Welcome to our latest e-newsletter.

We continue our series on structuring your business and the difference that getting it right can make. There's also some must-read material here for those operating their own superannuation fund.

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Getting your structure right - part 2

In our last edition, we discussed the importance of getting your business structure right. We looked at what it means to operate as a sole trader and as a partnership, which both had relative simplicity on their side. But in both cases, you would probably end up paying more tax than you needed to (for a reasonable sized business). What's more, both of these structures leave you carrying the load for the responsibilities and debts of the business, which can put your personal assets - your house, for example - at risk.

Company

So wouldn't it be good if there was something to carry the load for you? Essentially, that's what a company does. Historically, the development of the 'limited liability company' has been one of the great contributors to Western financial prosperity. This is because it gives business owners the confidence to operate and innovate without putting their personal assets at risk. A company is recognised as a separate legal entity, which means that it incurs liabilities and expenses and generates revenue in its own right. Under Australian law, provided there is no evidence of fraud or recklessness (trading while knowingly insolvent, for example) most potential liabilities that might arise are limited to the share capital of the company. In other words, if things don't work out as you'd planned, your personal assets are safe. Any recourse a third party might have against the business is limited to the company alone.

Often when people have a feeling they are paying too much tax, their first thought will be that they should set up a company. This is because in Australia **a company is taxed at a flat rate of 30%**. As your profit starts to increase, it's easy to see why this might be attractive. But it's important to note that a company is its own 'person' in every respect - including making money and accumulating profits. So any money the company makes is taxed at 30%, but it belongs to the company. If you want to get it out for your own personal use (either by paying yourself a higher salary or declaring a dividend, which is a distribution of profits to shareholders), there are strict rules in place to ensure that you are then taxed at your own marginal rate of tax for the difference. You do get a credit on dividends for any tax already paid in the company ('imputation' or 'franking' credits) but overall, you'll end up paying the same amount of tax as you would have if you earned it in your own name. There is still some advantage though where you and your partner are both shareholders of the company. In this case, you can declare a dividend but split it over two people, thereby taking advantage of two sets of lower tax rates and tax free thresholds. For example, if you wanted to take $100,000 out of the company by way of a dividend, you could pay $100,000 to yourself, or $50,000 each to you and your spouse. Generally speaking (though not always) you would pay less tax on two dividends of $50,000 to different people than you would on one dividend of $100,000 to a single individual.

There is greater flexibility with superannuation however. If you're self-employed, but you still earn a salary elsewhere, you can't put any money into super from the business if your salary forms more than 10% of your income. In a company however, you can put away up to the maximum concessional limit of $25,000 pa (subject to how much you have contributed from other sources - $25,000 is the total you can put away from all sources).

<u>Trust</u>

A trust arises at law where a person (a 'trustee') holds funds and other assets in 'trust' for other people (the 'beneficiaries'). A trust usually distributes all of its income each year to beneficiaries so that it effectively retains no profit. If any profit is left in the trust, it is taxed at the top marginal rate, which is a pretty good incentive not to do so! As such, it usually pays no income tax itself. Instead, tax is paid by the beneficiaries when they become entitled to receive their share of the net income.

Because a company is a legal entity in its own right, it can also play the role of trustee. In this case, the trust then has all of the asset protection benefits that you'd get from operating a company. Any potential problems and liabilities that are incurred by the business are quarantined and your personal assets remain safe (subject again to there being no evidence of fraud or negligence). Like a company, a trust can therefore be set up to carry the load for you, but it gives you far greater flexibility in terms of your ability to spread income tax more effectively.

Spouses and other family members can be beneficiaries of a trust, which means you can distribute the same amount of income across more people and take advantage of each person's lower rates of tax. You can also distribute income on a pre-tax basis to organisations that would not otherwise be tax deductible. So for example if you contribute money to your church, a community group and/or other aid or charity groups that are not tax deductible, these can possibly be beneficiaries of your trust which effectively gives you tax deductibility on those amounts. This means you can either give more and have it cost you the same, or give the same nominal amount at a lower actual cost to you.

It's worth noting though that in recent times the Tax Office has dramatically increased the compliance burden of trusts and as a consequence, they are becoming more expensive to maintain. Just this past year a change to the law meant that the minutes required when a distribution is made must specify the exact amount (or percentage) to be distributed to each beneficiary prior to 30th June, whereas previously it was possible to distribute in more vague terms (e.g. "enough to take his/her taxable income up to $x for the year"). This requires a lot more tax planning and as such means the accounting bills for trusts in future years will be higher. It's a change no one could have foreseen and yet it ends up costing the taxpayer more. Another example is that significant restrictions have been placed on how much 'unearned' income a minor can receive tax-free, i.e. children under the age of 18. You can now only distribute a maximum of $416 to a minor before they are subject to punitive rates of tax, which again reduces the tax effectiveness of the arrangement.

Conclusion

Both companies and trusts will cost more to administer. But as your business income increases, the costs are significantly outweighed by the tax savings. In our next edition, we'll demonstrate a very simple example to show how the right structure can save you tens of thousands of dollars in tax on the same amount of income. Of course, the additional benefits of these structures are that you protect your personal assets and also that you can potentially contribute more to superannuation.

It's important to note too that these examples are structuring at its most simple. As your income grows, all sorts of combinations of structures become viable - trusts that service companies, partnerships of trusts and so on. This may seem complicated, but it's essential to get it right to ensure that your desired financial goals are achieved while at the same time protecting your personal assets. This is where good advice is essential.

New rules for Self-Managed Super Funds

If you operate a Self-Managed Superannuation Fund (SMSF), new rules have tightened up the responsibilities for trustees. In most cases, that's you. In summary, the changes are:

1. Trustees must now review the investment strategy of the fund on a regular basis. This means you'll have to show evidence that in fact a review has been conducted.
2. Trustees are now required to consider insurance for all members (life insurance, total and permanent disability). It's often the case that SMSFs are used to tax effectively provide insurance cover for members, but now there is an explicit requirement to consider it.
3. All assets in the fund must now be valued at market value each year. We have usually done this as a matter of course for our funds, which means there will be no noticeable difference in your financial statements as a consequence of this measure unless you own property.
4. All money and other assets of the fund must now be kept completely separate from those of the trustee. To a certain extent, this has always been a requirement based on the governing rules of the fund, however this measure now gives

Kathy Allen working with BaliEye

Our director and senior tax partner Kathy Allen and her family recently went to Bali as part of the BaliEye Ambassadors program.

The BaliEye Foundation offers free eye screening, glasses and cataract surgery to people across Indonesia. Through this program, Kathy had the opportunity to see their work first hand on the 'frontline' as it were, and witnessed cataract surgery inside a mobile van. She also had the pleasure of returning the next day to see people who had impaired vision for years realising they can now see as the bandages were removed.

The Foundation also provides eye testing at schools, and Kathy's son was able to assist in this testing process.

Finally, they visited some children that the BaliEye Foundation supports in school, and provided them with some stationery.

Kathy described it as "a truly memorable experience". Perhaps the most amazing part was how much can be done with so little. It only costs $60 for cataract surgery to restore someone's sight and only $100 pa to send a child to school. Small change compared to what she spends on schooling!

the ATO the power to enforce it. It may seem minor, but it means that you must take extra care to ensure that any transaction conducted from your super fund is done in the name of "**<Your name(s)> as trustee for <name of your super fund>**". Any assets held only in your name, even though you are a trustee, cannot be held in the super fund.

These new measures highlight again the ongoing increase to obligations placed on SMSFs. They remain, however, an excellent way of controlling your retirement strategy and saving yourself a significant amount in management fees. The important thing is to exercise caution in all things and seek advice wherever you are unsure. We're experts in the area of superannuation and will continue to keep you updated and ensure that to the extent we are able, your funds remain compliant.

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