

Getting too close to your business: when personal and business funding blend

Most small business owners are pretty close to their business. For many, it is a major part of their life and the distinction between personal and business is easily blurred. This can also cross over to their financial affairs with business and personal finances being interrelated.

Some recent tax cases are a reminder of the risks you run if you don't **keep a sufficient separation between personal and business**. Get it wrong and you can lose some valuable tax deductions. The main area of risk is for those that operate their business through another entity such as a company or trust. Maintaining this structural separation is quite common and often makes a lot of sense for asset protection purposes. But **problems often occur when you personally incur an expense on behalf of your business and then seek to claim tax deductions for the expense**.

The most common example of this is **interest costs on borrowing**.

Your business needs funding and the bank is reluctant to lend direct to your company but more than happy to lend to you. Or, you decide it would be better to borrow at a personal level because you can secure a much better interest rate. All of this makes sense so far. You are your business; what's the difference whether the business borrows the funds or you borrow them and let the business repay the loan? The problem comes down to who is entitled to the tax deduction. If the loan is in your individual name you may want the tax deduction for interest paid at a personal level. You can only achieve this if there is a reasonable nexus between the interest incurred and income you derive from your business. And, simply earning salary or wages from the business is unlikely to satisfy this requirement. The Court's position is that **an employee is not normally required to provide funding for their employer**, so the fact that you earn a **salary from the business will not be enough**. You need to show a clearer connection; this could be from

- dividends you are receiving (probably unlikely in the first couple of years of business life),
- directors fees, or
- the best evidence is where you have on lent the money to the company and are charging a rate of interest. In this case you would have both interest income and an offsetting expense.

If the loan is in your personal name also be careful about just having the company make the repayment and claim the interest deduction. Your company could run into Division 7A problems and trigger an unexpected tax outcome.

Division 7A applies where payments, loans or debts by a private company to a shareholder have or appear to have been forgiven. The division treats these amounts as a deemed dividend to the extent that the amount represents a distribution of the company's profits.

Another common risk area is business expenses claimed at a personal level particularly if you operate your business through a discretionary trust. Where your sole source of personal income is from trust distributions, you are **unlikely** to be entitled to claim any tax deductions for expenses incurred in earning your income. **The reason for this is that as a beneficiary of your trust, you have no right to income until the trustee appoints that income to you at year end.** You do not have an automatic right to the income. And, at the time you incurred the expenses throughout the year e.g., car expenses, you had no income. You simply had an expectation that the trustee would appoint income from the trust to you at year end. Unfortunately, that's not enough.

The clear message is that you need to **put some formality around arrangements where the personal and the business cross over.** Yes, you and the business are almost one - but not from a tax perspective. Get this wrong and it can be expensive.

Avoid delays - Lodge early - Tax Refunds Sooner

Most property investors are negatively geared. This means that where they have not requested a variation of their PAYG deduction from their employer, they get refunds on lodging their tax returns at the end of the financial year.

ATO is now processing lodgement of returns very fast, particularly where there is a refund and the refund is being deposited electronically into the taxpayer's bank account. Some refund assessments are issuing within 7 working days.

Tax Tip - To get refunds lodge your tax return soon. **Property Tax Specialists** can help facilitate the process and minimise time and cost with their checklists and templates. Contact Shukri on Shukri@propertytaxspecialists.com.au

Help available

To make the compilation & reporting task for tax returns easier, clients of **Property Tax Specialists** received checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear **documentation**. ATO way means time/money wastage with possible audit investigation.

If you need help contact Shukri Barbara at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

*We look forward to being of Service – helping you towards
Prosperity & Peace of Mind*

Please do not hesitate to contact us if you would like to review & discuss your current property & tax situation, your asset protection strategy, structuring your next investment property, planning to legally minimise your tax position or just to prepare your next tax return.

We look forward to being of service. We also look forward to your referrals.

To improve our service we welcome all constructive comments on this newsletter and other materials.

For help contact **Shukri Barbara** at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

Disclaimer

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained.

Acknowledgement - parts of this newsletter have been taken from Knowledge Shop Pty Ltd client newsletters. Barbara & co – Property Tax Specialists is a member of the Knowledge Shop and Hayes Knight Network

Kind Regards
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