

Knowing when to change your business structure

For successful businesses, simple business structures often do not work. They leave you risk exposed, are ineffective for tax purposes, and are not efficient for succession or sale. In the early stages of business life the philosophy often is; keep it simple and low cost. This may mean trading as a sole trader, in partnership, or through a simple company structure. Where the business stays small this can be entirely appropriate and may serve you well for the lifetime of the business.

However, if your expectations are greater than this, or if you can see that your business is likely to grow in a significant way, then you will need to change structure at some stage. Successful fast growth businesses typically operate through a mix of company and trust structures. These structures are not for show. They create separation, tax efficiency, help to risk manage your business interests and allow for orderly transfer at the appropriate time.

The challenge is; when is the right time to put in place a more efficient structure? The answer is the earlier the better. Change comes with a cost. You can be exposed to capital gains tax and stamp duty, and this can be expensive and a distraction from the main focus of your business growth. If you have a very clear vision for your business and it is going to grow to a significant size then there is a lot of merit in putting the basic structure in place at the beginning. Equally, if your plan is to maintain a micro-business, keep it simple and don't be seduced by advice that over complicates what you need. Your structure should be appropriate and consistent with your expectations for the business – be they large or small.

If you have a clear vision at the beginning then the question of how to get your structure right can be an easier question to answer. For many business operators though, the reality is that you are not sure. You may start off small and the business booms with growth exceeding your expectations. Or, you may have hopes for something significant, but also know that it might not work. So, if you're in this situation, what are the signs that it is time to make the change?

The first should be when you can identify that there is significant value building in your business. This might be reflected by the assets held in the business or the development of goodwill or intellectual property. The existence of these assets means that you should be considering risk protection and ways to protect against the unexpected. Ideally, significant capital assets of the business should be separated from the operating structure. *Continued over the page..*

Your SMSF and borrowing

Knowing what assets your Self Managed Superannuation Fund (SMSF) can own is an important part of being a fund trustee. You should also know what assets your fund can acquire from you or related parties. New rules recently introduced may give more scope for your SMSF to borrow funds to acquire these assets but there are unique rules and guidelines that need to be adhered to.

As the trustees of your SMSF, you need to ensure that all assets held in the fund are consistent with the fund's investment strategy. That is, as trustee you need to consider issues such as risk and return, diversification of the fund's assets, liquidity within the fund, and of course, the ability of the fund to discharge liabilities.

Here are the common questions we're often asked about borrowing:

Can I move my existing rental properties into my SMSF?

If these are residential properties then in most cases the answer is no. Your SMSF cannot acquire property from a 'related party' unless the property is used in a business (called business real property). A related party includes you, your relatives, and in some cases your business associates. It can also include entities that are controlled by these people. *Continued over the page...*

Quote of the month

"A fanatic is one who won't change his mind and won't change the subject."

Winston Churchill

Your SMSF and borrowing *continued*

Can I own my business premises through my SMSF?

Assuming that the purchase of a commercial property makes sense for the fund, there is nothing to prevent the fund from purchasing a commercial property. The fund could even acquire the existing business real property from a member or related party! Your SMSF could then lease the property back to your business so long as the lease is on commercial terms. This could be a great way to boost your retirement savings as the rental income is taxed at a maximum of 15%.

Can my SMSF borrow money to buy property?

Since September 2007, SMSFs have been able to borrow to acquire assets. It's important to recognise that as there are strict rules surrounding this, you should always seek professional advice.

Your SMSF can only borrow to acquire assets that it would otherwise be allowed to acquire – so in some cases your SMSF could borrow to acquire the member's business premises. Be careful though as the SMSF cannot use the borrowings to improve the property (no extensions or renovations), so what you buy is what you're stuck with until your SMSF has paid off the loan.

Can my SMSF own property overseas?

As long as holding or purchasing the property is in line with the fund's investment strategy, there is nothing in the superannuation rules to prevent your SMSF owning property overseas. But again, beware of some of the traps.

In some cases it might be prudent for a company or trust to own the property and for your SMSF to own shares in the company or units in the trust. This may protect the fund from being sued by a tenant. However, there are restrictions on the company/trust under the superannuation rules. For example, the company or trust could not borrow or lend money, or place a charge over any of the assets. And, the company or trust may not be able to hold an overseas bank account.

You need to weigh up the benefits of using an 'interposed' company or trust to hold the asset with the restrictions that can be imposed. In all cases, you should make sure that you have adequate insurances in place both over the asset and also inside the SMSF.

Did you know?

There were 425,300 Self Managed Superannuation Funds in Australia at 30 June 2010 with 29,405 new funds created in the 2009/2010 financial year. Of those, 25% had a total asset value below \$200,000, and 49% had a total asset value between \$200,000 and \$1m. Just over 30% of all new funds in the same time period were set up by 45 to 54 year olds. As at December 2010, SMSFs owned assets worth a total of \$420,612,000,000 – 31% in listed shares.

Knowing when to change your business structure *continued*

The second sign is where you can see a material increase in your tax exposure. As your business grows, so too should your profits and your earnings from the business. And, in some cases profits and cash will not mirror each other. Typically cash lags profits, so you might be dealing with the tax on profits that are not readily available to you. Apart from the fact that you don't want to pay any more tax than necessary, the right structure can help to manage tax impacts and the timing differences between profits and cash.

Finally, if you are expecting to sell your business or to introduce other partners or shareholders, then the right structure can make a huge difference. To maximise your access to tax concessions and in particular the CGT small business concessions, you need to have your structure right in advance of any changes.

There are some ways to manage the tax costs associated with a change in structure. The first thing to do is to identify the structure that is right for your business. From there, quantify the cost of any change and the best way to put it into effect.

If you would like to ensure that your business structure is right for you now and in the future, talk to us today.