NEWSLETTER

August 2017

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This newsletter is written to assist in recognising issues and developing strategies prior to year end being finalised so as to maximise profits and minimise taxes payable in the current and future years.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If the strategy is to work, all of the elements must be considered and kept in balance.

You need to have a business plan, wealth and tax strategy that deals with:

- *lowering tax rates across the family's income spectrum;*
- *increasing your return on investment;*
- *paying off your home with pre-tax dollars; and*
- *freeing up cash to invest and by such means increasing your wealth.*

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The new Company Tax Rates under the Enterprise Tax System

In the 2016 - 2017 Budget, the Government announced that it intended to progressively reduce the corporate tax rate from 30 per cent to 25 per cent. These changes were outlined in the Enterprise Tax Plan 2016 Bill and the Enterprise Tax Plan 2017 Bill. Amendments were made to the 2016 Bill by the Senate on 31 March 2017. The amendments were accepted by the Government and received Royal Assent on 19 May 2017. The 2017 Bill is currently being debated in Parliament.

Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 was introduced to the House of Representatives on 11 May 2017 to increase the scope of which entities would be eligible for the lower tax rate in future years.

The new company tax rates will only affect you if firstly you are running a business and secondly you have generated a turnover in that business. From the year ended 30 June 2024 all companies irrespective of whether they are in business or have a turnover will be taxed at the same rate.

If you are not running a business or turning over more than the Aggregated turnover threshold, then the ongoing and continuing tax rate is 30% up to year ended 30 June 2023. If you are a company, then the tax rates will change if your Aggregated turnover is less than the following amounts for the years ended:

Year ended	Aggregated turnover threshold	Tax applicable to entities below the threshold	Tax applicable to all other companies
	$	%	%
30 June 2016	2,000,000	28.5	30.0
30 June 2017	10,000,000	27.5	30.0
30 June 2018	25,000,000	27.5	30.0
30 June 2019	50,000,000	27.5	30.0
30 June 2020	100,000,000	27.5	30.0
30 June 2021	250,000,000	27.5	30.0
30 June 2022	500,000,000	27.5	30.0
30 June 2023	1,000,000,000	27.5	30.0
30 June 2024	All corporate entities	27.5	27.5
30 June 2025	All corporate entities	27.0	27.0
30 June 2026	All corporate entities	26.0	26.0
30 June 2027	All corporate entities	25.0	25.0

This is very interpretive legislation and as much as there are guidelines as to whether a company is carrying on a business, it is up to an individual company to self-assess the fact.
In many cases this will be obvious, however for those wishing to derive a benefit it is going to lead to parties interpreting the law differently. ***The reality is if you are below the turnover threshold and you do not follow the essence of the law the Company involved will be paying more tax***. If the Company is owned by a family, this could be either good or bad depending on the dividend policy applicable to the Company.

In certain circumstances this will be an advantage because Companies ***from 1 July 2016 can only pay franked dividends at the tax rate applicable to the company in the year in which the dividend is paid*** (as distinct from the year in which the profit is earned).

Companies may either through their investments or from distributions from trusts receive franked income at a rate greater than the tax rate applicable to the recipient Company.

In those circumstances, surplus franking credits received are first applied to paying tax and when the franking credits are greater than the tax payable then the Company converts the surplus franking credits to tax losses. Those losses can be carried forward indefinitely.

A company earning a taxable income is obliged to pay tax on a self-assessment basis annually. From 1 July 2016 companies fall into two categories:

- Companies that will continue to pay tax at the rate of 30%; or
- Companies that will pay tax at the rate of 27.5% which will be called **Base Rate Companies.**

A Base Rate Company is a Company which will be able to avail itself of the lower tax rates being currently on offer to business. The Base Rate Company must have a turnover less than the **Aggregated Turnover Threshold** as set out in the diagram on page 3.

Within the provisions covering the definition of a Base Rate Company the **turnover of a company** is defined to include the turnover of connected and affiliated entities. Turnover as applied to the above is defined to be your ***annual turnover*** which will consist of ***all ordinary income the company earned in the ordinary course of running the business*** and will for the purpose of this legislation include connected and affiliated entities (not just companies) turnover.

Of interest, will be what is ordinary income to a Company and how in a self-assessment environment directors and public officers define it in the context of what they believe to be ordinary income and what they may believe should be excluded from that definition. Clearly capital gains and insurance settlements will be excluded but what else, dividends, interest?

Simplistically if you get it wrong shareholders will pay more tax because they will derive franking credits at the 27.5% rate where previously they derived franking credits at the 30% rate.

Much has been said about how high net worth individuals will have to fund the tax not paid by companies. If personal tax rates are not changed and individuals receive dividends from Companies who are Base Rate Companies, then those individuals will have to pay additional tax being the difference between the current 30% tax rate and the applicable Base Rate. Superannuation funds have heavily relied on 30% franking credits to offset tax payable on contributions and other income or in the case of tax free funds the refund of franking credits in part or in whole.

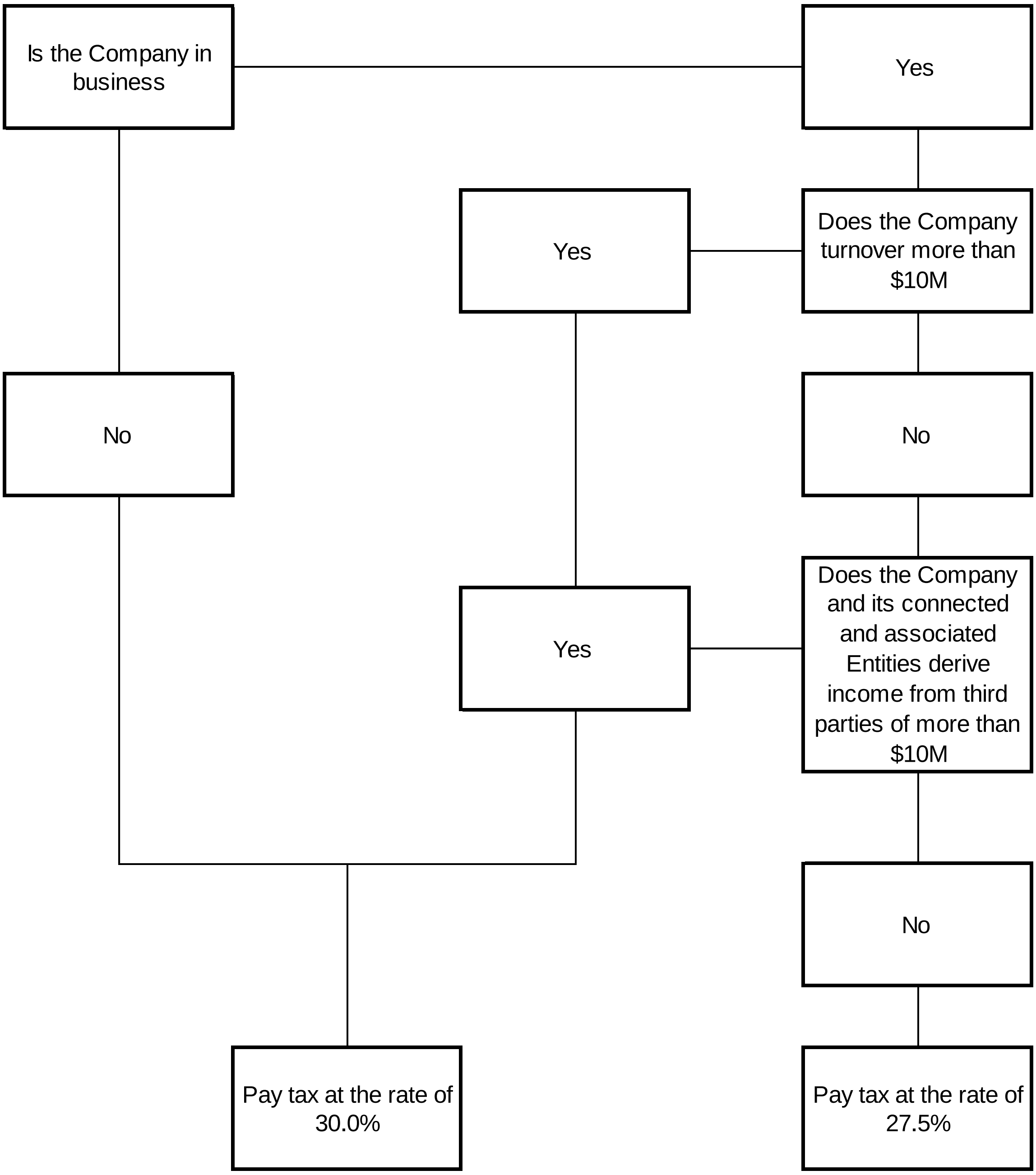
Retirees equally earning say up to $37,000 have relied on 30% franking credits to pay most of if not all of the taxes applicable to their retirement income. As the rate of tax dropped while the individual tax rates remained unchanged then retirees will have to fund more tax. This may not be that apparent in the year ended 30 June 2017 however as time moves forward and corporate rates applicable to investing companies reduces then retirees will find that unless the Government changes individual tax thresholds and all the rates of tax applicable then retirees and low income earners deriving dividend income will be paying more tax.

There are strategies that can be implemented to minimise the effect of the reduced Base Rate Taxes and this **MUST** be understood and implemented before the income tax returns for the year ended 30 June 2017 are adopted and lodged. There is real danger here that Directors, Public Officers and Accountants will focus on the lower tax rates and ignore the consequences to shareholders.

With the change in tax rates, taxes paid and accumulated and the ability to pay dividends at the higher rates, Base Rate Companies will find that franking credits will not be able to be distributed to shareholders. As a consequence of the franking credit reduction, surplus franking credits will arise and could be LOST to shareholders if strategies are not developed to pass them on to shareholders by 30 June 2023.

The following diagram sets out the decision-making process needed to be considered in working out Base Rate Tax applicable to each year of income commencing from the year ended 30 June 2017

DOES ABC PTY LIMITED PAY TAX AT THE RATE OF 27.5% OR 30%
FOR THE YEAR ENDED 30 JUNE 2017



Great care should be taken in **NOT** deciding that the applicable rate of 30% is unacceptable to you because if you are not a Base Rate Company and you decide to be ***because you want to pay less tax in the short term on an annual basis*** it will be very difficult to revert to the 30% rate to get out the 30% franked dividends later.

Minimising taxes covering discretionary income on the imminent death of a family member

As a matter of Estate Planning we believe you should be aware of and discuss what if anything should be done if a family member is very ill and may be going to pass on in the very near future.

On a person's passing a new taxpayer is created and the Estate becomes a separate taxpayer afforded all the advantages of the tax scaling otherwise available to any individual. This means that both the individual (the Late) and the Estate (the Estate of the Late) have made available to them a sliding scale of tax up to first $180,000 earned in any one year.

The individual tax scales are:

Taxable Income $	Tax on Taxable Income $	Percentage on Excess of Taxable Income in Column 2 %
18,200	Nil	19
37,000	3,572	32.5
87,000	19,822	37
180,000	54,232	45

To the amounts calculated above a 2% Medicare levy needs to be applied to the living and not to the deceased taxpayer.

Exemptions to the Medicare levy apply to taxpayers below a particular threshold. Further levies are applicable to taxpayers who do not have private patient hospital insurance.

By way of example, the first $18,200 of income earned by an individual is tax free etc. After that tax is applied at 19% plus Medicare and other levies are added to the taxes payable. On that basis for example the family member is earning say $80,000 a year in their own name would pay tax of $19,822 plus Medicare levy etc. This gives an average rate of tax of 22.78%.

If the family trust historically also distributed say $100,000 from their Family Trust to that individual, then the individual's taxable income would have been $187,000. Tax on this amount would have been $57,522 plus Medicare levies etc. This means that if the taxpayer had been alive at 30 June then the tax rate applicable to the earnings would be 30.76%.

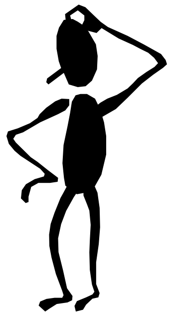
If say the family member passed away on 31 December and had only earned $43,500 then the tax applicable would have been $5,685. (an average tax rate of 13.06%) and the estate would be further assessed for the balance of $43,500 and also pay $5,685 making a total of $11,370.

If that person's Estate was distributed $100,000 in the second half of the year, then the tax on the Estate would be $40,727 making a total tax payable of $46,412, a saving of some $11,110.

If prior to death the trust distributed the first $50,000 of the $100,000 and after death distributed the second $50,000 then total tax would reduce to $44,545, a saving of $12,928.

As onerous as it may be if a Family Member is in a near death situation then consideration should be given by the Family to making a distribution from their Family Trust that effectively gives the person and their estate the same income in the year of death.

Why do businesses stall or fail?



The reason can be any one or a mixture of the following:

- **Bad planning**

  One of the most important things a business needs to do is plan.

  You should set up a business plan even before you commence your enterprise.

  This plan should constantly be reviewed. Many businesses do not use readily available tools to control or plan their activities. If you leave your reporting to your accountant, you are going to fail. Failure to invest your time and your money into timely information reporting will greatly enhance your chances of failure.

  "Failure to plan is planning to fail".

Financial

- **Reliance on historical reporting prepared well after the relevant date**
- **Uninformed, misinformed or bad management**
- **Lack of cash flow**
- **Failure to understand and implement changes to taxation laws.**

Strategic

- **Failure to exploit business opportunities**
- **Failure to embrace technological changes**

In this issue we will cover the financial aspects of successful business planning.

The key to financial success is control and the use of sound financial and cash flow management tools such as financial forecasting which highlights the inter-dependent relationship between profit and cash flow.

Good management should have:

- **A "feel" for the business' profit** based on its knowledge of sales, gross margins and monthly overhead expenses is essential. If you don't know approximately what the profit or loss is for a period before the results are produced, *you are a BAD MANAGER*

- The financial statements should merely be a confirmation of fact. **Timely historical information reporting** and **ongoing profit and cash flow forecasting.** Without being updated by timely financial reporting, the financial forecast is merely a stagnant historical statement ("the budget"). The budget is an historical document and becomes out of date within one month of it being ***produced due to normal commercial changes***

  The forecast should be a living document that represent actual results to date and be reviewed and revised for the remainder of the forecast period.

- A fully integrated forecast which shows the effects of a change in any variable of the forecast in *both profit and cash terms.* If a business cannot internally fund increased sales within the current credit lines, the financial consequence will immediately be identified.

FORECASTING AS A DECISION MAKING TOOL

Management should use an integrated forecast in all decision making to determine

- the profit and cash flow consequences
- the effect of expansion,
- the effect of an increasing or declining demand on the business
- when and how to expand or contract
- staff levels, overheads and infra-structure required to implement decisions
- the effect of other factors such as interest rates

The forecast model is only a tool and it requires a detailed knowledge by management of all the relative factors such as gross profit margins, debtors collection patterns, creditors payment patterns, staffing required, costing of premises, etc. The forecast can transform this information into a meaningful report which can also allow for a number of different scenarios to be run comparing all levels of risk.

BUSINESS FUNDING

Financial forecasting will provide an analysis to financiers funding and show how they will be serviced and repaid. In general, the financiers will be more receptive as the issue has been highlighted in advance and discussed prior to the decision being implemented.

THE BASIS OF PROFIT AND LOSS FORECASTING

The following points must be taken into consideration when formulating a profit and loss forecast:

- Sales and gross profit margins
- Expenses.
- Working schedules
- Accruals and prepayment
- Non-cash items

The forecast will reflect working schedules from which the cash flow forecast emanates.

THE BASIS OF CASH FLOW FORECASTING

The following points must be taken into consideration when formulating a cash flow forecast:

The **cash flow forecast commences** with collections from trade debtors. From this is deducted trading outgoings such as payment of trade creditors and expenses after adjusting for non-cash items. The result would be a trading surplus or deficiency.

Adjustments then need to be made for non-trading inflows or outgoings such as:

- Capital expenditure
- Income tax payments
- Payment of dividends
- Drawings or injections by the principals/shareholders
- Additional borrowings by the business or repayment of borrowings

This will **produce the movement in cash flow for the relevant period.**

MANAGEMENT IMPACT REPORT

Each business should develop a Management Impact Report comprising

- Balance sheet;
- Profit and loss; and
- Cash flow movements.

showing actuals to date and revised forecasting to the end of a reporting period.

It should show actual and expected sales, gross profit margin, total overhead expenses, profit for the period and cumulative profit to date, together with balances of trade debtors, trade creditors, stock, bank balances and other working capital items.