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Tax and your business's website costs

There's no doubt that the internet can be a crucial tool for small business, and many businesses are essentially just 'online' enterprises (no web, no business). But no website is a 'one-size-fits-all' proposition, as the purpose behind having an online presence varies greatly depending on the business involved. Is it just for promotions and marketing, to provide essential contact details or information about services offered? Will it offer e-commerce capabilities or other interactive services such as online quotes, or be capable of taking customer feedback?

Depending on the complexity or otherwise, the costs involved in creating, running and maintaining a website can vary greatly, and estimating the financial side of website development and maintenance can be far from straightforward. Similarly, the tax treatment of these costs can also be nowhere near straightforward.

From a tax treatment point of view, the sticking point with website expenditure is determining whether such costs are essentially of a 'capital' nature, or operational outgoings.

The software that allows the website to operate is deemed to be 'in-house software' if it is used to perform the functions for which it is developed. In-house software is a depreciating asset that can be written off over time. Of course the hardware (such as a computer server) if used in-house is considered 'plant and equipment' and can be depreciated, with the effective life for such assets generally being four years.

However costs dedicated to maintaining the website, and expenses associated with uploading content, such as price lists or changing details of goods or services on offer, and replacing text or pictures, constitute operating costs in the ordinary course of business, and are therefore deductible in the same year these costs are incurred. This includes the expense of paying someone else to host the website, as this is part of the regular ongoing cost of operations.

In very broad terms, these are the tax treatments available for website expenses.

Depreciable expenses

- Dedicated hardware (computer server)
- Creation and maintenance of more complicated website content. Deemed 'in-house software', which typically includes:
  - interactive functions
  - e-commerce tools
  - membership or 'sign-in' requirement
- Wages or contractor fees to the extent that they are in respect of the items above.

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About this newsletter

Welcome to Geoffrey Cliff & Associates' client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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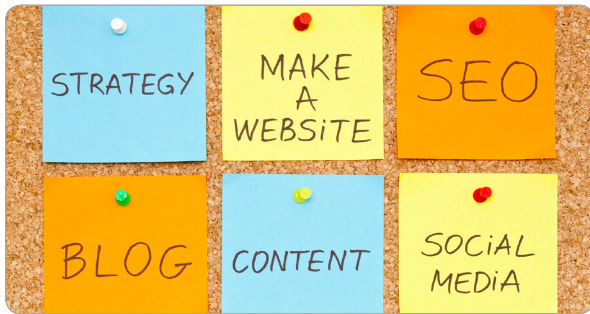

Deductible expenses

- Cost of third-party hosting
- Upload of simple text content, company information, price lists (replaced periodically)
- Operation costs in the ordinary course of business.

But the Tax Office's view of a website being 'in-house software' or not — and therefore treated as depreciable capital expenditure — can also be coloured by the simplicity and/or complexity of a website. It all comes down to what the Tax Office refers to as 'a question of fact' and degree.

A very general assertion can be made that the simpler a website is (that is, if it is merely a few documents converted to code) the more likely it is that the business can argue that costs — for example, the periodic uploading of content — are of a revenue nature carried out in the normal course of business. Expenses incurred in creating and uploading content for the bare-bones website are likely to be fully deductible in the year such costs are incurred.

But in cases where more sophisticated website elements come into play, such as adding a shopping cart, the Tax Office will likely take the view that software has been created and deployed, and the business involved may be denied a deduction, and costs may be required to be allocated to capital account and amortised. Salary, wage and/or contracting costs are generally also included, apportioned appropriately to website expenses.

As a rough guide, the Tax Office issued a tax ruling that set out some 'indicators' regarding the tax treatment of a business's website:

- it allows interaction with users, such as them 'signing in', or some system of membership
- it had to undergo a testing process to iron out bugs and fix errors
- it is specifically designed to meet certain criteria spelled out by the business
- supportive documentation is required to assist in the various phases of the lifestyle of the website.

The above ruling has now been withdrawn, and so far the Tax Office has not issued a replacement ruling. But if a business's website seems to cover one or more of these indicators, there's a good chance that the Tax Office will be looking to have related expenses apportioned on a 'revenue' (deductible) or 'capital' (depreciable) basis. Good advice will be essential in this area.

Concessions for small business

One thing to remember is the recently (from July 1, 2012) added ability of small businesses to instantly write-off capital assets up to a value of $6,500. As well, assets costing more than $6,500 can be allocated to a small business pool and subjected to a depreciation rate of 15% in the year of allocation and 30% thereafter. ■

Paid paternity leave set to become a reality

The government's newly legislated Dad and Partner Pay provides fathers – including adopting parents and parents in same-sex couples – with two weeks paid paternity leave at the pre-tax rate of $606-a-week minimum wage.

Effective from January 1, 2013, the payment is an extension to the Paid Parental Leave scheme that began on January 1, 2011. Families can start applying for the Dad and Partner Pay through Centrelink from October 2012 as it is paid through the Department of Human Services rather than by the employer.

The payment is available to eligible working fathers and partners who:

- care for a child born or adopted from January 1, 2013
- work full-time or part-time as well as casual, seasonal, contract or self-employed workers
- worked at least 330 hours in 10 of the 13 months before the birth of their baby
- earned $150,000 or less in the previous financial year, and
- fulfil the Australian residency test.

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SMSF tax return: Avoid the annual angst

Individuals and self-managed superannuation fund (SMSF) trustees alike are embroiled in a race to finish their annual returns, but for the latter the race is one that is more difficult and involved.

As we explained in our last edition, SMSFs have to appoint an 'approved auditor' at least 30 days before the due date of the annual return. The annual return cannot be lodged until the audit report has been finalised, as information from the audit report is required to complete the regulatory information in the return.

The annual return deadline for SMSFs is October 31 (except for clients using tax agents who have, generally, until 15 May). Newly registered SMSFs have to lodge by February 28 next year.

It is crucial SMSF audits are completed and annual returns are lodged on time as the Tax Office is homing in on three major areas in its compliance crackdown this year:

- non or late lodgements
- compliance breaches without an auditor contravention report, and
- unrectified auditor contravention reports.

Of all these breaches, the Tax Office reiterates the failure to lodge an annual return is the most prevalent and an offence it takes a hard line on.

The good news is SMSFs and trustees have only one return to complete as the Tax Office has merged the fund income tax and regulatory return with the member contributions statement to produce a single annual return. All SMSFs need to lodge an annual return each year in order to:

- report income tax
- report superannuation regulatory information
- report member contributions, and
- pay the supervisory levy.

Each piece of information in the annual return is inter-related – changing one label on the form is likely to require labels in other sections of the form to be amended too. As a result, it is advised that SMSF trustees provide their tax agents with all the necessary information required as the form must be completed in full, that is, not in parts.

The supervisory levy (which increased from $180 to $200 effective from July 1, 2011) will be included in the notice of assessment, and is due to be paid by the date stated. The levy needs to be paid even when a fund is in pension phase – that is, the trustees have retired and the fund is currently paying benefits.

The legal maximum number of members in an SMSF is four. All members must be included, even where no contributions were received for a member during the income year. You will also need to report members who have left the fund during that financial year if they were paid a benefit in that year.

In the annual return, the Tax Office expects answers to some ongoing disclosure questions about the SMSF's regulatory compliance – some of which may have been raised during the SMSF audit. The questions will include whether:

- the SMSF had/has financial involvement with related parties

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Paid paternity leave set to become a reality (cont)

An individual must be on unpaid leave or not working in the period that he receives the payment. A family can solely receive the Dad and Partner Pay or in addition to other payments like the Baby Bonus and the Family Tax Benefit.

Further, 'keeping in touch days' enable employees to perform paid work for short periods to assist with their return to work and are capped at 10 days for leave of up to 12 months. Parents who take additional unpaid parental leave (for a second 12 months) may access an additional 10 days.

The Paid Parental Leave Act was amended to provide that a 'keeping in touch day' must not be within:

- 14 days after birth/adoption of a child if the employee suggested/requested they perform work for the employer on that day, and
- 42 days after the birth/adoption of a child if otherwise (i.e. where it is employer-requested). ■

- investments have been undertaken on an arm's length basis
- the SMSF has allowed members access to assets and money before retirement
- the SMSF members has/had direct access to collectables such as art or wine held by the fund
- the SMSF has engaged in activities of selling goods and/or services
- all assets are appropriately secured through documentation as owned by the SMSF
- all investments have been revalued to current market value
- all assets were purchased and sold at a fair market value
- all SMSF investments – such as bank accounts, shares, unit trusts – are appropriately registered in the name of the SMSF trustees
- SMSF assets and personal assets have been kept separate
- superannuation contributions have adhered to the concessional and non-concessional caps
- non-cash contributions (known as 'in-specie' contributions) have been made to the SMSF
- the trustees have paid themselves for their services
- any of the fund's trustees have become disqualified during the year
- the relevant administrative obligations have been fulfilled, and
- the approved auditor has provided services other than auditing the fund to the SMSF

Trustees must disclose this information each year, and failing to answer may result in the return not being accepted by the Tax Office, and could even render a trustee liable for penalties that relate to making false or misleading statements.

In fact, expanded administrative penalties apply to SMSFs. The penalties apply for:

- failing to lodge returns on time
- providing false or misleading statements
- failing to keep and retain records
- failing to advise of a change of trustee, or other changes to the fund.

Failure to lodge an SMSF annual return by the due date can result in administrative penalties and the loss of an SMSF's tax concessions.

Lodgement relief

If your fund is newly registered but has not begun operating, and you tell the Tax Office in writing, you may not need to lodge an annual return.

Trustees may not need to lodge a return in the first year, or pay the supervisory levy of $200, if the SMSF:

- was registered late in the financial year (April, May or June)
- was not operating by June 30, and
- had not received contributions or rollover amounts by June 30.

The regulations pertaining to SMSFs are complex and can be daunting so please liaise with this office in regard to your SMSF's annual return.■

ATO outlines new obligations for SMSF trustees

As of August 7, SMSF trustees have to adhere to a raft of new measures which are intended to address potential risks and strengthen the SMSF regulatory framework. These measures mean SMSF trustees are:

- required to conduct a review of the fund's investment strategy on a regular basis
- required to consider insurance for fund members as part of the fund's investment strategy
- required to value the fund's assets at market value for the purposes of preparing financial accounts and statements (consult this office to find out more about the valuation guidelines for SMSFs)
- required to keep money and other assets of the fund separate from any money or assets held by them personally or a standard employer-sponsor.

While trustees have always had an obligation to keep the money and other assets of the SMSF separate from those held by them personally, it was not enforceable until the Tax Office made it a prescribed operating standard – along with the other rules above – on August 7.

This means the Tax Office is now able to enforce compliance and trustees who contravene these standards run the risk of being fined up to 100 penalty units (one penalty unit is equivalent to $110). ■

Business performance benchmarks

The Tax Office's business performance benchmarks provide a snapshot of an average business by providing a measure of costs and income (expressed as a range) that the Tax Office would normally expect a business to report when operating in a particular industry.

So far, benchmarks have been developed for small businesses in more than 100 industries. Feedback from the Tax Office indicates that around 90% of operators in benchmarked industries report within the benchmark range, which it says indicates that the vast majority of businesses are competing on a level playing field with their peers.

The Tax Office says its benchmarks were developed as part of an on-going strategy to deal with businesses that are not declaring all their income, and that they are used as an aid to help identify businesses that may be avoiding their tax obligations. By developing its benchmarks, the Tax Office has effectively drawn a line in the sand, making it clear what it expects from an average business in a particular industry. The fact that a business reports outside of its benchmarked range can serve as a red flag to the Tax Office that perhaps not all income is being reported, not all tax obligations are being met, or that a certain level of cash transactions are taking place.

While the Tax Office accepts that a proportion of businesses reporting income below the benchmark range may simply be under-performing for a variety of reasons, it says that where the shortfall is significant further checking will generally be undertaken. This can be via matching data against other known transactions, reports from other institutions or government bodies, or through direct enquiries to the business.

A business identified as reporting outside of benchmarks and contacted by the Tax Office will typically first be encouraged to review their records to ensure they have accurately reported all income — especially cash transactions — and given the option of making a voluntary disclosure to correct mistakes. Results from a 'letter program' carried out over a recent reporting season showed that the majority of businesses contacted by the Tax Office report more tax afterwards, make a voluntary disclosure, or self-amend. A small number of businesses provided valid reasons for a variance from a benchmark, often connected with incorrect business industry codes.

The other side to the benchmark coin however is that if a business finds it is reporting significantly more net income than its industry peers, this can serve as an alert that the business may not be claiming all relevant deductions, and that further enquiries in this area could yield favourable results. So keeping an eye on the benchmark reporting standards for an industry can also serve the purposes of a business owner, not just the Tax Office's stated goal of being vigilant on tax compliance and cracking down on the cash economy.

Performance benchmarks contain several ratios to help compare and check business results, and may include:

- cost of goods sold to turnover
- cost of materials to turnover
- labour to turnover
- rent to turnover
- motor vehicle expenses to turnover.

There may be good reasons for disparity between reported results and the benchmark, but taxpayers who find they are outside the benchmarks for their industry should also ensure that appropriate records and paperwork is on hand. Should the Tax Office make enquiries, simply having the right evidence to explain expenses and income will generally be all that is required.

Input benchmarks

Input benchmarks apply to tradespeople who undertake domestic projects, and show an expected range of income based on the labour and materials used. The benchmarks were developed using information provided by industry participants and trade associations. They can assist businesses to:

- compare operations to the general industry's benchmark range
- check that records accurately reflect the business's income
- estimate a level of turnover based on labour and material costs.

Should you require further information or direction on industry benchmarks for your business, please contact this office. ■

Choosing the right business structure

Start up businesses need to make one important decision from the outset – what type of business set-up will suit you best?

You've got a choice of four basic business structures – sole trader, partnership, company or trust. Of course, there are also more sophisticated structures out there, but most possible structures are essentially hybrids of two or more of these basic ones. Which structure is best will depend on a few considerations that we can run through right now; and there are real advantages in getting this choice right from the outset to avoid the headaches and costs that would come with fixing up problems down the track – like they say, prevention is better than cure!

One tip that every new business owner should hear is this: Sit back, put your feet up, and answer yourself this question – where will your business be, and what will it look like, a few years from now?

The sorts of things you need to chew over are: Do you want to stay small and work from home? Will you need to employ staff? How long will you stay in business? Will you have a partner or partners? What is your market? Will you need to chase start-up capital?

But don't sweat over your choice. You can always change business structure as your enterprise changes and grows. For many businesses, the growth plan may well include changing to a different structure at a key point in the future – for example, if you plan to expand overseas. Ultimately, the business should be in the structure that is most appropriate in each stage of its life cycle. The important thing is to have a robust and long-term plan right from take-off.

Although the choice is yours, it may help to know how each structure will affect the way your income is taxed, your operating costs, how you will be able to protect your assets, and how clients and other businesses will deal with you.

Sole traders

To be a sole trader is the simplest business structure, and as the name implies you will be operating the business on your own, and will control and manage all aspects of your business. For tax purposes, your personal financial affairs and your business's affairs are one and the same – there is no separation.

There are few legal formalities, but you will need an ABN (Australian business number), and the structure is inexpensive to set up. You receive the full benefit of any profits, and keep all after-tax gains when you sell-up. However you also personally bear the full brunt of any operating losses.

Also, access to finances is limited to your own resources, and you are legally responsible for everything the business does. You also put private assets at risk, such as your house or car, if the business goes into serious debt and these private assets are targeted in any debt collection efforts.

As a sole trader:

- you use your individual tax file number when lodging your tax return
- the income of the business is treated as your own income
- your business income is taxed at personal income tax rates along with your income from other sources
- depending on your turnover, the Tax Office may need you to pay PAYG instalments (pay-as-you-go) over the year towards the amount of tax that can be expected at the end of the financial year
- you may also have to register for GST (goods and services tax)
- you will also need to take care of superannuation arrangements, but may still be able to claim for personal contributions
- and if you decide to take on an employee, you'll need to pay 9% of their ordinary time earnings into their super fund.

Amounts of money you take from your sole trader business are not 'wages' for tax purposes, even though you may consider this the case, so you can't claim a deduction for money you 'draw' from the business.

Partnerships

This arrangement sees you carrying on business with one or more other people, and receiving income jointly. There are more shoulders to bear the burden, but also more people to share profits, losses and responsibilities.

Partnerships are still inexpensive to set up, and there will likely be greater financial resources than if you operated on your own as a sole trader. On the flip side however, you and your partners are responsible for any debts the partnership owes, even if you personally did not directly cause the debt.

And each partner's private assets may still be fair game to settle serious partnership debt. This is known as 'joint and several liability' – the partners are jointly liable for each other's debts entered into in the name of the business, but if any partners default on their share, then each individual partner may be severally held liable for the whole debt as well.

As a partnership:

- the business itself doesn't pay income tax. Instead, you and your partners will each need to pay tax on your own share of the partnership income (after deductions and allowable costs)
- the business still needs to lodge a tax return to show total income earned and deductions claimed by the business. This will show each partner's share of net partnership income, on which each is personally liable for tax
- if the business makes a loss for the year, the partners can offset their share of the partnership loss against their other income
- a partnership does not account for capital gains and losses at all; if the partnership sells a CGT asset, then each partner calculates their own capital gain or loss on their share of that asset
- the partnership business is not liable to pay PAYG instalments, but each partner may be, depending on the levels of their personal income
- as a partner you will need to take care of your super arrangements, as you are not an employee of the business
- personal contributions should still be deductible, and any eligible employees of the business will still need to be covered for the compulsory 9% super guarantee.

Money drawn from the business is not 'wages' for tax purposes. As with any business, you will need an ABN and will need to register for GST if the business's annual turnover is more than $75,000 (before GST).

Companies

Operating your business as an incorporated company will transform your enterprise into a separate legal entity. This more complex business structure is usually more costly to set up and administer, and will also come under the regulations of the Australian Securities and Investments Commission (ASIC).

A company will have far greater access to capital, shareholders are not liable for the debts of the business beyond the amount of capital they contributed, there will be greater asset protection because creditors can't go after the shareholders' personal assets, only the company's own assets, and it will pay its own tax on its own profits. But tax reporting requirements are more onerous, and minority shareholders have little say in the running of the business unless they are in senior management.

For a company:

- it will need its own bank account, and its own tax file number
- it needs to lodge an annual income tax return, as money earned by the business belongs to the company
- the tax return will need to show the company's income, deductions and tax it is liable for
- PAYG instalments will need to be paid, which are credited against the end-of-year income tax
- it will pay tax on its assessable income (profits) at the company tax rate of 30%, and there is no tax-free threshold
- GST will need to be taken care of if annual turnover is more than $75,000 (for not-for-profits, it's $150,000)
- compulsory superannuation payments have to be made where required by law in respect of the company's employees (including yourself, if you are a director of the company)
- if you receive wages or director's fees, this needs to be shown on your individual income tax return.

If you are a shareholder in the company then you are entitled to receive dividends on which you will pay tax. Just be aware that if the company makes loans or payments to you, or if you take company assets for yourself, the law may treat these transactions as unfranked dividends, and they'll be taxable to you as such, unless they are formally converted into interest-bearing loans.

Trusts

Another way to describe a trust is as an obligation or a promise – where a person or a company agrees to hold income-earning assets or property for the benefit of others. A trust formalises this obligation. The one who legally holds the assets is the trustee. Those who benefit from the income are the beneficiaries.

So one basic function of a trust is to separate legal ownership and control (which the trustee has) from beneficial ownership (which the beneficiaries have). A natural result from this is increased asset protection, as the beneficiaries' personal finances are not put at risk by the business, since the business assets are legally owned by the trustee and not by the beneficiaries.

The most common variety is a discretionary or family trust. Setting up a trust can be more expensive, and administrative paperwork potentially more complicated, but there can be tax advantages, as:

- tax is usually paid by the beneficiaries at their personal tax rates, which may be well below the top marginal rate, not by the trust, which would be taxed at the top marginal rate of 46.5%
- as trustee, you can use your discretion each year to decide which beneficiaries receive income, and how much – as long as the outcomes are within the rules contained in the trust deed, which is the document governing how the trust operates
- the trust's beneficiaries, via their individual returns, pay tax on their share of the trust's net 'distributed' income
- if all income is distributed, the trust itself would generally not be liable for any tax except in limited circumstances, when the trustee would pay tax on behalf of certain beneficiaries
- a trust will need its own tax file number, and the above ABN and GST obligations apply
- a trust is not liable for PAYG instalments, but trustees and beneficiaries may be
- the same superannuation obligations also apply
- obligations also apply if the trust hires employees for its business.

If a beneficiary is not over 18 years of age or is not an Australian tax resident, the trustee will pay tax on the distribution on behalf of the beneficiary. The beneficiary has to declare the income anyway, but can claim a credit for tax paid on their behalf.

If the trust holds on to income, you as trustee will be assessed on that income at the highest individual marginal rate. If the trust carries on a business, all income earned and claims for expense deductions must be shown on a trust tax return, which will also show the amount of income distributed to beneficiaries. ■

Trust reform delayed another year

The government's broad reform of the taxation of trust income has been delayed yet again, from July 1, 2013, with a likely commencement date of July 1, 2014, which would coincide with the intended commencement date for a new tax system for managed investment trusts.

A landmark High Court case highlighted the legality or otherwise of the streaming of trust income, and the fact that amounts on which a beneficiary is assessed for tax may not always match the amounts they are entitled to under trust law. The mismatch led to unfair outcomes and opportunities for tax manipulation, according to the Tax Office, so amending legislation was put in place to allow for capital gains and franked distributions to be streamed to beneficiaries (where permitted by a trust deed) by making them 'specifically entitled'.

Other key issues at stake in trust law reform are fixed trusts and managed investment trusts (and the ability or not to admit further unit holders, and at what value) and the entitlements of beneficiaries under the general trust laws, including where there is no beneficiary presently entitled, disability trusts and child maintenance trusts.

While extending the deadline for proper trust law reform could be viewed as prolonging a good measure of uncertainty for many trustees, it is also appropriate, given the importance and complexity of trusts, that informed consultation and more considered solutions are adopted, which will hopefully result in better outcomes. We will advise of further developments as they occur. ■

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