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**Is ATO Getting Smarter?** With their huge budget ATO has used technology very effectively improving their IT resources enormously. These IT resources were used to leverage the enormous amount of data they receive on lodgement of tax returns.

Going further now they are using technique marketing and management to analyse business performance.

Together with reference from relevant industry bodies, ATO now has combined the lot and leveraged the information producing benchmarks against which businesses will be compared.

The list below relates only to the most common businesses. With the diversity of small business now the benchmarks may have limited application. But is this only the beginning ...

See below for more details.

**Tax Tip** - Where the business has kept all the appropriate records and working papers supporting the information on their accounts and tax returns and they have complied with the tax law ... there should be minimal problems

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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.”

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.

## ***ATO list – Is your small business being targeted – See below***

<b><i>Accommodation and food services</i></b>		
Chicken shops	Coffee shops	Fish and chips shops
Kebab shops	Pubs, taverns & bars	Restaurants
Sandwich shops	Takeaway pizza shops	Takeaway food services
Sushi takeaways		
<b><i>Administrative and support services</i></b>		
Building and other industrial cleaning services		Pest control services
<b><i>Construction</i></b>		
Air conditioning, refrigeration and heating services		Bricklaying
Blocklaying	Concreting services	Electrical services
Fence construction	Painting services	Plumbing services
Plasterboard installers	Plastering and ceiling services	Roof guttering installation

Roof painting and repair	Roofing services - includes roof tiling and metal roofing services	
Tiling - floor and wall	Tiling and carpeting services	
Timber floor sanding	Timber floor installation	
<b>Manufacturing</b>		
Cake shops and patisseries	Bakeries and hot bread shops	
Plasterboard installers	Plastering and ceiling services	Roof guttering installation
<b>Rental, hiring and real estate services</b>		
Video and other electronic media rental and hiring		
<b>Retail trade</b>		
Clothing retailing	Computer retailing	Floor covering retail
Florists	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	
<b>Transport, postal and warehousing</b>		
Courier services	Delivery services	Furniture removalists
Road freight transport services	Taxi drivers and operators	Towing services
<b>Other services</b>		
Barber and men's hairdressing	Beauty services	Hairdressers
Laundry and dry-cleaning services		Nail salons

## ***ATO 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.

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.

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.

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## *Investment Allowance traps*

The Investment Allowance (or tax break) was part of the Government's stimulus package designed to ensure that business investment remained consistent, despite the dwindling economy.

Unfortunately, a lot of time passed between when the Government first announced the tax break and the rules being enacted by Parliament. As a result, there was little guidance on exactly how the Investment Allowance would apply in real life despite being heavily utilised and promoted. Since the release of the enacting legislation, the ATO have clarified many of the points of concern to business.

### **Where the asset is used for personal as well as business use**

To qualify for the Investment Allowance, an asset needs to be for the "principal purpose of carrying on a business." There has been a lot of confusion around what "the principal purpose of carrying on a business" really means, particularly for assets like cars where the asset might be used for personal as well as business use.

The Tax Commissioner has since concluded that where a taxpayer is expected to use an asset for more than 50% of the time for the purpose of carrying on a business, this will meet the eligibility criteria for the Investment Allowance.

### **Hire purchase agreements**

To qualify for the Investment Allowance the “investment commitment time” must occur after 12.01am, 13 December 2008 and before 1 January 2010. Also, in order for a non-small business entity to qualify for the 30% Investment Allowance, the investment commitment time must have occurred before 1 July 2009.

When it comes to hire purchase agreements, the Tax Commissioner has stated that the “investment commitment time” is the time at which the hire purchase agreement was entered into. It is not when the deposit was paid or order placed. So, be careful you have the right dates in place if you are claiming the investment Allowance.

### **Demonstrator vehicles**

Generally, the Investment Allowance only applies to new cars. The exception is where the car has been used as a demonstrator vehicle held for “testing and trialling”. But be careful, just because the dealer calls it a demonstrator vehicle doesn’t mean the tax office will accept their definition. To qualify you need to prove that the car was only held for a reasonable period of testing and trialling. As a general rule, the ATO have stated that a demonstrator vehicle will be considered ‘new’ where it has been used for demonstration purposes for a period up to three months.

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## ***Avoid delays - Lodge early – Tax Refunds Sooner***

Most property investors are negatively geared. This means that where they have not requested a variation of their PAYG deduction from their employer, they get refunds on lodging their tax returns at the end of the financial year.

ATO is now processing lodgement of returns very fast, particularly where there is a refund and the refund is being deposited electronically into the taxpayer bank account. Some refund assessments are issuing within 7 working days.

**Tax Tip** - To get refunds before Christmas lodge your tax return soon.

Another reason for lodging early is that ATO is rolling over their old IT to new IT in January?

*Here is what ATO has recently advised all agents:*

“Business and individual taxpayers may be affected by our plans to implement our new income tax system in late January 2010.”

### **What ATO are doing**

The Tax Office's computer systems will be **unavailable from Friday, 22 January until Wednesday, 27 January 2010** while they implement the new system.

In addition, they will need to **suspend** some processing in the weeks leading up to the implementation.

There will also be some **processing delays in the weeks following the implementation** as the new system gradually returns to full processing levels. We expect these **delays may continue during February 2010**.

**Tax Tip** - Visit your accountant sooner rather than later this year.

If you need help call **Property Tax Specialists** Shukri Barbara on 02 9411 8133 or visit our website.

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## *10 secrets of a winning business*

Every day business owners ask the question 'what makes a great business and what do I need to do to move from good to great?'

The recipe for a great business is not about industry, size or location; it's about a series of winning fundamentals that define all great businesses. Let's have a look at them:

### **1. Vision**

The business's leadership can see where the business will be in three to five years. They understand their market and position the business for the future. In many cases, they are market leaders and they drive the direction of the business.

### **2. Leadership & drive**

The owners are true entrepreneurs. They lead and drive the business. Their energy is contagious and their team is excited to be part of the business.

### **3. Differentiation**

They have carved out a point of differentiation for the business. It is meaningful, sustainable and easily articulated. Their differentiator immediately separates the business from its competitors and provides the business with a sustainable competitive advantage.

### **4. Market presence**

Great businesses have market presence. This does not necessarily mean that they have great marketing or are necessarily spending large amounts of marketing. They may drive their business off a very small customer base that produces substantial revenues. Or, they may be highly visible through their marketing efforts. The key is they understand their market intimately and do what is necessary to position the business in that market.

### **5. Team**

The business has developed beyond the owners. It is sustainable through the strengths of a great group of people who bring together a mix of skills. In part, it is great because of the fusion of these skill sets.

**6. Strong financial management**

The business operators know their numbers and actively manage them. There are few surprises. Most of what happens is predictable. They manage the 'health & hygiene' financial management well and have lead indicators in place that provide early warning signals for any problems that might occur. These lead indicators are in carefully chosen KPIs – generally seven at most, that provide management with essential performance information on the business. They are supported by strong operating budgets, cash-flow forecasts and a strong follow-up system. Stock, debtors, debt and cash all have clear target positions and are actively managed.

**7. Great reporting**

As focussed as they are on growth, they maintain strong corporate governance and a reporting system that meets the needs of all stakeholders. Generally, this will include regular monthly and quarterly updates, a comparison to forecasts, and the resetting of latest period estimates that balance the past with the future.

**8. Sustainable business model**

Not just a good idea, not just passion and energy, not just hard work and commitment, great businesses have a sustainable and profitable business model. They bring together all of the elements required to produce a great result in a consistent business format. They have thought through what is required for success. Their focus is on outstanding performance and they will accept nothing less.

**9. Operational fulfilment**

Great businesses deliver. Others have good ideas or can sell well, but without the ability to deliver, the business is going nowhere. They have worked out what is required and have a strong fulfilment system in place.

**10. Adequate capital**

They understand how much capital is required and have worked out how to put that capital in place. The owners are prepared to leave profits in the business and manage cost structures down to allow the business to grow and develop. They know how to feed the business.

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## ***We look forward to being of Service***

Please do not hesitate to contact us if you would like to review & discuss your current property & tax situation, your asset protection strategy, structuring your next investment property, planning to legally minimise your tax position or just to prepare your next tax return. Contact us on [info@propertytaxspecialists.com.au](mailto:info@propertytaxspecialists.com.au), or call Shukri on 02 9411-8133.

We also look forward to your referrals where you think we can be of help.

To improve our service we welcome all constructive comments on this newsletter and other materials.

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*The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained. Contact your accountant or Property Tax Specialists at [info@propertytaxspecialists.com.au](mailto:info@propertytaxspecialists.com.au) or call 02 9411 8133*

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Kind Regards  
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