

# Tax basics for business operators

## Main topics

- Tax basics
- How tax works for different business structures
- Summary of business taxes and payments
- Claiming deductions for business expenses
- Why keep good business records?
- Contacts for information and support

## The basics:

- the type of business structure you choose affects how you pay tax and how much you pay – before choosing a business structure (e.g. partnership) you should check the tax obligations
- make sure you keep good records as this will save you money and time
- accounting software is well worth purchasing – it can also process GST
- the ATO website ([ato.gov.au](http://ato.gov.au)) has many online resources – these include the **Checklist for people starting a new business**, calculators to do the hard work, record keeping software and print-based publications

## Tax basics

All businesses are legally required to pay tax. Australia has self-assessment taxation, which means you (or your tax professional) have to work out your tax obligations and pay the correct amount to the Australian Taxation Office (ATO) by the due date. You are required to keep records to support your calculations.

For most businesses, the income tax year ('financial year') runs from 1 July to 30 June. Commonwealth or state taxes (and sometimes exemptions) will apply to your business, depending on your size and location.

- **Commonwealth taxes:** the ATO administers federal taxes, which include income tax, the Goods and Services Tax (GST), and Fringe Benefits Tax (FBT)
- **State taxes:** the State Revenue Office (SRO) administers Victorian taxes, including Payroll Tax, Land Tax and Land Transfer Duty

■ **How income tax is collected** Income tax is collected in two ways: the pay as you go (PAYG) system and annual income tax returns. If you're in business, you'll probably have to pay quarterly instalments to pay your income tax as you earn your income. The ATO will credit your quarterly PAYG instalments against your annual income tax liability at the end of the tax year. You pay tax on your taxable income (assessable income minus allowable deductions).

■ **Tax File Number (TFN)** The ATO issues everybody with a TFN. Your TFN is yours for life even if you change jobs, move interstate or change your name. Partnerships, trusts and companies have their own TFN.

■ **Australian Business Number (ABN)** Every business has an Australian Business Number (ABN) for GST and other business tax registrations. You will need to quote your ABN, for example, on invoices, even if you're not registered to collect GST. You can apply for your ABN online at the Australian Business Register website ([abr.gov.au](http://abr.gov.au)).

■ **Business Activity Statement (BAS)** Businesses report and pay most of their taxes through their BAS and income tax return. The BAS is used to report and pay GST, PAYG, fuel tax credits, fringe benefits tax and some company and superannuation fund instalments. Your BAS is personalised, with some parts already filled in. BAS can be paid quarterly or monthly, or annually if you're voluntarily registered for GST.

## Step-by-Step Guides

■ New starters can get help with the key aspects of business taxation by using the online step-by-step guide, **Tax Basics**. You will finish the guide with a personalised checklist of jobs to complete.

Go to: [business.vic.gov.au/stepbystep](http://business.vic.gov.au/stepbystep)



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■ **Tax concessions for small business** The ATO offers tax concessions to small businesses with an annual turnover of less than \$2 million. The concessions reduce red tape and compliance costs for depreciation and trading stock rules. An eligible business can choose the concessions most suited to its needs. If you're not already taking advantage of these concessions, visit the ATO website ([ato.gov.au](http://ato.gov.au)) for more details.

### Tip

Is your business tax-ready? is a Tax Office online tool for new starters. Answer a few questions online and develop a customised report that will get you ready for lodgements and payments to the ATO.

Complete contact details for the Tax Office can be found on the last page.

## How tax works for different business structures

The type of business structure you choose affects how you will pay tax and how much you will pay. Before you choose a business structure (e.g. sole trader), you should check the tax obligations. Refer to the information sheet **Choosing the best structure for your business**. It can be downloaded from the Business Victoria website ([business.vic.gov.au](http://business.vic.gov.au)).

### Sole trader

- **Description:** a sole trader is the simplest business structure. An individual trades on their own, controlling and managing the business.
- **Tax File Number:** the sole trader uses their personal tax file number when they lodge their income tax return
- **ABN:** a sole trader may apply for an ABN for their business and use this number for all their business dealings
- **How tax is paid:** any business income is treated as the person's individual income. They are responsible for any tax payable by the business. This means that after deducting allowable expenses, they include the business income and add it to their individual tax return. Sole traders pay the same tax as individual taxpayers at 'marginal tax' rates. Individuals don't pay tax on the first \$6,000 they earn ('tax-free threshold').

### Partnership

- **Description:** for tax purposes, a partnership is an association of persons that run a business as partners or receive income jointly
- **Tax File Number:** a partnership needs its own tax file number and uses it when lodging its annual income tax return
- **ABN:** the partnership may apply for an ABN and use this for all partnership business dealings
- **How tax is paid:** a partnership is not a separate legal entity and doesn't pay income tax on the income earned by the partnership. Instead, partners pay tax on their share of net partnership income. The partnership itself also has to lodge a separate annual partnership income tax return.

### Company

- **Description:** a company is a distinct legal entity with its own income tax liability, separate from an individual's income tax
- **Tax File Number:** the company must register for a tax file number and use it when lodging its annual income tax return
- **ABN:** a registered company is entitled to an ABN
- **Australian Company Number (ACN):** a registered company must display its ACN on its public documents

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- **How tax is paid:** money earned by the business belongs to the company. Companies must lodge an annual company tax return and usually pay PAYG instalments. Company tax rates are lower than personal tax rates.

### Trust

- **Description:** a trust is an obligation imposed on a person to hold property or income for the benefit of others ('beneficiaries')
- **Tax File Number:** the trust must have its own tax file number
- **ABN:** if the trust is a business operating in Australia the trustee may register with the Tax Office for an ABN
- **How tax is paid:** this depends on what type of trust it is, and how the trust distributes income to the trust beneficiaries

#### Tips

Use the **Find an Adviser** service at the Business Victoria homepage to locate an accountant or bookkeeper in your local area.

And ask them about the accounting software they use before you buy your own.

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## Summary of business taxes and payments

■ **Goods and services Tax (GST)** The GST is a broad-based tax of 10 per cent on the sale and supply of most goods and services. Generally, a registered business includes GST in the price of sales to their customers or clients. The business then claims credits for the GST which is included in the price of their business purchases.

While GST is paid at each step in the supply chain, businesses don't actually pay the tax. This is because they include GST in the price of the goods and services they sell, and can then claim credits for most GST included in the price of goods and services they have to buy. The final consumer bears the cost of GST as they can't claim GST credits.

You must register for GST if:

- your business has an annual turnover of \$75,000 or more
- you provide taxi travel as part of your business, regardless of your annual turnover

You must register for GST to be able to claim input tax credits for GST included in the price you pay for goods or services used in your business. If you're not registered for GST, you cannot claim input tax credits. When you register for GST, you must decide if you are going to report on and pay GST on a monthly or quarterly basis (or annual basis if you are voluntarily registered for GST). You will also need to decide if you are going to report on and pay GST on a cash or a non-cash basis. For further explanations of the GST and online assistance to calculate your obligations, go to the Tax Office website ([ato.gov.au](http://ato.gov.au)).

■ **Capital Gains Tax (CGT)** If you sell or dispose of a business asset for more than it originally cost, you have made a capital gain and may have to pay CGT. You calculate your annual net capital gain at the end of each tax year. The final CGT total is the difference between your total capital gains and capital losses for the year, less any relevant CGT discounts or concessions. Don't think of CGT as a separate tax, but rather think of it as a component of your annual income tax assessment. The ATO expects you to keep a record of capital gains and losses of assets year to year for tax purposes. For further explanations of your CGT obligations go to the ATO website ([ato.gov.au](http://ato.gov.au)).

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■ **Pay As You Go (PAYG) instalments** The PAYG instalment system is used if you are a sole trader, partner in a partnership or an employee of your own company. The ATO expects you to pay quarterly PAYG tax instalments on your taxable income, but these normally start after your first year in business.

When you submit your annual income tax return, the ATO assesses your tax liability for the entire tax year. The ATO will then credit any PAYG instalments you made during the year to see if you owe any tax. Note that PAYG instalments are different to PAYG withholding which is explained below.

■ **Special taxes** Other items e.g. wine, luxury cars, petrol, tobacco and alcohol have special tax implications. Check at the ATO website for details.

■ **Land tax** The *Land Tax Act 1958* imposes an annual tax on the total unimproved value of all land owned in Victoria at midnight on 31 December of the year prior to the year of assessment. The State Revenue Office (SRO) issues assessments from March to June each year.

### Payments you have to make if employing staff

■ **Pay As You Go (PAYG) withholding** If you have employees you generally withhold money from the payments you make to them, make contributions towards their superannuation and pay fringe benefits tax if you provide fringe benefits for them or their associates.

You need to register for PAYG withholding, calculate how much to withhold from payments and report and pay the withheld amounts to the ATO. You also record the amounts in your quarterly activity statement and annual tax return. The ATO website offers an online Tax Withheld Calculator.

■ **Superannuation** This is not actually a tax, but if you employ staff you may have to pay a basic rate of superannuation for them. The current rate is 9% of the employee's base earnings. You pay the money to a superannuation fund at least quarterly, and report to the ATO quarterly. Payments for superannuation are tax deductible and are covered by the federal superannuation guarantee legislation.

■ **Fringe benefits tax (FBT)** This is a tax paid on certain benefits employers provide to their employees or associates of their employees (typically family members) in place of or in addition to, salary or wages. FBT is separate from income tax and is based on the taxable value of the fringe benefit. The term 'benefit' is broadly defined and includes rights, privileges and services. For example, an employer is providing a fringe benefit when they: allow an employee to use a work car for private purposes, or provide an employee with a cheap loan, or pay an employee's private health insurance costs.

■ **Payroll tax** Payroll tax is a Victorian state tax; currently payable at the rate of 4.95 per cent calculated on wages paid by an employer. The State Revenue Office (SRO) collects and administers payroll tax. Victorian employers must register for and pay payroll tax if their total Australian wages exceed the Victorian general exemption level of \$45,833 a month or \$550,000 over the full financial year; and/or it is grouped with other businesses and the combined Australian wages of the group exceed the Victorian general exemption level. For further information go to the State Revenue Office website ([sro.vic.gov.au](http://sro.vic.gov.au)).

#### ■ Tip for employers

##### Is it a fringe benefit?

To work out if you're really providing a benefit in relation to employment, ask yourself if you would still be providing that benefit if the recipient was **not** an employee.

## Tax basics for business operators

### Tax Basics seminars

The Tax Office runs free seminars for new and existing business owners. Seminars are run across Melbourne and regional Victoria.

Seminar topics include:

- income tax and GST
- expenses and deductions
- business structures
- Business Activity Statements
- record keeping
- superannuation and other employee basics

To make a booking go to the Tax Office website or call the ATO on 1300 661 104.

## Claiming deductions for business expenses

Under income tax law you can usually claim deductions for expenses incurred in running your business. There are some basic rules. You must have spent or plan to spend the money, and the expense must be business related. You must be able to show why you had to spend the money to run the business. What deductions will the ATO allow? There's no complete list of what you can claim because business activities are so variable.

However, the following common expenses are usually deductible:

- rent or lease of business premises (including home business premises)
- electricity, gas, water, insurance
- business motor vehicle expenses, transport and freight
- hire, lease or repairs of plant and equipment
- decline in the value of assets (depreciation)
- registered tax agent fees
- employee wages, superannuation, WorkSafe Injury Insurance premiums
- cost of trading stock
- business travel (away from home)
- interest on borrowed money, bank fees and charges

**Tax deductions for motor vehicles** Expenses for business purpose vehicles are generally deductible. These are vehicles like trucks or vans that have a dedicated business use and some smaller vehicles (e.g. utilities or panel vans) where private use is restricted to home-to-work travel. (Note that some types of vehicles do not qualify as a 'car' for vehicle deductions.) How much you can claim as a deduction depends on your business structure. Businesses using fuel may also be eligible for fuel tax credits.

**Business travel** For sole traders and partnerships, the travel expenses you incur running your business are deductible. The rules for deductions and the records you need to keep depend on whether you stay away from home and for how long. If travel is for both business and private purposes, you can't claim the private expenses. Different rules apply to companies and trusts.

**Tax deductions for a home-based business** The ATO allows you to claim two types of expenses normally associated with the running of your home. They are running expenses and occupancy expenses. If you set aside a specific work area you may be able to claim both. If you haven't set aside an area just for the business, you can only claim running expenses. If you want to avoid the calculations the ATO offers a simple hourly rate deduction. The ATO website also offers an online **Home office expenses calculator**. Be sure to record the method you use to calculate your deductions. Note, that there may be Capital Gains Tax implications should you sell your house.

Table 1: Running and occupancy expenses you can claim deductions for

Some running expenses are:	Some occupancy expenses are:
Electricity for light, heating, cooling and computers	Rent
Printer consumables	Mortgage interest
Cleaning	Insurance premiums
Phone costs	Council rates
Decline in value of fittings e.g. curtains, furniture	

Make use of the following help at the ATO website: Carrying on a business at or from your home, Home office expenses calculator and Record keeping for small business

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■ **Depreciation** Business assets lose value over time and have a limited life. Depreciation is a way to claim for their loss in value. Common examples of assets the ATO allows depreciation to be claimed on are computers, electrical tools, furnishings, carpet and business vehicles.

You can claim a deduction for part of the value of a depreciating asset in each year of its 'effective life'. The effective life of an asset means the length of time you expect to use that asset for business purposes. The ATO publishes a list of assets and their 'effective lives', or you can self-assess the effective life of your depreciating assets.

### ■ Tip

The Tax Office has a serious expectation that you will be able to explain and verify **all your business transactions**. This is the main reason why you should be serious about maintaining good business records. If you're just starting, investigate the range of record keeping assistance available at the ATO website.

## Why keep good business records?

■ **Why should you be keeping good records?** Apart from being legally obliged to keep accurate records, there are also strong commercial reasons for keeping good records of your business transactions.

Commercial reasons include the following:

- it makes it a lot easier to complete your activity statements, annual income tax and fringe benefits tax returns, so it's more likely you will receive what you're entitled to and pay only what you need to
- you can keep a high level, strategic watch on the health of your business, and therefore make better business decisions e.g. calculating your cash flow to make sure you can pay bills in six months time
- lenders (e.g. banks), suppliers and potential purchasers of the business may demand soft or hard copy records to verify your financial viability

■ **Should record keeping be done manually or electronically?** The answer to this question is whatever works best for you. Information from business transaction documents can be recorded into a cashbook either manually or electronically. Recording your transactions manually can be as simple as using an exercise book, but it's probably a good idea to use a commercial cashbook designed for the purpose from an office supplier.

To record transactions electronically you can use a simple spreadsheet or one of the software accounting packages. Use the spreadsheet to record your business transactions (e.g. income and expenses, payments to workers, stock and asset details) and automatically tally total amounts. In addition to these functions, a software accounting package can also produce invoices, complete activity statements, and provide summaries for GST and income tax purposes. Competition between accounting packages is healthy so shop around.

■ **How can the ATO Business Portal make a difference?** As part of their growing range of online services, the ATO has a Business Portal for small businesses to complete their tax obligations online. To find out more click **Portals** on the ATO homepage. Use the Business Portal to:

- prepare, lodge and revise your activity statements
- view and request refunds from your Tax Office accounts
- view payment options and transfer funds between accounts

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### Contacts for information and support

Small business enquiries and online information on starting and growing a business	Ring Business Victoria on 13 22 15 Visit the Victorian Consumer & Business Centre Ground Floor, 113 Exhibition Street, Melbourne VIC 3000	<a href="http://business.vic.gov.au">business.vic.gov.au</a>
Victorian Government Business Offices (VGBOs) are located across Melbourne and regional Victoria	For your nearest Victorian Government Business Office call 13 22 15 or go to the website	<a href="http://business.vic.gov.au/vgbo">business.vic.gov.au/vgbo</a>
Small business mentoring from experienced business professionals	Small Business Mentoring Service (SBMS) Make an appointment by calling 13 22 15 or visiting the website	<a href="http://sbms.org.au">sbms.org.au</a>
Registrations, licences and permits required by state, federal and local governments, includes application forms	Business Licence and Information Service	<a href="http://business.vic.gov.au/licences">business.vic.gov.au/licences</a>
Online and print-based resources at the Tax Office website	Australian Taxation Office (ATO) Casselden Place, 2 Lonsdale Street, Melbourne VIC 3000 The Tax Office also has offices in Dandenong and Geelong. Check the website for contact details.	<a href="http://ato.gov.au">ato.gov.au</a>
Includes detailed assistance with: - Australian Business Number - Capital Gains Tax - Goods and Services Tax - Business Activity Statement - Pay As You Go withholding - Tax File Number - Fringe Benefits Tax - Superannuation guarantee - Fuel tax credits	Ring 13 72 26 for business tax self-help (to use this service you will need your ABN or TFN).	
Tax Basics seminars	To make a booking ring 1300 661 104	
Business Portal		
- Payroll Tax - Land Tax - Land Transfer Duty	State Revenue Office GPO Box 1641, Melbourne VIC 3001 For all enquiries ring 13 21 61	<a href="http://sro.vic.gov.au">sro.vic.gov.au</a>

#### For more information:

- call Business Victoria on 13 22 15
- visit the Business Victoria website at: [business.vic.gov.au](http://business.vic.gov.au)
- visit a Victorian Government Business Office (VGBO). For a list of locations go to: [business.vic.gov.au/vgbo](http://business.vic.gov.au/vgbo)

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