

The \$88k FBT motor vehicle trap

You know you're having a bad day when you get an \$88,000 FBT bill from the Tax Office for a car that you thought was exempt. This is exactly what happened to one taxpayer.

A sole director of a company bought a Lexus in June 2004 for \$119,000. The Director purchased the car through his company for use in the business (100% business use by the Director). The company operated from the same block of land as the Director's principal place of residence but the two buildings were divided by a wall and had separate driveways and letterboxes. As the car was for business use and garaged at the business, it was assumed that FBT did not apply and as a result, no FBT returns were lodged. No log books were kept evidencing the business use of the car until the Tax Office announced their intention to audit the business.

Following an FBT audit in 2009, the Tax Office gave the Director an assessment for just under \$88,000 in outstanding tax. The Director challenged the Tax Office's assessment as "excessive" but lost. The reason for the assessment is that the FBT Act states that a vehicle will be available for private use (and subject to FBT) if the car is garaged or kept "at or near a place of residence of the employee or an associate of the employee." In this case, the Administrative Appeals Tribunal found the Lexus was kept 'near' the Director's place of residence and as a result, gave rise to a car fringe benefit for each day it was garaged there.

Another complicating factor for the Director and the company was that the operating cost method, commonly called the log book method, could not be used to evidence the business use of the car. To use the operating cost method you need to make an 'election' to the ATO that you will be using this method and keep a log book and other appropriate records. The Director only had a partial log book compiled after the audit was announced. The Tax Office will accept the non-lodgement of an FBT return as an election if there are no taxable fringe benefits. However, and this is the important part, you still need to keep a log book and other documents to show how you arrived at a nil FBT position.

If there are no records to show how you arrived at a nil FBT position, the statutory method will apply instead. The statutory method uses a prescribed formula to calculate the FBT liability that hinges on the number of days the car fringe benefit is provided (in this case, 365 days a year!). In this case, as no election to use the operating cost method had been made, the Tax Office used the statutory method to calculate the company's FBT liability. *Continued over the page*

Business scruples

How do I know how much my business is really worth? We've been talking to a new investor and are starting to doubt our assumptions about its value.

Business owners are often so invested in their business they lose sight of what the value of their business really is. If you put your heart and soul, and sweat and tears into the business you expect it will be worth the effort.

If you own a publicly listed company or an interest in one, you know what the market says your interest in that business is worth on any day of the year. A private business is very different. For most businesses, like yours, there is no ready or automatic market that will tell you what the business is worth.

So, how do you know if your perception of the value of your business is fair, below what it should be, or totally unrealistic? Knowing what your business is worth should be a fundamental of being in business not just for sale or succession. Proving the value of your business is critical if you are looking to borrow, to understand where you are growing the business, for assessing business performance and the adequacy of your profits, or if you are looking to complete a restructure.

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Business scruples *continued*

The value of your business is a key benchmark. If you don't know what it is worth then you have no real frame of reference against which to measure your performance and this could cost you a lifetime of under-performance. But this you know.

Not all businesses are measured in the same way. One reason why many business owners misunderstand the value of their business is because they compare it to another business which may be fundamentally quite different. There are a number of different generally accepted valuation methods for small and medium businesses. At a high level, the majority of businesses will be valued on their earnings, their cash flow, or their assets. Different approaches will produce different results. The right answer is not the one that produces the best result but rather the one that is in line with the fundamentals of the business. For example, a business that has a limited life with a defined income stream will be valued on the cash stream it will produce. Whereas a mature business, like a wholesale business being valued as a going concern (that is, as an ongoing business), is likely to be valued on a multiple of its earnings. A business, like a farm, is more likely to be valued on its tangible assets.

Risk also influences business value. The higher the risk, in most cases, the lower the relative value. Risk impacts the ability of the business to maintain its earnings, the stability of the cash flow or the reliability of the assets. Irrespective of the valuation method employed, variations in risk will influence value. Risk is measured at an economic, industry, business and ownership level. If you want to enhance business value, then look at areas where you can 'de-risk' the business without impacting on earnings.

Ideally, your business should generate and grow its earnings, its free cash flow, and its asset base. These factors, and a positive growth trend, are indicators of real value and a business that is likely to be growing in value. The absence of these factors may bring into question the value that really exists.

If you are basing commercial or tax decisions on your business value, have a business valuation completed. At least then you have a third party opinion of what your business is really worth.

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While this particular case is unusual because the Director's principal place of residence was on the same block of land the company operated from, there are a couple of key points that all employers (including the self employed) should take away:

- Always keep records to justify your tax decisions; and
- Be aware of what method you need to use for FBT and motor vehicles

As always with tax, the devil is in the detail.

For motor vehicles, it's important to have a record of what cars are subject to FBT, when things change, periods of use, and the method being used to calculate FBT. If you use the statutory method, make sure you do an odometer reading at the end of the FBT year on 31 March, and if you have elected to use the operating cost method, make sure that your log books are current.

Don't forget that informal arrangements between employers and employees can unintentionally give rise to an FBT liability - such as allowing employees to use company cars for private use over a weekend.

Quote of the month

*"Don't find fault, find a remedy."
Henry Ford*