior to their success however, there were many years of experimentation and losses not helped by an uncertain political and economic environment.

Until recently, taxpayers were able to offset losses incurred in the hobby business against their other tax liabilities if certain tests were passed.

Last month, the Government moved to prevent individuals with an adjusted taxable income above \$250,000 from offsetting tax losses incurred in the hobby business (non-commercial losses), unless they can prove to the Tax Office that the business is a genuine commercial activity.

The change was announced in the 2009/2010 Federal Budget as part of the Government's integrity measures. Legislation was introduced into Parliament last month to effect the changes which apply from 1 July 2009.

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"...the Government moved to prevent individuals with adjusted taxable income above \$250,000 from offsetting tax losses..."

The small business hit list: is the Tax Office targeting your business? *Continued from page 1*

The small business benchmarks provide an indication of likely costs relative to turnover for different industries. Up to five ratios are used:

Cost of goods sold to turnover	$(\text{Cost of goods sold} \div \text{turnover}) \times 100 = \text{cost of goods ratio (\%)}$
Labour to turnover	$(\text{Labour costs} \div \text{turnover}) \times 100 = \text{labour/turnover ratio (\%)}$
Rent to turnover	$(\text{Rent} \div \text{turnover}) \times 100 = \text{rent/turnover ratio (\%)}$
GST-free sales to turnover	$(\text{GST-free sales} \div \text{turnover}) \times 100 = \text{GST free sales/turnover ratio (\%)}$
Motor vehicle expenses to turnover	$(\text{Motor vehicle expenses} \div \text{turnover}) \times 100 = \text{motor vehicle expense/turnover ratio (\%)}$

So, for a pub with sales between \$250,000 and \$750,000, the expected cost of goods sold to turnover ratio is 36%-50%. In this same example, the expected labour to sales ratio is 15% - 23%. If the pub falls outside of this benchmark, the Tax Office will take a closer look at their records and determine if an audit is required.

The danger is that if your business falls outside of the benchmark for legitimate reasons, you still need to ensure that you can justify the reasons for the variations. This will be a common problem where businesses do not neatly fit into an industry definition.

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Crackdown on the 'hobby businesses' of the rich

Continued from page 1

In a recent statement, the Government labelled the change a crackdown on a "\$700 million hobby farm tax loophole" but the changes can apply to any type of business that fits the characteristics. The examples in the explanatory memoranda to the amending legislation explore party planners, vineyards, and a business which bred and sold cattle.

Under the non-commercial losses rules, you can generally apply losses against other income if you pass one of four tests:

- assessable income test — the assessable income generated from the activity must be at least \$20,000;
- profits tests — the activity must have produced a profit in three of the last five income years;
- real property test — the reduced cost base value of real property or interests in real property used on a continuing basis to carry out the activity is at least \$500,000; and
- other assets test — the reduced cost base of any other assets used on a continuing basis to carry on the activity is at least \$100,000.

If you want to know more about reducing your tax risks, contact us today.

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Crackdown on the 'hobby businesses' of the rich

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Genuine business activities are typically those that have an expectation of becoming commercially viable in the near future. For those seeking the Commissioner's discretion in order to deduct the losses, they will need to detail the business itself, the nature of the losses and the reason for failing the tests, and provide objective and independent evidence that even though the business is producing losses now, the business will pass one of the four tests within a period of time that is considered commercially viable for the industry concerned.

While there is no doubt that the Clicquot champagne house would pass the non-commercial losses tests, even they may have struggled in the first few years to prove that they were a commercial operation rather than just simply a passion. As with many tax issues, the devil is in the detail.

If you are uncertain of your position, want to start up a business, or simply want to review your options, talk to us today.

"Genuine business activities are typically those that have an expectation of becoming commercially viable in the near future."

The small business hit list: is the Tax Office targeting your business? *Continued from page 2*

The Tax Office small business benchmark hit list

Accommodation and food services

- Chicken shops
- Coffee shops
- Fish and chips shops
- Kebab shops
- Pubs, taverns and bars
- Restaurants
- Sandwich shops
- Sushi takeaways
- Takeaway food services
- Takeaway pizza shops

Administrative and support services

- Building and other industrial cleaning services
- Pest control services

Construction

- Air conditioning, refrigeration and heating services
- Bricklaying
- Blocklaying
- Concreting services
- Electrical services
- Fence construction
- Painting services

• Plasterboard installers

- Plastering and ceiling services
- Plumbing services
- Roof guttering installation
- Roof painting and repair
- Roofing services - includes roof tiling and metal roofing services
- Tiling and carpeting services
- Tiling - floor and wall
- Timber floor installation
- Timber floor sanding

Manufacturing

- Bakeries and hot bread shops
- Cake shops and patisseries

Rental, hiring and real estate services

- Video and other electronic media rental and hiring

Retail trade

- Clothing retailing
- Computer retailing
- Floor covering retail
- Florists
- Footwear retail

- Fresh fish and seafood retailing
- Fresh poultry retailing
- Fruit and vegetable retailing
- Furniture retail
- Grocery retailers and general stores
- Houseware retailing
- Liquor retailing
- Meat retailing and butchers
- Newsagents
- Tyre retail

Transport, postal and warehousing

- Courier services
- Delivery services
- Furniture removalists
- Road freight transport services
- Taxi drivers and operators
- Towing services

Other services

- Barber and men's hairdressing
- Beauty services
- Hairdressers
- Laundry and dry-cleaning services
- Nail salons

Want to know more? Talk to us if you are concerned or want to know more about any of the areas covered.

Quote of the month

"The true sign of intelligence is not knowledge but imagination."

Albert Einstein

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