Welcome to our latest e-newsletter.

Over the next two issues we'll look at some different business structures and the pros and cons of each. And we'll also demonstrate the difference it can make to your tax bill!

In this edition...

Getting your structure right

We recently presented a session on business structuring to the Australian Chinese Medical Association. It highlighted again for us how important it is to get your business set up in a way that is going to give you maximum protection and ensure that you're not paying more tax than you need to.

Setting up or buying a business is an exciting challenge. If your goal is longevity, you're going to need to do some planning. Like building any new structure, you need to engineer your business in such a way that it can withstand what is thrown at it. You want to make sure that it is robust and will survive. And you want to protect your personal assets so that you are able to operate the business with confidence.

If you're like most of us, you'll also want it to be tax effective. We all know that we need to pay our fair share of tax. We use the roads and hospitals and so on, and in return for that we expect there to be some cost. But if you structure your business in a way that is not as tax effective as it could be, you end up paying more tax than you need to under the law. Not only does this extra tax mean less in your pocket, but it's also money that could be reinvested into your business to help it grow and thrive.

So it's worth spending the time to get it right from the beginning. We're going to show you why, with a few simple examples. For many of our clients, it's something we've worked through with you at some point in your journey with us. But even if you have been in business for a long time, it's a good reminder of the difference good structuring can make. And it's always worth a review from time to time to make sure that your structure is still best for your current circumstances.

This time around we're going to look at the difference between going it alone and setting up a partnership.

<u>Sole Trader</u>

If you were to start operating your own business today - as in, you just went out and started selling products or services - you would most likely operate as a 'sole trader'. What this means is that you're operating a business, but not as a separate legal entity. Your tax return would have a section for salary income, for investment income, and also one for business income. Here you'd simply summarise your income and expenses for the business and come up with a net profit or loss and include that in your return. The advantage of doing this if your initial enterprise is small is that it's very simple and there's no entity costs involved. But it offers very little flexibility and no asset protection. By asset protection, we mean your personal assets. If the business gets in trouble with debt or say a lawsuit, your liability is not limited only to the business. Your house and other personal property could be at risk. You're left carrying the entire load yourself.

The other important consideration is tax. When you operate a business in your own name, you pay tax at your personal marginal rates of tax. That means that if the business starts to become profitable, you quickly begin to pay more tax than you necessarily need to. Again, this is money that could be going back into your business. For 2012-13, the personal rates of tax are:

- Taxable income $0 - $18,200: **Nil**
- Taxable income $18,201 - $37,000: **19c** for each $1 over $18,200
- Taxable income $37,0001 - $80,000: **$3,572** plus **32.5c** for each $1 over $37,000
- Taxable income $80,000 - $180,000: **$17,547** plus **37c** for each $1 over $80,000
- Taxable income $180,000 and over: **$54,547** plus **45c** for each $1 over $180,000

On top of this, most taxpayers will also be liable for the Medicare levy, so you can add an extra 1.5c in the dollar to those rates. So if your business is reasonably successful and you make more than $180,000 a year from it, you'll lose nearly half - 46.5c in the dollar - of everything over $180,000 in tax.

There's absolutely no problem from a taxation perspective with operating a business in your own name, especially because in the early stages or if it is more of a side project, the set up and maintenance costs are so low. But as it grows it could end up costing you more in tax than the maintenance costs of a more complex, and tax effective, structure.

Partnership

A partnership is not a legal entity in its own right but is rather a form of shared ownership. In the end any profit (or loss) made by the partnership is distributed out to each partner in accordance with their share, as per the partnership agreement. Basically, think two (or more) sole traders working together in one business.

So just like operating a business in your own name, flexibility is limited. Your share of income is taxed fully at those marginal rates of tax, and what's more, liabilities are incurred jointly and severally. This means that each partner *shares* responsibility for any debt but also takes *full* responsibility for all of it. So there's no protection of your personal assets and on top of that, if one partner does the wrong thing, the others are fully responsible for the entire cost individually. If one partner skips out of town or declares bankrupt, the others are each responsible for that partner's share of any debts.

There can be an advantage in operating a partnership in terms of tax though. There are limitations on the kind of business you can have within an entity structure, and we'll talk more about those in our next issue. In a nutshell, if the activity you perform is just what you would normally do on your own (i.e. in a service profession), it doesn't matter what structure you operate - you'll be forced to distribute all the income of the business to you alone because the structure is really just for tax purposes. But where you have a business that generates income in its own right - say where you produce a product or you have other people working for you - a husband and wife (for example) can both work in a partnership and split the income. That means that each person gets less income overall, and so pays less tax, but the total income to the couple is the same. However where you're looking at going into partnership with someone else, at arm's length, there is no real tax advantage to a partnership.

A partnership can have great value in some situations, especially if the partners are (say) companies or trusts themselves rather than individuals. But the risks can be significant and there is little tax benefit unless it is being used by a family who are each partners.

Conclusion

So there you have it. Hopefully you can see very simply how, where circumstances are right, just making a simple change from operating a business in your own name to setting up a partnership with your spouse can help save you some tax. But of course there is much more that can be done in terms in reducing your risk and minimising your tax. Next time we'll look at companies and trusts, and also run through a simple example using some actual numbers to demonstrate just how the right structure can help you reduce your tax bill.

The value of Self-Managed Super Funds

Self-Managed Superannuation Funds (SMSFs) are great for taking control of your money and using your super as a part of your overall financial planning strategy. It turns out they might also be cheaper to operate.

For those that don't know, an SMSF is where you invest in your own fund rather than one provided by an industry body, bank, insurance company or other commercial provider. You set up an entity much like you would a company. Superannuation is subject to very strict rules in terms of how you can then invest your money and when you can get access to it, but within those restrictions there is still a lot of flexibility. You can even use your super fund balance to buy property.

These tight controls mean that getting your fund's compliance right is extremely important, and that involves accounting fees. The accounting fees can put some off setting up their own SMSF. But in this context you need to think of the accounting fees as part of the management of the fund. All funds pay management fees and comparatively, they can be much less for an SMSF (in the form of accounting fees) than the fees charged by industry and retail bodies.

Research & Development - worth another look?

If you have a company that has been involved in the development of new products for yourself or your customers, or you've been developing innovative processes to improve the way you do business, now is a great time to reassess whether you are entitled to a government incentive or grant.

In our April edition, Lina Cavallaro from Cavallaro & Anderson discussed grants and incentives that might be available for businesses to develop new products and/or improve their processes. Of particular interest at this time of year is the Research and Development (R&D) Tax Incentive. This initiative can save you a substantial amount through a 45% tax credit, and depending on your circumstances may even result in a cash return to your business. Companies should consider their eligibility for R&D incentives now so that they don't miss out. Those that may have missed out in the past should revisit this to check their eligibility under the new legislation.

Registration to Innovation Australia for claims to be made in 2012 tax returns need to be lodged by April 2013 or prior to the tax return being due. So it might be worth taking time now to review and

There's no question you need a reasonable balance to get started, as there is a certain level of accounting fees that will be required regardless of the size and activity of the fund. But assuming you have enough, it's worth comparing what an industry or retail fund might charge in management fees with what you'd incur to operate your own SMSF. A recent study conducted by SuperRatings found that on average Australian super funds paid around 1.3% of funds under management per annum in fees, with some paying as high as 4%! In large industry funds, the admin fee may appear very low but if you read the fine print, in many cases you will see that they have already deducted their management fees before paying your return.

So it's possible that SMSFs can end up paying considerably less even allowing for the accounting fees. There are other considerations you need to take into account of course, but when thinking about your own SMSF it's worth remembering that the fees involved may well be less than those of an industry or retail fund. And lower fees means more money for you in retirement.

determine eligibility, identify eligible deductible costs and prepare all compliance records.

Finding and accessing funding often seems a complicated and difficult process and determining eligibility may be a challenge as the program is very detailed. But the benefits can be significant. If you think you might be engaged in eligible activity, please contact us for a complimentary meeting to discuss it further.