Q4 2016

DJ SPIN

Strategies for managing your business

INSIDE:

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DJ SMITH GROUP

CHARTERED ACCOUNTANTS

Investing in business real property

Investing in a business premise through a self-managed super fund (SMSF) is popular investment strategy among small business owners in Australia.

While SMSFs are not permitted under Australia's superannuation rules to purchase a residential property that is owned by a member or anyone related to a member, SMSFs are allowed to lease a business property - or business real property - that is run by a member or a related party.

Business real property is an exception to the in-house asset and related party acquisition rules. As stated on the ATO website, business real property refers to land and buildings used wholly and exclusively in a business.

Before an SMSF invests in business real property, trustees must ensure the level of investment still meets the investment strategy of their SMSF, including diversification of assets, liquidity and maximisation of member returns in your fund.

In most cases, opting to own your business property through your SMSF can be a financially rewarding investment. The strategy ensures tenancy security and also helps business owners save more money for retirement since they are paying rent to their super fund at the market rate. It also allows SMSF trustees to hold a valuable asset in a more tax-effective structure.

However, SMSFs that lease the business premises to the business must ensure all transactions undertaken are on an arm's length basis to avoid a conflict of interest. The purchase and sale price of the business premise must always reflect true market value and the income from the business premise should always reflect a true market rate of return.

This means transactions must be carried out on a commercial basis i.e. as if there is no relationship between the SMSF and the business.

To ensure this happens, the SMSF must have a formal commercial lease in place between itself and the tenant (the business). The written lease agreement should be signed by both parties and include information such as terms of the rental payments and what should happen if or when the rent cannot be paid.

SMSF trustees must be prepared to enforce the terms of the signed lease. For example, it is not acceptable for rent payments not to be made purely because the business is not doing well financially.

Those who fail to comply with the arm's length rules may come under scrutiny from the ATO, which can impose significant penalties, including disqualifying trustees and prosecution.

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New PAYG withholding rates

Following an announcement in July, the Australian Government recently increased the 32.5 per cent tax threshold from $37,001 – $80,000 to $37,001 – $87,000.

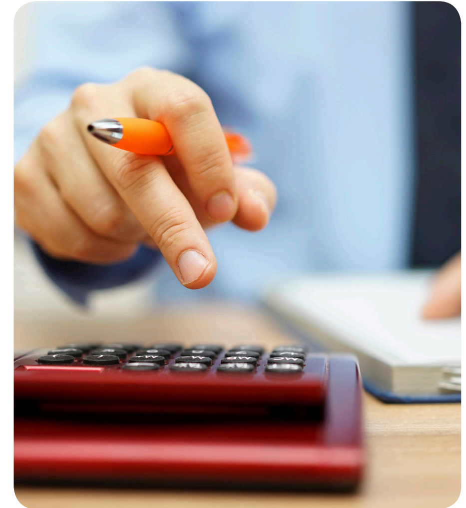
The new PAYG withholding rates will apply to individual taxpayers who earn more than $80,000 from 1 October 2016.

The Australian Tax Office provides a range of tables to assist employers work out how much to withhold from payments they make to their employees. Since the latest edition of the new tax tables is now available, employers should use these new tax tables for payments made from 1 October 2016.

The Tax Office also provides a tax withheld calculator employers can use to calculate the correct amount of tax to withhold. The tax withheld calculator applies to payments made in the 2016-17 income year and provides the correct rates for the 2016–17 income year.

Updated tax tables do not include any catch-up component for the portion of the year which has already passed. Individuals who are affected will receive the full benefit of the tax changes upon an assessment of their income tax return for the 2016-17 income year.

Employers do not need to make any other adjustments or refunds as the ATO will refund any over-payment of tax when employees lodge their 2016–17 income tax return.



Taking out a chattel mortgage

Taking out a chattel mortgage to finance the purchase of a business vehicle is an attractive option for small business owners from a tax-saving perspective.

A chattel mortgage is a mortgage on a movable item of property i.e. motor vehicles. A finance company lends money to a business to purchase a car, which the business then pays back through regular repayments.

Among the many business car finance options available, a chattel mortgage can provide significant financial advantages for companies, partnerships and sole traders looking to buy a vehicle to be used primarily (50 per cent or more) for their business. The interest rates for chattel mortgages are also generally quite low, as the finance is secured against the purchased vehicle.

While the business takes ownership of the vehicle at the time of purchase, the finance company takes out a mortgage over the vehicle to provide security for the loan.

Chattel mortgages are a viable vehicle financing option for certain businesses, as they can claim any GST paid on the purchased motor vehicle in their business activity statement (BAS). Business owners can also claim depreciation and interest charges on their income tax return.

Other benefits include flexible contract terms ranging from 12 months to five years, fixed interest rates and fixed monthly repayments.

Unfair contract terms extended to small business

Small business owners will now be protected from unfair terms in standard form contracts by a new law introduced 12 November 2016.

A standard form contract is one that has been prepared by one party to the contract and where the other party has little or no opportunity to negotiate the terms.

Small businesses enter into and renew standard form contracts regularly, especially between large suppliers such as lenders, insurance companies and telecommunications.

The new law will apply to a standard form contract entered into or renewed on or after 12 November 2016, where:

- it is for the supply of goods and services or the sale or grant of an interest in land
- at least one of the parties is a small business (employs less than 20 people)
- the upfront price payable under the contract is no more than $300,000 or $1 million if the contract is for more than 12 months.

Under the new law, a contract's terms may be considered unfair if:

- terms enable one party (but not another) to avoid or limit their obligations
- terms enable one party (but not another) to terminate the contract
- terms penalise one party (but not another) for breaching or terminating the contract
- terms enable one party (but not another) to vary the terms of the contract.

From 12 November 2016, small businesses will have a higher level of protection so business owners should carefully review all terms of any contracts they enter into. If you believe the terms of a standard form contract are unfair, ask the other party to remove the term or amend it so it is no longer unfair.

For those businesses drafting a standard form contract, be sure to carefully review your terms and, if in doubt, seek professional advice

Preparing for your business exit

Preparing a business for sale is a complex and often long-term process, which requires a lot of preparation and planning. Yet few business owners are prepared when it comes time to be sale-ready.

Exit planning involves careful preparation and consideration of the business, tax and legal implications. Here are five tips to help business owners prepare for a successful business sale:

Prepare early

Business owners should start preparing early to minimise the risk of a failed transaction and to optimise the value of their business. Anticipation of internal and external factors, including market conditions must be anticipated and managed prior to sale.

A seller must provide key factual information for a potential buyer through the due diligence process. Due diligence is a time-consuming process requiring a lot of documentation. A business' failure to keep adequate and accurate financial records can severely damage their sale price and slow down the sales process.

Reduce risk for buyers

Sellers must be very careful to ensure that information provided and statements made in the lead up to the sale are accurate and not open to interpretation. Be sure to provide a clear business forecast and realistic ongoing business model.

All verbal conversations with the buyer should be followed up in writing, such as email, as informal conversations can be relied upon for Court proceedings after the sale. Ensure the contract of sale is well-drafted and states in plain English what you understand to be the agreement.

Evaluate different exit options

It is not necessary to sell 100 per cent of the business immediately. A gradual exit can benefit both parties. For purchasers, it retains customer goodwill and gives new owners time to adjust to the business' operations. For sellers, there is the advantage of keeping an interest in the business and demonstrating its worth to the new owners.

If you are passing the business on to family members, the transition may be over a number of years. A formal succession plan can help guide the business through a smooth transfer of control.

Understand tax implications

Sellers may need to pay GST or capital gains tax (CGT) on some of all the business assets they sell, including land or buildings, or intangible assets, such as patents, licences or goodwill. Some small business concessions and exemptions may apply. Sellers will also need to cancel their GST registration within 21 days of ceasing business, and their ABN within 28 days. Business records will need to be kept for at least five years after the end of financial year in which the business is sold.

Avoid insufficient disclosure

To avoid a claim that there had been insufficient disclosure of financial information; sellers must ensure that the Disclosure Statement accompanying the Contract of Sale (or information provided in due diligence) complies with statutory requirements. Where the Disclosure Statement is sufficient, the responsibility is then shifted to the buyer to conduct their own enquiries about the suitability of the business.

ATO proposes changes to small business penalties

The Australian Tax Office has recently proposed some changes to the way they handle mistakes made by small business owners in their tax returns.

For various reasons, many small businesses in Australia make errors that are not deliberate in their income tax returns or activity statements each year. To make it easier for those who make a reasonable effort to comply, the ATO has proposed changes to its approach to penalties.

If implemented, the changes will apply to small businesses with annual turnovers of under $2 million.

The ATO has stated that it will provide one chance before applying a penalty in the following circumstances:

- where failure to take reasonable care resulted in false or misleading statements being made in income tax returns and activity statements
- for late lodgement of income tax returns and activity statements

These changes will apply to the first error and late lodgment subject to penalty. The one chance timeframe will be refreshed after a set period of time. The ATO will also confirm in writing to these small businesses that while they were liable to a penalty, it has chosen not to apply one on this occasion.

The changes would not be available to those who demonstrated reckless or dishonest behaviour and those who disengage and cease communicating with the ATO during an audit or review.

All small businesses would receive a clear explanation of how the error occurred and understand what they need to do to get things right in the future

After a defined period of time (i.e. a three or four year financial cycle) the opportunity would be reset. Given the frequency of reporting for activity statements, when considering late lodgement penalties this set period may be different for income tax returns and activity statements.

After the one chance opportunity has been provided, failure to lodge on time would automatically apply if lodgment was not received by the due date

The ATO has focused on these particular penalties because they represent the majority of penalties imposed on small businesses in 2015. For example, for all false or misleading statements in income tax returns and activity statements last year, approximately 57 per cent of penalties were imposed on small businesses and over 50 per cent were found to have failed to take reasonable care. In the same year, 83 per cent of all failure to lodge on time penalties were imposed on small businesses.

Are you underpaying employees?

Employee underpayment, whether it be failure to pay penalty rates or unauthorised wage deductions, is a breach of the Fair Work Act and consequently can result in hefty employer penalties.

Employers are responsible for paying staff members the minimum monetary amounts including allowances, prescribed under an award or agreement. When an employer fails to do so, the employee can claim for underpayment of wages within six years of the money becoming due.

Underpayment can result in various ways; here are three common risk areas for employers:

Incorrect classification

Generally, classifications are based on the nature of the role and the employee's qualifications and experience. Employers must firstly make sure they use the relevant award or agreement for the employee and then match the classification to the corresponding hourly pay rate.

Failure to pay entitlements

Incorrect payment of entitlements, such as penalty rates, overtime, leave and allowances is considered underpayment. Any allowances, loadings or penalties set out in an award or agreement must be applied to employees.

Special care must be taken when applying annual leave; employers must check the rate of pay, and if an annual leave loading applies as per annual leave clause in the award or agreement. Employers must also ensure they remain up-to-date with any changes to modern awards, such as annual award increases and increases to rates of pay.

Unauthorised deductions from wages

An employer must only make reasonable deductions from wages, such as a salary sacrificing agreement. A deduction must be authorised in writing and work in accordance with a modern award or agreement.

Any deductions that directly or indirectly benefit the employer are considered unauthorised deductions. Employers are at risk of breaching the Fair Work Act if they deduct costs such as tools and equipment, uniform and breakages from an employee's wages.

A case for workplace policies

Workplace policies are not reserved for the big corporations; small businesses are increasingly subject to unfair dismissal and adverse action claims that could be minimised by implementing workplace policies.

With the lead-up to Christmas, now is a great time for employers to set or review workplace policies. Workplace policies set the framework for expected employee behaviour and performance; and the consequences of not complying with their responsibilities.

Well-enforced policies can provide employers with a basis for defending potential liabilities if a legal dispute arises between an employee and employer. A workplace policy not only clarifies functions and employee responsibilities but ensures uniformity and consistency across all operational procedures.

Although, not all workplace issues require a policy; employers should have policies for fundamental issues, such as anti-discrimination and equal opportunity, code of conduct, anti-bullying, sexual harassment, privacy, drug and alcohol use, and workplace health and safety.

For a workplace policy to be effective, it must be publicised and provided to both new and existing staff members. A policy should set out the aim of the policy, why it was developed and who it applies to. It should clearly outline acceptable and prohibited behaviour, as well as disciplinary action for breaching the policy.

Employers must include a date for when the policy was developed and be sure to regularly review and update policies where necessary. Any changes to employment law and/or your industry's award or agreement may require a review of your policies and procedures.

Policies must be explained in full and employees should sign off on documents to acknowledge their awareness and understanding of policies. For policies to work effectively, a breach of policy should be implemented and objectively followed by all levels of management, according to the procedures set out in the policy.

Important tax dates

21 NOVEMBER
Lodge and pay October 2016 monthly activity statement

25 NOVEMBER
Lodge and pay quarterly activity statement for quarter 1, 2016-17 (Tax Agent prepared)

28 NOVEMBER
Lodge Superannuation guarantee charge statement – quarterly

28 NOVEMBER
Pay the super guarantee charge for quarter 1, 2016–17

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