

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 be scrutinised by the Tax Office.

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.

See over the page for the Tax Office small business hit list.

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

Quote of the month

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

Albert Einstein

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. *Continued over the page*



The Tax Office small business benchmark hit list

Accommodation and food services		
Chicken shops	Coffee shops	Fish and chips shops
Kebab shops	Pubs, taverns & bars	Restaurants
Sandwich shops	Takeaway pizza shops	Takeaway food services
Sushi takeaways		
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	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	
Manufacturing		
Cake shops and patisseries	Bakeries and hot bread shops	
Plasterboard installers	Plastering and ceiling services	Roof guttering installation
Rental, hiring and real estate services		
Video and other electronic media rental and hiring		
Retail trade		
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	
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

Crackdown on 'hobby businesses' *continued*

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.

If you are uncertain of your position, want to start up a business, or simply want to review your options, contact us on t: 07 5593 3555 or e: info@marzollholloway.com.au