

# prosperity

Prosperity Advisers, ADP Prosperity Advisers and Prosperity Salary Packaging newsletter

Your Financial Solutions

Issue 2, 2010

## ATO targets SMEs

By Stephen Cribb

Director Business Services & Taxation

On the 8 July the Australian Taxation Office (ATO) warned that it will be cracking down hard on SMEs abusing taxes with particular attention to trusts, cash economy, GST and fraudulent refunds.

Following release of the ATO's 2010/11 compliance program, they will be targeting a range of areas across small business. They include:

**Trusts** – The ATO are looking to see an improvement in the completeness and accuracy of reporting by trustees.

**Division 7A** – The ATO claims many SMEs still don't understand their obligations in this area. Common mistakes include not correctly repaying loans, not declaring loans as taxable income and not amending tax returns when a deemed dividend is identified.

**Cash economy** – The ATO are looking for instances where SMEs pay cash-in-hand wages, skim some or all of the cash takings or run part of their business off the books.

The ATO has developed benchmarks for 100 industries, to assist SMEs understand the sorts of income and deductions companies in their specific sectors should be lodging.

**Business Activity Statement fraud** – The ATO says it will verify over 48,200 Business Activity Statement refund claims from micro enterprises in the next 12 months as it ramps up its monitoring of fraudulent BAS statements.

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*Welcome* to the second issue of Prosperity's Your Financial Solutions newsletter for 2010.

With mixed economic signals, Australian business owners and investors commence the new financial year with a sense of trepidation. While there is some cause for some optimism, we have some timely advice in this edition to help you protect the downside risk.

Our article on benchmarking highlights an important tool to assist you in focusing on areas of potential financial improvement. Some pointers on minimising your interest and taxation exposures are critical components of a business or investment strategy. Finally, asset protection initiatives must be on the radar, in this uncertain economic environment.

We also take this opportunity to welcome Marcus McLellan as Principal of our Brisbane office, strengthening the firm's senior leadership team and business advisory practice. Marcus has more than 25 years experience advising clients on business advisory, finance and taxation matters. Marcus is recognised as an exceptional business advisor and has a passion for coaching and developing the strategic thinking of his clients.



Marcus McLellan

We have also reached an important milestone, with Director, Michael Hughes celebrating 20 years with the firm. Michael has been a significant contributor to the growth and success of Prosperity and has been of invaluable assistance to many clients and members of the firm over that period. Congratulations Michael.



Michael Hughes

We hope you find our newsletter useful and we look forward to discussing the matters raised with you.

A handwritten signature in black ink that reads "Allan M'Keon".

CHIEF EXECUTIVE



# In business, as in sport, failing to benchmark can mean marking time on the bench

By Michael Griffiths, Director Business Services and Taxation

If you are not comparing your business performance with that of the opposition, you will soon find yourself losing out.

In the sporting arena, checking your performance against that of the opposition makes sense. This applies whether you play a team sport such as Rugby League or an individual sport such as tennis. If it makes sense in sport to check your performance against that of the competition, why do so many businesses fail to?

Swimming is a great example of how much things can improve over time. In the 1956 Olympic Games, Murray Rose broke the world record for the 1500 metres, beating his nearest rival by half a lap. In the 2000 Olympics, Grant Hackett broke the record in a time that would have put him a staggering 5 and a half laps ahead of Murray Rose.

In business, if you are not regularly comparing your performance with that of the opposition, for such things as gross profit margin, stock turnover, wages as a percentage of sales, and customer satisfaction, you can quickly find yourself struggling to make a profit.

Comparing the performance of a business with others in the same industry makes great sense when you own a business; it makes even more sense when looking to buy a business. Comparing the operating results of a business you are considering buying with that of other businesses provides valuable information in assessing the business's viability and value.

Benchmarking is also invaluable if you are looking to sell a business. By knowing what the best-performing and most profitable businesses are achieving in an industry, you can work on your business to make it an attractive proposition for a potential purchaser.

The number of businesses covered by Prosperity Advisers Benchmarking has grown to almost 100. These businesses are divided into seven main industry categories: automotive, building and construction, financial services, food and hospitality, medical, retail and service industries.

A report can be produced comparing the results with that of other businesses in the same industry and information and advice is provided on ways of improving the business.

To gain maximum benefit from benchmarking, the financial information collected for the business must be accurate; the information collected for tax purposes may not provide sufficient detail.

Information gathered by the Tax Office is another reason businesses should consider benchmarking. When a business lodges its tax returns and business activity statements, the information is analysed by the ATO and used to compile industry averages. Businesses producing results consistently different to industry averages become prime targets for an ATO audit.

If you would like more information on benchmarking your industry, please contact your Prosperity Adviser.

## iPad envy? Get a half price iPad by using tax concessions

by Stella Serghis, Business Services & Taxation

Opportunities exist to use available tax concessions to reduce the out-of-pocket cost of an iPad.

In a situation where the use of the iPad is to be primarily work or business related, using salary sacrifice strategies, a tax saving of between \$192.73 and \$410.91 can be achieved on the purchase of an iPad for the value of \$800, depending on your income and tax rates. That is, an effective out-of-pocket cost of between \$389.09 and \$607.27 for an iPad worth \$800.

Alternatively, where the iPad is used by school children (primary or secondary) and the use is primarily for education purposes, eligibility for an Education Tax Refund (ETR) may apply. Application of the ETR for an \$800 iPad would generate a refund of \$400 based on use by either one secondary aged child or two primary aged children, giving an out-of-pocket cost of \$400. Availability of the ETR is subject to the family receiving Family Tax Benefit Part A or the child meeting other "independence" tests.

To discuss the application of the above strategies for your individual circumstances contact your Prosperity Adviser.

# get debt smart and shrink your tax bill

By Matthew Smith, Lending Specialist

We all have to live with debt at some point in our lives, but with the right strategies you can pay off your debts faster and reduce the amount of tax you pay.

## Mortgage offset

If you have a home loan and a mortgage offset account, you earn interest at the same rate as your home loan (which will generally be higher than interest on a normal bank savings account) and pay no tax on it.

Let's say your home loan is \$200,000 at 6.24% interest. In a 31-day month you'd be charged \$1,059.96 in interest. You also have \$15,000 in a standard bank savings account earning 4.5% interest per annum.

Assuming tax at a marginal rate of 30%, you would have a net income of \$40.14 from your savings. But by putting your \$15,000 in a mortgage offset account instead, you earn 'nominal' interest on your savings at the same rate as your home loan as the table below shows.

Because you don't pay tax on the offset interest, you could get almost double the amount. The offset interest isn't credited to your savings account; instead it's taken off your loan interest, so in this example you would only pay interest of \$980.46 for the month instead of \$1,059.96.

Using this strategy you could save thousands in interest payments and reduce your loan term. Your savings are still at call if you need them.

## Gearing in joint names

It's common to invest a combination of borrowed funds and your own money. If you have a partner, splitting ownership of your investments could help reduce the tax you pay.

### *Cath and Steve*

Cath pays tax at a marginal rate of 16.5%<sup>1</sup>, Steve at 41.5%<sup>2</sup>. They have \$40,000 in savings and want to borrow more money to invest.

They decide to invest the \$40,000 in a managed fund in Cath's name. Cath allows Steve to use her investment as third party security for a margin loan, so he can borrow \$60,000 to invest in other assets. Cath's investment earnings will be taxed at her marginal rate, which is much lower than Steve's.

Steve holds the geared investments in his name and claims the interest payments as a tax deduction.

Because Steve's marginal rate is much higher than Cath's, he gets more benefit from the tax deduction.

<sup>1</sup> Includes a Medicare levy of 1.5%.

<sup>2</sup> Assumes Steve and Cath's investments have a security ratio of 60%

## Borrowing to build wealth

If you wait until you've paid off your home loan before you start investing, you may not give your investments enough time to grow to meet your long-term goals. By using 'gearing' (borrowing to invest), you can potentially pay off your home loan years earlier and really concentrate on growing your wealth.

## Time to review your debt?

It's a good idea to review your debt as your circumstances change throughout your life. Getting married or divorced; buying a house; changing jobs; inheriting money; getting ready to retire; all these life events can change your debt position.

If you would like more information on debt reduction strategies, please contact your Prosperity Adviser.

# ATO targets SMEs

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**Employer obligations** - The ATO says it will focus on employers not meeting their obligations to make tax and superannuation payments on behalf of their workers.

**Companies with turnover of \$100-250 million targeted** - In 2008/09 the ATO was responsible for increasing their scrutiny of companies with \$100-250 million in turnover over the following four years, and the program will continue into 2010/11.

**Claiming losses** - The ATO is scrutinising small businesses claiming losses they are not entitled to.

**Fringe benefits tax** - The ATO remains concerned about problems in the area of fringe benefits tax and says many taxpayers are failing to identify where FBT is actually payable, particularly in the area of motor vehicles.

**Capital asset sales** - The ATO will continue providing guidance on the correct application of the law and will also monitor incorrect allocation of capital losses as revenue losses, and vice versa, and the transfer of capital losses between entities or from offshore.

If you would like information on how to protect your business against unfavourable tax audit outcomes, please contact your Prosperity Adviser.





# a critical protection measure for business

by Owen Griffiths, Estate Planning and Asset Protection specialist

Whether your business is structured through a company, trust or partnership, few have effective mechanisms in place for the transfer of equity and/or control, if one of the business owners departs the business due to death, total & permanent disablement (TPD), or a critical illness.

An Australian University research unit has reported that less than 30% of business owners aged 51 to 61 have a written business succession plan and more than 70% have no plan at all! Without a succession plan and funding agreement in place, the loss of a business owner under these circumstances, can result in the demise of an otherwise healthy business.

The two primary issues that need to be addressed when planning for business succession are:

- The legal transfer of control and ownership of the business; and
- The way the transfer of the business will be funded. Funding is usually achieved by using life, TPD and other insurances.

The two points above can be covered by implementing a properly structured Buy Sell agreement. The importance of ensuring a Buy Sell agreement is correctly structured including the linked insurances is critical. The issues are complex. Matters often overlooked or not given due consideration are:

- Ownership of the various relevant insurance policies, for example, self ownership, cross ownership, company ownership, trustee ownership (whether by a special purpose trust or superannuation trust), and applying an ownership model which provides certainty, flexibility, simplicity, a favourable tax outcome and is in the best interests of the business and owners.

- Providing for properly drafted put options and call options in the Buy Sell agreement.
- Owner guarantees for the business debts.
- A deceased or incapacitated owner having lent money to the business.
- Division 7 loan account balances.
- An effective and accurate valuation mechanism for the business and the departing owner's interest in the business.
- Alternative arrangements should a business owner not be able to obtain life insurance.

Overlooking such matters can lead to unnecessary tax being paid on policy proceeds, tax inefficiency, an ineffective transfer of a business interest, a business interest being transferred to an entity which is not in the best interests of the ongoing business owner(s), heavy loss of business value and expensive litigation.

If you would like more information on safe guarding your business assets, please contact your Prosperity Adviser.

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