THE FINANCIAL STATEMENT

A NEWSLETTER ON ECONOMIC, ACCOUNTING, INVESTMENT, TAXATION AND BUSINESS NEWS

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EXPERIENCE IN BUSINESS 40TH ANNIVERSARY 1970-2010

SMALL/MEDIUM BUSINESS NEEDS

by Paul St. Clair, F.C.A., Dip. Fin. Services

A question that springs to mind when dealing with a subject like this is, what is a small/medium size business? There is no official definition. Various governments and other groups have defined a small/medium size business as being one which employs up to 100 employees. Latest federal industrial relations laws make reference to 15 employees as representing small business. So the scope is wide as to what is a small/medium business which leaves a lot to be desired, e.g. businesses that are labour/non-labour intensive.

All business is up against competition, sometimes fierce competition. But competition, so long as it is fair, is part of the system we operate in, generally referred to as the market economy. Governments have set up 'watch dog' organisations to see that, in general, fair competition prevails.

Typical areas of concern are where big business takes advantage of its size and forces small/medium business to close down. A typical example of this is big business selling below cost which can be sustained by them but cannot be sustained by small/medium size businesses.

Another area can be with large shopping centre chains using their market place strength to insist on unfair clauses such as rents, lease period and conditions in lease agreements. Similar harsh clauses are, at times, found in franchise agreements. These practices are well known to the legal profession and they are well able to advise.

In general, various government agencies have sufficient legal support available to deal with most breaches. The regrettable situation is that too often small/medium size business owners do not seek advice or do not seek it promptly. Never sign a document unless you are absolutely sure you understand it. Otherwise seek professional advice.

Always take all necessary steps to avoid trouble. This is the least expensive approach. If a material problem arises regardless of how, seek professional advice. Another source of assistance where the problem relates to a complaint against a government department or agency is to seek advice from the free services of an ombudsman. They are most experienced and helpful where the problem is in their domain.

Governments are in a position to play a dominant role in assisting small/medium size business needs. Regrettably too often they are a hindrance. Here are four areas in which governments are actually a hindrance.

(1) Creating uncertainty. In general nothing is worse for business than creating uncertainty. The mining tax is a good example of Governments creating uncertainty in small mining companies and consequently to contractors and other small/medium size businesses.

(2) Undue delays in approving projects at all levels of government, (local, state and federal).

(3) Quite unnecessary red tape. Creating laws that pander to a very very small proportion involved and yet create immense work for small/medium size businesses.

(4) Applying in many cases the same laws to large and small businesses which are in some cases immaterial or irrelevant to small businesses. It is acknowledged that some laws do distinguish between large and small businesses, many don't. This situation is particularly prevalent in Taxation, Superannuation and Financial Planning. For these reasons it is generally agreed in the Accountancy Profession that to have a small superannuation fund under $200,000 in assets is not cost effective.

The tax laws relating to what most people would say should be simple, such as entertaining and travel expenses are quite complex. Likewise the rules relating to contractors, (and they vary between taxation, superannuation and workers compensation) can be very complex. While Governments of all political persuasions attempt to come to grips with these problems, the outcome is usually new legislation marketed as the new simplified tax system. In reality it is nothing of the sort. In some cases it has made it more complicated. The solution is that governments genuinely wishing to assist the needs of small/medium size businesses have to come to grips with exceptions to supposedly water tight laws.

In attempting to make the laws water tight, governments should take on board the concept of materiality. (A very important concept in Auditing). Also the degree of complication, the numbers they are trying to protect in regard to both the big and small picture.

Small/Medium size business generally survived the Global Financial Crisis well, considering it was the biggest financial crisis in over sixty years. Some small/medium size businesses did fail. The mix that failed were mainly those that would have failed in due course. However, the unfortunate situation was, as in most down turns, some good businesses failed. This is a serious cost to the nation both financially and with job loss. A change in our taxation laws may save good businesses from failing and thus maintain jobs. The change could be modelled on a similar concept in U.S. tax laws. Under our system businesses pay tax on their taxable income based on a yearly assessment. If in a particular year a loss incurred, under certain conditions that loss is carried forward to reduce subsequent years taxable income. If our laws were amended to allow a carry-back of losses for say two years this may save some good businesses from failing. Making the point clearer – a good business in good times makes lots of money; big tax is paid, and then comes a serious down turn affecting the business to the degree that it cannot pay its creditors. An amendment being made to say the last two good years of tax assessments may result in a large refund of tax allowing the good business to pay its creditors, survive and retain jobs. This would indeed assist those small/medium size businesses in need.

There are many areas Government could assist business in reducing the vast load of paper work which would enhance efficiency. Get rid of the many so called small taxes including stamp duty and payroll tax, which inhibit employment. In order to protect the revenue, increase Goods and Services Tax (GST) from the present 10 percent (1/11th) to 12.5 percent (1/9th). Our present rate for GST is the lowest in the world.

No one likes increasing tax, but if certain taxes are repealed, the Government may be justified in saying that the revenue must be protected. Improving efficiencies in Government expenditure may not be enough to compensate the loss of tax revenue.

What governments should not forget is that in the three areas of financial activity namely, big business, government and small/medium size business, small/medium size business employs over sixty percent of Australian workers, a statistic too important for Governments of any colour to neglect small/ medium size business needs.

(Paul St. Clair was a former President of The Institute of Chartered Accountants Small Business Committee, also a member of the Small Business Development Corporation appointed by and advising the New South Wales Government on Small Business matters and President of The Small Business Association of New South Wales.)

What is REAL INCOME?

by Evan Kambourakis, Dip. A, B. Com, ASA

Economists have recommended down through the decades that a fair and reasonable return on investment is 2% after income tax and inflation. For many, 2% may seem a ridiculously low figure, but this may be because income received in the past has been too high, fuelling inflation, or the impact of tax and inflation on the "real" 2% earning was much greater than realised. The table below shows just what the real impact of tax and inflation is:- (An excellent reason why both taxes and inflation should be kept low.)

INFLATION RATE	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
INCOME TAX RATE											
60%	10.0	12.5	15.0	17.5	20.0	22.5	25.0	27.5	30.0	32.5	35.0
40%	6.7	8.3	10.0	11.6	13.3	15.0	16.7	18.4	20.0	21.7	23.3
30%	5.7	7.1	8.6	10.0	11.4	12.9	14.3	15.7	17.1	18.6	20.0
20%	5.0	6.3	7.5	8.8	10.0	11.3	12.5	13.8	15.0	16.3	17.5

FIRSTLY — select the column which matches the inflation rate (2% to 12%).

SECONDLY — select the line which approximately matches the income tax rate (20% to 60%).

THIRDLY — the number which appears at the intersection of the column and the line indicates the rate of return necessary to offset the combined effect of income taxes and inflation.

For example, if you assume inflation will be approximately 3 % for 2011 and your tax rate is presently, say 40%, then you must earn approximately 8.3% per annum in order to show a 2% real growth after adjusting for both income taxes and inflation. It is also important to note that the above calculations do not take into account the erosion by inflation of the income received from the time of receipt (possibly monthly) until the end of the year.

Proof of calculation given in the example:-

(Based on an investment of $100)	Gross Income		8.30
	Less:	Inflation (3% of $100)	3.00
			5.30
	Less:	Income Tax (40% of $8.30)	3.30
	Real Income (after Income Tax and Inflation		$2.00

N.B.

1. The income tax rate of 40% is used in the example as it is closest to the rate that many Australians will be paying on their top dollars in the 2011 tax year.
2. In a calculation of this nature the top rate of tax must apply and not the average rate of tax.

Australia has a "more level playing field" than most countries which means that the impact of competition will keep a downward pressure on prices. In this sort of economic environment we all may expect lower profits.

SOME ADVANCED SUPER OPPORTUNITIES

by Peter Small, B. Bus, F.C.A., Dip. Fin. Services

In recent issues of this Newsletter, we have looked at some basic superannuation strategies that are now available under the new simpler super rules. As always, you must ensure that the Trust Deed of your fund is sufficiently flexible to allow you to adopt these strategies. If the wording of the Deed does not allow the trustees the power to do something, the fact that the fund would be permitted by law to do it is irrelevant. And finally, any investment undertaken by the fund must be in accordance with the Investment Strategy of the fund. If the current Investment Strategy does not allow you to make the investment, the solution may be to amend the strategy before making the investment.

If your objective is to build up your superannuation benefits quickly, you should consider **investing in growth assets** as a way to achieve the goal (subject to the higher risk usually associated with this type of investment). There are also some more exotic strategies that may be applicable in some circumstances, such as where a more adventurous approach is justified because substantial amounts of money are involved.

Another way to increase the amount accumulated in your superannuation fund is to invest in **instalment warrants**, which are a form of geared investment. Funds are otherwise not allowed to borrow, but warrants are a legitimate way to try to grow your superannuation assets more quickly.

A **distribution of trust income** by a discretionary trust to a superannuation fund is classified as "special income" of the fund, and taxed at the top personal rate of $46.5%. Nevertheless, if the distribution would otherwise go to an individual paying tax at the same rate, it could be worthwhile distributing to the fund – distributions are <u>not</u> contributions and would therefore not be counted for contributions cap purposes. Once within the superannuation fund, earnings on the distribution would qualify to be taxed at standard fund rate of 15%, rather than the individual earning income on the distribution and being taxed at the top personal rate on the investment earnings.

Contributing for minor children (or even grandchildren) is an effective way to transfer your wealth to future generations. The benefit increases if the contributions are structured so as to qualify for the government's Co-contribution payment (where contributions by some low-paid taxpayers attract a matching payment from the government of $1.00 for each $1.00 contributed).

Reserves can be used by a fund to accumulate wealth within the fund. It is therefore possible to retain the fund's wealth for younger generations. For example, where a person has accumulated substantial benefits in their fund and no longer needs to increase the balance of their account, the fund can accumulate its income in a reserve, instead of distributing it to the member. The reserve can then be allocated at some later date to another fund member, so as to boost that person's balance. The use of reserves in this way can be a useful tool where different members of a family have disproportionate superannuation balances.

Superannuation funds may even be eligible to accept **gifts** (or bequests, in the case of gifts made under a will). These amounts are not subject to contributions tax (as they are not contributions); for the same reason, they also do not breach contributions cap rules. The amount gifted would be held as a reserve in the fund, and if desired might not be allocated to any specific member of the fund. This strategy could allow for growth in value of the fund as a storehouse of family wealth, although it would require careful structuring to satisfy the rules applicable to superannuation funds, and so would be applicable only in specific circumstances.

An opportunity for those with a mortgage on their home may be to convert the mortgage to interest only, and then contribute into your superannuation fund the amount that you save on your repayments. In this way you use your **mortgage to pay your superannuation**, although this strategy would also be beneficial only in certain situations, so it is essential to do the calculations to check the potential savings before adopting this tactic.

❑ TAX RATES – 2010/11

We remind readers that the income tax rates for the year to 30th June, 2011 are:-

Income range ($)	%
0 – 6,000	0
6,001 – 37,000	15
37,001 – 80,000	30
80,001 – 180,000	37
180,001 +	45

The income tax rate for companies remains unchanged at a flat 30%.

❑ SUPERANNUATION RATES – 2010/11

The superannuation contribution caps that will apply from 1st July, 2010 remain unchanged. The maximum concessional contribution amount is $25,000, while the cap for transitional contributions (applicable to those aged 50 – 74) is $50,000. Non-concessional contributions are capped at $150,000, with the three-year bring-forward amount will be $450,000. The small business CGT exemption cap (for proceeds on disposal of a business that are rolled over into superannuation) is $1,155,000.

For those drawing a pension from their superannuation fund, the minimum pension payable for the 2011 year remains unchanged (the minimum rates vary according to the age of the person drawing the pension. For details, contact us).

Employers are reminded that the minimum contribution rate required to be made for employees is unchanged for the 2011 year. Thus, an amount equivalent to 9% of salary must be contributed for eligible employees (if you have any doubts about the eligibility of any employee, you should contact us with details).

❑ CAR EXPENSE CLAIMS – 2009 / 2010

The rates for motor vehicle expense claims using the cents per kilometre method for the 2009 / 2010 year have been announced. The rates remain unchanged from the previous year, and are:

Engine capacity (cc) #	**Rate per Kilometre (cents)**
0 - 1,600	63 cents
1,601 - 2,600	74 cents
2,601 +	75 cents

\# Conventional engines only; halve these rates for rotary engines.

The maximum allowable value of motor vehicles for depreciation purposes will be $57,466 for the 2011 year.

❑ PRIVATE COMPANY LOANS – INTEREST RATE

The minimum interest rate required for Division 7A purposes (ie. on loans by private companies to associates) for the 2011 tax year is to be 7.4% (up from 5.75% for 2010). Those who have borrowed funds from their company must ensure that the loan complies with the Division 7A rules, or better yet, contact either Paul St. Clair or Peter Small about reducing the company’s exposure to Division 7A.

❑ CHILDRENS TAX LIMIT – 2010 / 2011

The increase in the low income offset to $1,500 for the 2011 year means that children under the age of 18 will be able to earn up to $3,330 of investment income in the 2011 year without being taxed if there is no other income. This effective tax-free threshold may be useful to some parents who can structure their affairs so as to legally direct investment income to a child (this is a complex area, so we suggest that you should contact us to discuss your strategy before you take action, to ensure that you do not break the law). These rates apply only to investment income; personal exertion income is subject to the standard tax-free threshold of $6,000. Thus children can earn up to $6,000 in wages as well as $3,330 of investment income without paying tax.

❑ PAYROLL TAX (NSW)

The threshold at which employers in NSW are subject to Payroll Tax has been increased, effective from 1st July, 2010, to $658,000 per annum. (Readers in other states should contact us in regard to their exposure to payroll tax in their state)

WHAT WE NEED TO PREPARE YOUR TAX RETURN

Whilst gathering your tax information for preparation by us, you may like to check the undermentioned items to see if you have included them in your summary of information. Although the following list is not exhaustive, it will serve as a useful guide.

- ***ASSESSABLE INCOME***

PAYG Payment Summaries
Interest and royalties
Business/Partnership – income and expenses
Commissions received
Trust income
Allowances, benefits, earnings, tips and directors' fees
Dividends, including imputation details
Share transactions (full details)
Rent received
Sale of any asset where the asset was acquired after 19th September, 1985
Termination payments received (with accompanying documents)
Social Security benefits received
Pension/Annuity payments

- ***ALLOWABLE DEDUCTIONS***

These claims are subject to the substantiation provisions, where applicable.

Advertising
Bad debts (written off during the year)
Bank charges applicable to earning income
Business Expenses
Capital purchases details for stimulus
Commissions paid
Convention/Seminar expenses
Contributions to approved superannuation, provident or retirement funds (generally non-employees)
Donations & gifts over $2.00 (approved)
Education expenses - for income producing Purposes
Film investments
Home office expenses
Telephone expenses applicable to the earning of assessable income
Travelling expenses (including overseas with details)
Insurance premiums (business)
Interest on borrowings for business Purposes
Leasing costs
Legal expenses (in certain cases - full details)
Losses of previous years
Motor vehicle expenses (including business use proportion and log book if applicable)
Newspapers essential to your business
Plant, furniture, fittings, motor vehicles etc., subject to depreciation (limited to $57,180 for a vehicle purchased during the 2010 year)
Stationery, postage, printing costs
Superannuation contributions
Subscriptions to trade, business or professional associations
Sun protection, where exposure is a risk.
Purchases for resale
Rates and taxes on income producing property
Repairs to income producing property (not alterations, additions or improvements)
Tools of trade
Tax agent fees, accounting and audit fees
Wages and salaries

- ***REBATES***

Spouse and dependants (subject to any amount of Parenting Allowance received)
Sole Parent
Net Medical expenses (over $1,500 in total)
Franked dividends

- ***OTHER***

Education tax offset is available on eligible education expenses such as home computers and related expenses (eg internet, software, printers), text books study guides and tools for school based apprenticeships provided certain conditions are met
Trade debtors (at 30th June, 2010)
Private Health Insurance - rebate and surcharge details required, and Fund membership number
Stock value at 30th June, 2010 (valued at cost or market replacement value)
Depreciable assets acquired – for each assets, cost and date of acquisition
Trade creditors (at 30th June, 2010, listed under suitable headings)

by Paul St. Clair, F.C.A., Dip. Fin. Services

SMALL businesses are lagging behind larger enterprises in benefiting from the economic recovery, according to the Australian Chamber of Commerce and Industry (ACCI). The latest survey announced by the ACCI stated that overall small business conditions improved marginally during the first three months of this year being the highest level since the December quarter of 2007. Indicators also showed that Australia's economic growth is expected to continue to rebound strongly.

INTEREST cash rate, as announced by the Reserve Bank of Australia at its August 2010 meeting, remained steady at 4.50 %. However the Reserve Bank's message was clear that it expected to put up interest rates over the next two years. This being the case those considering borrowing money at variable rates, would be wise to factor into their calculations an increase in interest rates of say 2.5 % adding around $1,000 a month on a $500,000 mortgage. Alternatively consider and look into obtaining fixed interest money. It may be the way to go depending on the rates on offer between fixed and variable money. If you are going to borrow money, or are going to lease or hire purchase a motor vehicle or plant do come and see us for your finance. Kindly ring me, Paul St. Clair on (02) 9221 4088.

MOBILE phone numbers went public from April, 2010 for telemarketers use. You may now get these types of calls on your mobile phone. You will be charged for these calls. Be careful otherwise you may find that you have been signed up to all sorts of goods and services that you don't want or know about. Below is a link where you can enter your phone numbers on line to put an end to telemarketing calls; https://www.donotcall.gov.au. (Private numbers only.)

BUSINESS name registration is to be taken over from the States and Territories by the Australian Securities and Investments Commission (ASIC), as the National System to be operational by 31st March, 2011.

GOODS & Services Tax (GST) regulations specifying the requirements for documents to be 'Tax Invoices' or 'Recipient Created Tax Invoices' (RCTIs) have been removed. The new regulations commenced as from 1st July, 2010 and apply in relation to net amounts for tax periods starting on or after 1st July, 2010. This now means that the terms 'Tax Invoices' or 'Recipient Created Tax Invoices' are not required on invoices.

NEW ZEALAND is determined to match its cousin across the Tasman. In the 1960s New Zealand was in the top five OECD countries on the basis of the usual measure of wealth. It is now number 22, 16 places behind Australia and marginally ahead of South Korea. The current Prime Minister, Mr Key, has established a target to match Australia by 2025.

INTEREST rates are high in Australia by comparison with the rest of the world. Our cash rate is 4.5 %, home loan rate about 6.5%, 90 day bank bill rate about 4.75% plus about 2% bank charges, whilst the overdraft rate is about 9.5%. High interest rates go hand in hand with a strong economy, (although some small business people would not agree), and a high dollar attracting foreign investors. This is nice if you are an importer, buying goods from overseas or are travelling overseas.

The Australian dollar is a floating currency which means its value increases or decreases depending on demand for the Australian dollar. This is generally considered a good thing since it is a controlling factor for the Australian economy. Not all countries operate through a floating currency. For those that don't, their currency trading is referred to as a fixed exchange rate, and may create distortions in their economy.

PERSONAL Property Securities Act. Big big changes from 1st May, 2011. The new law threatens ownership of equipment and other goods in a way never seen in Australia. It will apply to leases of goods, putting goods on consignment for sale, selling goods on a retention of ownership basis, charging others to use or allow display or possession of goods. If you don't 'perfect' your interest under the new law, ownership of the goods could be lost. If you lease or supply anything to your customers but want to keep ownership of it you can't afford to ignore this new law. We suggest you contact your solicitor or telephone us and we shall suggest a specialist legal firm for you to contact on this matter.

4C's lenders may consider when assessing a loan application –

1. Character of the borrower
2. Capacity to repay the loan
3. Capital required
4. Collateral the security being offered.

- The national unemployment rate for August is 5.1%. Inflation has risen to 3.1% annually. The current account deficit for the latest quarter was $5.64 billion, a substantial drop from the previous quarter, whilst the trade balance narrowed to a surplus of $1.88 billion in July, 2010 seasonally adjusted. The cash rate for September 2010 remains steady at 4.50%.
- The Australian economy grew at a respectable 3.3% annual rate, its fastest quarterly pace in three years on the back of surging household consumption and strong commodity prices, ahead of all developed world economies.
- The per capital wealth of Australians increased over the latest year to $46,000, after reaching a low point of $36,200 just a year ago. This improvement still leaves us short of the high point of $58,900 that was reached before the economic crisis hit.
- New Zealand's Goods and Services Tax (GST) has increased from 12.5% to 15% as from 1st October, 2010.
- China has replaced Japan as Australia's leading export market, bringing to an end Japan's run as our major trading partner, which began in 1967 and lasted for 43 years.
- International tourist arrivals jumped 11% in July compared with July, 2009, led by Japanese and Chinese visitors.
- The value of investment by Australian companies in Africa's resources sector has grown to an estimated $20 billion.
- In relation to share dealings on the stock market you never get certainty, confidence and value together.
- Technology has completed its takeover of school classes, with the last blackboard in a NSW public school replaced by an interactive whiteboard.
- Australia's aspiration to be a "clever" country may be undermined by our lack of expenditure on research and development; we spend less than the OECD average, and less than half that of Japan and Sweden, the world leaders. Our agricultural industries show the biggest improvement in productivity, demonstrating the highest level of Australian innovation.

ONE LAST THOUGHT

A plan without action is a waste of time.

*Help save our environment - please do not throw this newsletter away.
When you have finished with it, give it to a friend!*