WMC accounting

YOUR Knowledge

Getting to close to your business: when personal and business funding blend

Most small business owners are pretty close to their business. For many, it is a major part of their life and the distinction between personal and business is easily blurred. This can also cross over to their financial affairs with business and personal finances being interrelated.

Some recent tax cases are a reminder of the risks you run if you don't keep a sufficient separation between personal and business. Get it wrong and you can lose some valuable tax deductions. The main area of risk is for those that operate their business through another entity such as a company or trust. Maintaining this structural separation is quite common and often makes a lot of sense for asset protection purposes. But problems often occur when you personally incur an expense on behalf of your business and then seek to claim tax deductions for the expense.

The most common example of this is interest costs on borrowing. Your business needs funding and the bank is reluctant to lend direct to your company but more than happy to lend to you. Or, you decide it would be better to borrow at a personal level because you can secure a much better interest rate. All of this makes sense so far. You are your business; what's the difference whether the business borrows the funds or you borrow them and let the business repay the loan? The problem comes down to who is entitled to the tax deduction. If the loan is in your individual name you may want the tax deduction for interest paid at a personal level. You can only achieve this if there is a reasonable nexus between the interest incurred and income you derive from your business. And, simply earning salary or wages from the business is unlikely to satisfy this requirement. The Court's position is that an employee is not normally required to provide funding for their employer, so the fact that you earn a salary from the business will not be enough. You need to show a clearer connection; this could be from dividends you are receiving (probably unlikely in the first couple of years of business life), directors fees, or the best evidence is where you have on lent the money to the company and are charging a rate of interest. In this case you would have both interest income and an offsetting expense.

If the loan is in your personal name also be careful about just having the company make the repayment and claim the interest deduction. Your company could run into Division 7A problems and trigger an unexpected tax outcome. Division 7A applies where payments, loans or debts by a private company to a shareholder have or appear to have been forgiven. The division treats these amounts as a deemed dividend to the extent that the amount represents a distribution of the company's profits.

Another common risk area is business expenses claimed at a personal level particularly if you operate your business through a discretionary trust. Where your sole source of personal income is from trust distributions, you are unlikely to be entitled to claim any tax deductions for expenses incurred in earning your income. The reason for this is that as a beneficiary of your trust, you have no right to income until the trustee appoints that income to you at year end. You do not have an automatic right to the income. And, at the time you incurred the expenses throughout the year e.g., car expenses, you had no income. You simply had an expectation that the trustee would appoint income from the trust to you at year end. Unfortunately, that's not enough.

The clear message is that you need to put some formality around arrangements where the personal and the business cross over. Yes, you and the business are almost one - but not from a tax perspective. Get this wrong and it can be expensive.

Talk to us today about how to structure your business to achieve the best possible outcome for your business and yourself.

Quote of the month

"Failure is simply the opportunity to begin again, this time more intelligently."

Henry Ford

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Tax planning: where are the real benefits?

Some tax planning only creates timing benefits rather than real savings. So the question is; what delivers real results?

The majority of tax planning falls into one of three categories - health and hygiene decisions that every business should review each year, timing benefits, and permanent savings.

The timing benefits do exactly that. They create tax savings that should ultimately materialise over the life of the business but they bring them forward. Typically, these are triggered by either deferring income or by bringing forward expenditure. This income or expenditure would have fallen in a later year causing the tax impact to also fall into that later year. Your actions change that and bring the tax benefit into the current year. As a simple example, declaring bonuses prior to the end of June 30. The declaration of the bonus prior to June 30 means that your company is committed and liable to the payment of the bonus, albeit that payment will not be made until after June 30. In this case you are able to take up the deduction in the 2011 year whereas if you did not declare the bonus and simply pay it in say July 2011 then the tax deduction would fall into the 2012 year. In either case you will be eligible for the tax deduction; you simply have the ability to bring forward the timing. Doing this has no impact on the recipient of the bonus. They will only declare it in the year of receipt.

Subject to any differential tax rates that could apply to the tax saving between years, it normally makes sense to take advantage of the tax benefit at the earliest possible opportunity. It saves you cash, gives you the time value of the tax saved and the immediacy of the benefit creates greater certainty for you. Where you operate through an entity structure such as a company, if you have any years where you incur tax losses for the year, those losses are quarantined in the company and you will have to wait until a future year where profits are made to recoup those losses. If your business is always profitable this is less of an issue. However, there are plenty of businesses who have made profits in previous years but then find themselves in one or more loss years. Taking advantage of timing benefits for tax normally makes good sense. And, there are a lot of opportunities to take advantage of those timing benefits. Sometimes the action of one day can make the difference of a year in when the tax is paid.

Talk to us before June 30 and we can outline all of the opportunities in your business for tax timing benefits. Once you have this information, you can make the decisions on what you want to do.

Can your SMSF buy artwork?

Why stop at art? What about collectors items - some fine wine perhaps? Or, a few antiques?

The answer is yes you can (as long as the asset is genuinely for retirement income purposes, not for your personal use now, and not acquired from a related party) but the Government is looking closely at what SMSF's acquire and how those assets are managed.

Last month, the Government released draft regulations that will guide what and how SMSFs buy, sell, and manage collectibles. The regulations seek to ensure that trustees do not gain a benefit from those assets now. For example, you cannot hang artwork purchased by your SMSF on your wall at home or wear jewellery acquired by the fund. This is because the Superannuation Industry Supervision Act (SIS) requires that all assets acquired by a SMSF are used for retirement purposes only. If you are using the assets now, you breach SIS as the asset is not exclusively for retirement purposes.

Storage of collectibles owned by your SMSF will be a major issue as it will be important to show that you are not benefiting from the asset now – so no storing the asset at home or in the home of a related party. Nor can you arrange to lend the asset to a related party, even if the asset is being rented.

The regulations cover collectable and personal use assets include artwork; jewellery; antiques; artefacts; coins or medallions; postage stamps or first day covers; rare folios, manuscripts or books; memorabilia; wine; cars; recreational boats; and memberships of sporting or social clubs.

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