Business Tax Information & News!

June 2024

A summary pack of business news and lookouts from a tax point of view in the 2024 Financial Year.

LL Tax and Accounting

Written by Louie Loizides from LL Tax and Accounting

The Brief

Small business is the backbone to our entire economy and thus it is important that they are looked after from a financial and taxation standpoint to ensure that everything is above board and structured appropriately so not to find themselves in a huge mess and in the Tax Office's bad books along with their own suppliers, customers/clients and other creditors.

Working with small businesses for a long time, I have a passion for helping them achieve their financial goals and to go about it the correct and proper way to avoid any significant problems along the way. Tax advisory and structuring has never been more important.

Key areas for Business

- Sole Traders and potential to restructure.
- Company's, Division 7A and the Franking Account
- Trusts and Unpaid Present Entitlements (UPE's)
- Fringe Benefits Tax (FBT)
- Tax Planning Strategies

M: 0449 291 622
E: Louie@lltaxandaccounting.com.au
W: lltaxandaccounting.com.au

Sole Traders and Potential of Restructuring

All businesses start somewhere, whether it's a hair salon or a lawn mowing service – absolutely anything! Sometimes a business is purchased off a third party and thus inheriting a cost base and goodwill along with any stock. It is known that usually within the first two or three years, a business started from scratch will make a loss.

When a sole trader business makes a loss, there are several tests involved to determine whether that loss can be offset against other assessable income in that tax return for that income year. These are called the Non-Commercial loss tests of which there are four along with an income requirement.

However, lets look at the opposite of this and flip the table the other way to now say that the sole trader business has now made a taxable net profit of which is putting the sole trader on a very high taxable income and possibly in the 45% marginal tax bracket (Ideally this should be captured early enough that it does not reach this) as it could result in a hefty tax bill. Restructuring the business involves taking the necessary steps involved to move into a different structure.

The Small Business Restructure Rollover can come in handy especially when there are assets that are CGT assets or trading stock etc. There are other considerations and eligibility criteria just like anything however, potentially an option.

Assets can then be moved into the new entity such as a company (which is usually the case). Effective tax planning needs to be looked at when looking at a potential restructure.

Company's, Division 7A and the Franking Account

Private Company's in Australia are largely used for several purposes and most commonly they are used to run businesses within them. Normally what happens is a company will incorporate through ASIC and then register a business name for its business. There is often a misconception with clients that just because they have a company, it is theirs. Unfortunately, that is not the case. This entity is a separate legal entity that can sue and be sued. Therefore, a "natural person" from a legal standpoint. These vehicles can have the ability to offer asset protection, limited liability and the ability to raise capital.

In respect to the tax implications of companies, they enjoy a lower tax rate which is either a flat 25% or 30%. Yes, there is a difference in the tax rates and that is dependent on the type of income a company derives. If a company is a small business entity – it can access the lower tax rate of 25%. In a nutshell, any business income can access the lower tax rate.

For companies that derive other types of income known as passive income, this is normally taxed at 30%.

Now, remember where I said above that the company is a separate legal entity. This is why it is so important from a tax perspective. Most company directors of which do not receive the appropriate tax advice can get themselves in a sticky situation with the tax man.

For context, a company needs to prepare a set of financial statements and a tax return from for compliance purposes. The reason for this is to ascertain the revenue, expenses, assets, liabilities and equity at the end of the reporting period.

If you have a company and have been using an accountant that provides good advice, you may have heard of the term "Debit Loan". This is a very important aspect to look at when the accountant is preparing the year end accounts. If you haven't got a company but are planning to set one up, this will be news to you.

Let’s say a company has one director and one shareholder because this is the minimum requirement for setting up a company. This director has been running a very profitable business within the company but decides not to draw out an actual wage (comprising of gross wages, less tax withholding and super guarantee on these wages) but instead, any profits or just physically taken out of the bank account.

The first tax effect of this is the profit but also no deduction for wages (Because the director didn’t take the funds as wages) and no super deduction (Because the director did not pay super as there were no wages paid). Leaving the company a tax bill based on 25%.

You may think to yourself, yeah – why is that so bad? The tax rate is limited to 25% instead of paying wages to the director putting them on a higher marginal tax rate.

The issue is that the funds pulled out of the company are out untaxed taxable profits. I won’t bore you with the accounting entries because of drawing these funds out but what happens is they get sat on the balance sheet as a “Debit Loan”.

The tax consequences involved can be quite significant if not dealt with accordingly with the worst-case scenario is the ATO says the drawing of funds could result in a deemed unfranked dividend. This is bad news, because this deemed dividend forms part of the director’s assessable income and depending on when this was noticed, the director may have already spent these drawings and now faces a significant tax bill…. bad news.

Debit loans can fall into the anti-avoidance provision of Division 7A. It is very important to ascertain the right advice from your accountant to deal with this becoming a very widespread issue. There are ways to deal with it accordingly depending on the circumstances, but it requires a deep level of tax planning.

To summarise, companies are a very effective vehicle to use for running a business but there are also limitations just like anything and they can work the right way with the right and appropriate advice.

The Franking Account

The next important area is the Franking Account. This account is not a financial account which means it does not sit on the books within a company’s financial statements – it is an account that sits on the tax return and rolls forward every year depending on what occurs.

To give you a brief introduction of the types of transactions that affect the Franking Account, I have made table, see figure 1.1 below:

Figure 1.1

Year ended 30 June 2024

Date	Franking Transaction Details	Amount (DR)	Amount (CR)	Balance
1/07/2023	Opening Balance		$ 10,000.00	$10,000.00
28/07/2023	June 2023 PAYG Instalment Paid		$ 1,000.00	$11,000.00
30/10/2023	September 2023 PAYG Instalment Paid		$ 1,000.00	$12,000.00
14/01/2024	December 2023 PAYG Instalment Paid		$ 1,000.00	$13,000.00
28/04/2024	March 2024 Instalment Paid		$ 1,000.00	$14,000.00
31/05/2024	Income Tax (2023 Financial Year Paid)		$ 11,000.00	$25,000.00
30/06/2023	Closing Balance			**$25,000.00**
			Maximum Dividend Payment (Subject to Retained Earnings)	$75,000.00
			Franking Credits	$25,000.00

What this account does, is capture any transactions that are in relation to the tax that has been paid for a company of the life of it. This is highly important when it comes to potentially paying out dividends to company shareholders. These are paid out of company profits (These could also

M: 0449 291 622
E: Louie@lltaxandaccounting.com.au
W: lltaxandaccounting.com.au

potentially assist in dealing with "Debit Loans"). Franking credits paid out, reduce the account balance.

Some items that increase the Franking Account:

- Income Tax Paid
- PAYG Instalments Paid
- Franking Credits Received from Dividends

Some items that decrease the Franking Account:

- Franking Credits Paid to Shareholders via Dividends
- Income Tax Refunds

The other thing to also note is that dividend payments are capped at what the company's retained earnings are

In Figure 1.1, assuming a tax rate of 25% - the company directors can declare a maximum dividend payment of $75,000 of which can be fully franked (subject to retained earnings).

A working knowledge of the franking account is essential when it comes to tax planning, please ensure your accountant is on top of this.

Trusts and Unpaid Present Entitlements (UPE's)

Trusts are an interesting entity type that are used for different purposes which could include running a business, holding investments such as shares in a private company within your family group or holding other business assets such as equipment and receives a lease fee. Trusts are widely used for various situations and activities.

There are various types of trusts out there but to keep it simple, we will stick with a Discretionary Trust or more commonly known as a Family Trust. From a compliance angle, a trust will prepare a tax return and financial statements and importantly to show what the beneficiary entitlements are in the financial accounts.

A trust exists to hold assets, otherwise there is no trust. If you have a trust, you may be familiar with the settlement sum that is required to execute the trust. This is what brings it into existence. A trust will also need to have a trustee which can either be an individual or a corporate trustee (i.e. a company). A trust is governed by the Trust Deed. This statement is not to be taken lightly the trustee can only act in accordance with the Trust Deed.

Now, depending on what type of activity the trust is involved in as its main activity whether it is an investment trust or whether it runs a business within it, at some point it is going to derive income from its activities. Income that a trust derives differentiates from trust law income and tax law income. This is again, highly important.

At the end of each financial year, the trust will be left with income. This income must be distributed to its beneficiaries and cannot be retained in the trust unlike a company that has retained earnings that it carries forward to pay out dividends or use as working capital etc.

For a trust to make a distribution that is **valid**, it must make a Trust Resolution Minute of to which beneficiaries are going to be presently entitled to its income and in accordance to the deed. There are significant tax consequences if this is not done right. This must be made prior to 30 June of the income year in question and is done every year. Some Trust Deeds make it known that the resolution must be made prior to 30 June. For Capital Gains, this must be done by 31 August.

Unpaid Present Entitlements (UPE's)

What I want to flag in this letter however is Trusts and UPE's and when they arise. Let's say a trust has Net Income of $100,000 and it is a discretionary trust. It has a list of beneficiaries it can decide to distribute to but decides via a resolution that a company in the family group will become presently entitled to the net income of the Trust. Even though the trustee could have chosen the net income to be distributed to maybe a wife, husband or someone else.

Figure 2.1 shows how the accounting entry is recorded in the books.

Figure 2.1

Journal Entry 1 - To Record a Trust Distribution to ABC Pty Ltd			
Date	Account	Debit	Credit
30/06/2024	Profit Distribution (P&L)	$ 100,000.00	
29/06/2024	Share of Profit (Beneficiary Entitlement) - Liability		$ 100,000.00

Journal Entry 1 - To Record Distribution Received From (XYZ Trust)			
Date	Account	Debit	Credit
30/06/2024	Unpaid Present Entitlement (UPE) - Asset	$ 100,000.00	
30/06/2024	Distribution Receieved - Revenue		$ 100,000.00

Contingency

The ATO has held the view that a UPE is captured as a "loan" under the Division 7A provisions, and they have acted accordingly in reinstating this point. Currently there is a case before the courts that could turn this whole situation on its head. The Administrative Appeals Tribunal (AAT) determined that it should not be considered a loan. The ATO has now appealed, and it is going to the Full Federal Court (FCT).

Now, it is important to note that during the year – there will have been cash drawings from the trust. These cash drawings could have gone to the person involved in the business such as a husband, wife or someone else. These drawings have probably been spent on living expenses etc.

The problem here is that we have a Debit balance of a UPE in the company's books which means that the company is entitled to this net income of the trust because that is who the distribution has been made to. However, the ATO sees this situation as providing financial accommodation therefore can treat this as a loan for Division 7A purposes which has tax consequences. This is because the physical cash has not been paid over.

The main reason for this view is because that distribution would have been only taxed at 25% or 30% in the company's hands where the ATO say "The ultimate economic benefit was actually for another party therefore they should have been assessed on that income".

And this is why Division 7A is an anti-avoidance provision. There are other consequences of trust distributions to be aware of, but I won't get into these at this point.

M: 0449 291 622
E: Louie@lltaxandaccounting.com.au
W: lltaxandaccounting.com.au

Fringe Benefits Tax

Fringe Benefits is an important area of which recently has received quite a bit of coverage in terms of compliance activity from the ATO. A lot of clients say that they want to buy a car in their company and just write it off.

Unfortunately, it does not work like that and the private portion of use on the vehicle will be subject to Fringe Benefits Tax which could be quite costly. Cars can also be subjected to the Cost Limit which limits depreciation deductions.

The Fringe Benefits Tax Year is from the 1st of April until the 31st of March. If there are fringe benefits being provided to employees, then a fringe benefits tax return will need to be prepared and lodged.

Fringe benefits tax is calculated on the Taxable Value of the benefit. The most common fringe benefit is a motor vehicle benefit.

Please speak to your accountant for more information on this as you do not want to expose yourself to compliance activity from the ATO.

I have found that this issue gets put on the backburner, but it really needs to be considered from a compliance perspective.

Planning Strategies

- Maximising Super contributions by way of undertaking an effective analysis of any unused contributions that could be made and utilised.
- Delaying income, if possible, into the next financial year by not raising invoices until 1 July 2024.
- Utilising bucket companies by also being aware of the correct way of structuring and considering the issues of UPE's.
- Incurring any expenses to bring them in as a deduction in the 2024 financial year.
- Cash flow management and really looking at where your money is going.
- Utilising instant asset write off's where now it is $20,000 **however has not become law yet.**
- Family Trust Elections (FTE).
- Fringe Benefit Exemptions on some vehicles.

Wrap Up

Small business is the backbone of our economy and I feel very passionate about helping them achieve their financial goals along with understanding all their tax obligations and making sure that there are no surprises when it comes to tax time by taking the necessary steps to ensure that everything has been done appropriately and above board.

Louie Loizides

Accountant and Registered Tax Agent

LLTAXANDACCOUNTING

LL Tax and Accounting

M: 0449 291 622
E: Louie@lltaxandaccounting.com.au
W: lltaxandaccounting.com.au

M: 0449 291 622
E: Louie@lltaxandaccounting.com.au
W: lltaxandaccounting.com.au