2021 Tax Planning Strategies for SMEs

By Peter Bembrick, tax consulting partner, HLB Mann Judd, and Joe Kaleb, Australianbiz CEO

Below are some practical strategies that SME business owners should consider in the lead up to 30 June 2021 to reduce this year's tax liability.

SMALL BUSINESSES

The following two strategies apply only to small businesses that satisfy the aggregated turnover requirements:

1. Deduction for prepaid expenses

A small business with an aggregated turnover of less than $50 million claim an immediate deduction for certain prepaid business expenses where the payment covers a period of 12 months or less and that period ends before the end of the next income year. The most common expenses that you should consider prepaying by 30 June 2021 include lease payments, interest, rent, business travel, insurances and business subscriptions.

Note that your business must be obligated to make the prepayment under the relevant contractual agreement to get the immediate tax deduction this financial year - you cannot simply choose to prepay the expense.

2. Other tax concessions

A small business, with an aggregated turnover of less than $10 million, is also entitled to the following additional tax concessions for the 2020/21 year:

- Simplified trading stock rules, giving small businesses the option to avoid an end of year stocktake if the value of their stock has changed by less than $5,000 from the previous year; and
- The option to account for GST on a cash basis and pay GST instalments as calculated by the ATO.

Temporary full expensing of the depreciating asset expenditure (replacing the instant asset write-off concessions)

Under the Government's latest COVID-19 stimulus measures, specifically the October 2020 Federal Budget and extended in the May 2021 Budget, the instant asset write-off concessions have been replaced with a more generous regime that allows a full write-off of the cost of new depreciating assets, and improvements to existing depreciating assets, incurred by a business with aggregated turnover of less than $5 billion and installed and ready for use from 7.30pm on 6 October 2020 up until 30 June 2023.

The immediate deduction is also available to businesses with aggregated turnover of less than $50 million for purchases of second-hand assets, and businesses with aggregated turnover of less than $10 million with a low value asset pool get an immediate deduction for the closing pool balance.

Importantly to obtain an immediate tax deduction in a particular year, the asset must be used or installed ready for use by the end of that year, and in all cases must be used or installed ready for use no later than 30 June 2023. This could be an issue for imported equipment and also in the

domestic context where Australian suppliers are COVID-19 impacted or transport companies are having difficulty keeping up with the demand for deliveries.

Scrap obsolete equipment

If obsolete plant and equipment is sitting on your depreciation schedule, it should be scrapped and written off by 30 June 2021 to generate an additional tax deduction.

If your business is classified as a small business and assets were allocated to a small business pool, as noted above if you choose to apply temporary full expensing, then the balance of your small business pool will be written off at the end of the income year, otherwise you would continue to claim one deduction for the pool of assets - you cannot separately write-off individual assets in the pool.

Loss carry back concession for companies

Another concession introduced in the October 2020 Federal Budget and extended for a further 12 months in the May 2021 Budget, this concession allows a company (i.e. not available to partnerships, trusts or individuals) to "carry back" tax losses incurred in any of the 2020, 2021, 2022 and 2023 years to an earlier year as far back as 2019. A refund could be claimed on lodgement of tax returns from the 2021 year onwards, representing the tax saving that would have arisen if the tax loss had been available to claim in the earlier year.

Claiming concessional superannuation contributions

The maximum concessional superannuation contribution limit is $25,000 for all individuals. Note that employer super guarantee contributions and salary sacrifice contributions are included in the cap.

Where a concessional contribution is made which exceeds these amounts, the excess is taxed at your marginal rate, less a 15% tax offset for the tax already paid by the super fund on the excess contribution.

If you are making a personal superannuation contribution, ensure you obtain the relevant documentation from your superannuation fund to substantiate claiming the deduction before lodging your 2021 tax return.

In order to obtain a deduction in the 2021 financial year, the contribution must be received by your superannuation fund by 30 June 2021 - refer points (ii) and (iii) below.

Other important superannuation issues in the lead up to 30 June 2021

(i) Carry-forward concessional super contributions

From 1 July 2019, you can make 'carry-forward' concessional super contributions if you have a total superannuation balance of less than $500,000 at the end of the previous year. The unused concessional contributions caps can be used on a rolling basis for five years upon which they will expire.

For example, if a person had $20,000 in concessional contributions made on their behalf during the 2019-20 year, the $5,000 balance carries forward to the 2020-21 year.

This means the person can make concessional contributions of up to $30,000 this financial year without breaching the contributions cap if their super balance was less than $500,000 at 30 June 2020.

(ii) Super contributions made by cheque or electronic funds transfer (EFT)

Care needs to be taken where last minute contributions are made by cheque or electronic fund transfer to ensure that the deduction can be claimed in the current financial year.

Where the super contribution is made by cheque and the fund receives it by 30 June 2021, the deduction is allowed in the current financial year so long as the trustee banks the cheque within 3 business days and the cheque is not subsequently dishonoured.

Where the contribution is by EFT, it is taken to be made when the amount is "credited" to the bank account of the fund and not when the transfer is made.

Unless the contribution is made between linked accounts of the contributor and the fund (held at the same bank), the deduction may be deferred to the next financial year where the funds are not credited to the super fund account by 30 June 2021.

(iii) Super contributions made to the government's small business superannuation clearing house (SBSCH)

To ensure a deduction can be claimed for employee super guarantee contributions in the 2021 year, the ATO says that due to processing time delays, payments need to be accepted by the SBSCH by 23 June 2021.

Defer income & capital gains tax

Businesses that return income on a cash basis are assessed on income as it is received. A simple end of year tax planning strategy is to delay "receipt" of the income until after 30 June 2021.

Businesses that return income on a non-cash basis are generally assessed on income as it is derived or invoiced. Income may be deferred in some circumstances by delaying the "issuing of invoices" until after 30 June 2021.

Realising a capital gain after 30 June 2021 will defer tax on the gain by 12 months and can also be an effective strategy to access the 50% general discount which requires the asset to be held for at least 12 months. The date of the contract is the realisation date for capital gains tax purposes. In some cases, the capital gain can be further reduced to Nil under the small business capital gains tax concessions.

Tax rate reduction from 1 July 2021 for certain companies

Balanced against the timing benefits of deferring income and bringing forward deductions, it is worth noting that a company that is a 'base rate entity' (BRE) will have its tax rate reduced from 26% to 25% from 1 July 2021. A BRE is a company with aggregated turnover for the year less than $50 million and 'base rate entity passive income' (BREPI) representing 80% of less of its total assessable income for the year. BREPI is passive income such as dividends, interest, rent, royalties and net capital gains (although note that this excludes business income flowing up from a trading company to a holding company by way of a dividend).

Family trust distributions

For the 2021 year, minors (i.e. children under the age of 18 at 30 June) can receive investment income (including trust distributions) of up to $416 without paying tax. Any income earned above this amount is taxed at penalty rates.

Income received by a family trust should be allocated amongst the various beneficiaries by 30 June each year and documented by way of resolution. It is preferable that the resolution is made by 30 June 2021 to avoid any later dispute with the ATO as to whether the income was properly allocated by this date.

The exact requirements for allocating trust income are set out in the trust deed, and as each trust deed is different, it is vital that trustees are aware of the terms applying to that particular trust.

Failure to follow the terms of the trust deed and to allocate the relevant income by 30 June 2021 may result in the trustee paying tax on income of the trust at the top marginal tax rate of 47% (including 2% Medicare levy).

Note also that special rules apply to the “streaming” of capital gains and franked dividends received by family trusts to particular beneficiaries, and if you wish to stream it is critical that there are sufficient “streaming” provisions in the family trust deed which allow the trustee to do so.

Write-off slow moving or obsolete stock

All businesses have the option of valuing trading stock on 30 June 2021 at the lower of actual cost, replacement cost, or market selling value. A different valuation method may be applied for each item of trading stock.

For example, where the market selling price of stock items at year-end is below the actual cost price, your business can generate a tax deduction by simply valuing the stock at market selling value for tax purposes.

Also, in situations where stock has become obsolete at year-end (e.g. fashion clothing), your business may elect to adopt a lower value than actual cost, replacement cost, or market selling value, provided the value adopted is reasonable.

Claim deductions for expenses not paid at year end

All businesses are entitled to an immediate deduction for certain expenses that have been “incurred” but not paid by 30 June 2021 including:

Salary and wages. A tax deduction can be claimed for the number of days that employees have worked up to 30 June 2021, but have not been paid until the new financial year.

Directors fees. A company can claim a tax deduction for directors fees it is “definitely committed” to at 30 June 2021 and has passed an appropriate resolution to approve the payment. The director is not required to include the fees in their taxation return until the 2022 year when the amount is actually received.

Staff bonuses and commissions. A business can claim a tax deduction for staff bonuses and commissions that are owed and unpaid at 30 June 2021 where it is “definitely committed” to the expense.

Repairs and maintenance. A deduction can be claimed for repairs undertaken and billed by 30 June 2021 but not paid until the next income year.

Write-off bad debts

If your business accounts for income on a non-cash basis and has previously included the amount in assessable income, a deduction for a bad debt can be claimed in 2021 so long as the debt is declared bad by 30 June 2021.

Your business will need to show that it has made a genuine attempt to recover the debt by 30 June to prove that the debt is bad. It's preferable that this decision is made in writing (e.g. a company directors minute).

Your business can also claim back the GST paid on debts that have been written off as bad, or where not written off as bad, the debt has been outstanding for 12 months or more.

Personal services income rules

If you conduct a business through a trust or company structure that relies on your personal effort and skill to generate the income, there are different rules that apply to the diversion of some or all of that personal services income.

For example, if your company earns personal services income, the ATO can treat the income as having been earned by the individual rather than the entity that earns the income, unless certain tests can be satisfied. The personal service income regime also denies particular types of deductions which would otherwise be available to a business.