UBTA Bulletin
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Understanding the impact of your business decisions

You will learn

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7 Profit Drivers

Improve the lead measures that drive profits with these 7 steps

Matt Cowell
Manager

Want to achieve greater profits but not sure where to start? Although profitability is typically the key goal for a business, it's a lag measure of the many activities and transactions occuring every day.

There are a lot of levers to pull, initiatives to implement and items to manage to achieve greater profits. These measures all have different levels of complexity, effort, and varying levels of impact and return. With all the activity, noise and whirlwind in a business it can be challenging to know what to target.

There are endless metrics that can be measured however there are 7 key profit drivers which, when focused on, can make a profound effect on the bottom line. As we know in business, sales are where profit starts from and is where the first 5 drivers are focused;

1. Leads
The first profit driver to consider is how many leads the business is generating. Leads can come through various means and could be defined differently from business to business. Work out what this number is in your business and drive the key activities that generate these leads. These include outgoing calls, appointments, quotes amongst others.

2. Conversion Rate
The next driver is the conversion rate from a lead to a customer. Are there some methods, customer profiles or salespeople that always seem to work that need leveraging? On the flipside, are there some products or customers that take up all your time and never seem to convert? Find measures to increase this ratio such as filtering your quotes, increasing follow-ups, analysing your losses and improving your pitch and presentations.

3. Retention Rate
Of the customers you have, what is your retention rate? Track and manage your service levels and customer satisfaction and understand why customers may stop purchasing from you. Get feedback from your customers – an unhappy customer can be an excellent source of feedback and a small favour or discussion may turn them around.

4. Order Frequency
Next, what is your customer order frequency? Look to set up supply or service agreements or make a point to reach out to them if they haven't purchased in a while. Consider, are there more products in your range you could sell to existing customers, or do they have additional departments or branches you could service?

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5. Average Sale Value

Finally on sales, understand and work to drive up your average invoice value. Can you set minimum order quantities, price rises or incentives to purchase above a certain value? Are you upselling or can you add more products? If you are going to the effort of fulfilling an order, it doesn't take much more work to increase its size – and the results are compelling.

6. Gross Profit Margin

Gross profit margin is a very well understood and considered figure – and for good reason. It's one thing to get the sale however, there needs to be healthy margin on them. Ensure your costings are accurate and your pricing reflects the value you provide. Often the key to profit in a business is its purchasing, with costs of sales being the biggest expense of a typical business. Is there endless supplier price increase creeping in that aren't being passed on or, with sales growing, are you able to renegotiate pricing?

7. Overheads

The final, but not least significant, driver of profit is your overheads. Go through line by line and transaction by transaction – see if there is any fat that can be cut. Make sure each line is providing good value and have a budget and cost control process to ensure the business is running as lean and efficiently as possible.

It can be a very powerful to work out your current numbers and engage with the team to build some scenarios - small changes can result in massive improvement. Integrate these drivers into your goals, make the results visible and reward staff for achieving certain milestones – these are the key numbers that will make the difference.

You won't be able to target and improve these drivers all at once and some may detrimentally affect the others. However, understand the context, go for the low hanging fruit, and watch the gradual improvements. Although profit improvement is an ongoing journey, remember a journey of a thousand miles begins with a single step.

Watch the testimonial today

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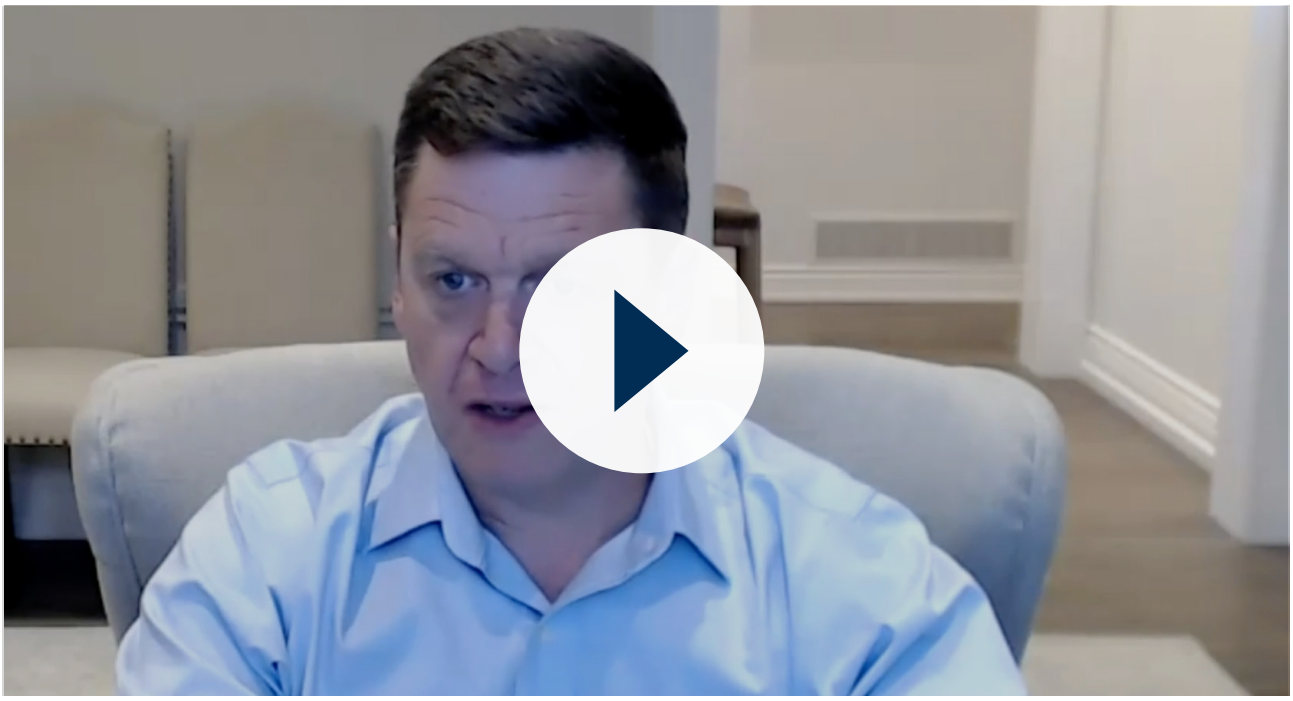

Trust Distributions: Don't attract the scrutiny of the ATO!

What is section 100A and how does it affect my business?

Campbell McEwen
Accountant

Background of Section 100A

Discretionary Trusts (or family trusts, where distributions are at the discretion of the trustee) are a key part of the structure of many businesses, thanks to their flexibility in income distribution, including distributions to members outside of the direct family group.

However, this flexibility also brings risk of ATO scrutiny if it falls outside of what the ATO consider 'ordinary family and commercial dealings'.

What is Section 100A?

Section 100A of the Tax Act was introduced in 1979 to deal with reimbursement agreements and Trust Stripping arrangements, where the taxpayer entitled to the trust income is not the beneficiary of the income. Crucially, unlike other anti-avoidance provisions Section 100A has no time limit on any audits, allowing the ATO to target distributions made years ago.

What are 'ordinary family and commercial dealings'?

The definition of 'ordinary family or commercial dealings' has been vague and uncertain ever since the legislation was introduced.

Until recently there have been few judicial rulings relating to this issue, so although ATO has released its position there is not enough evidence to be able to confidently determine a courts perspective.

Problematic arrangements

Two practices the ATO have particularly targeted in the recently released approach to S100A are:

Unpaid Distributions to Low Income Individuals.

Where income is distributed to low-income individuals, and then the after-tax amount is gifted or loaned indefinitely back to the parents or controllers of the trust. This arrangement is of particular concern when:

1. The money is gifted back to reimburse parents for school fees. These expenses are considered a wholly parental responsibility and should be paid for by the parents.

2. The distribution is repaid to the parents through excessive board, above commercial rates.

3. The distribution remaining unpaid in the trust with no genuine intention of paying the amount.

Bucket company arrangements

Where income is distributed to a 'bucket company' with a tax rate of 25-30%, rather than the controllers at the top margin rate of 47%. This arrangement is of particular concern when:

1. Income is distributed to a company, however the cash loaned to the controllers for private expenses, or

2. Where the shares in the company are owned by another or the same trust. (This is commonly referred to as a washing machine arrangement, where there can be an endless cycle of distributions to the company and dividends back to a trust.)

Whilst majority of distribution arrangements would comply with the ATO's views, it is important to ensure that your financial arrangements are structured effectively to avoid ATO scrutiny, as it's always better to avoid a fight then to win a fight.

If you have any questions in relation to your trust arrangements, reach out to a UBTA manager.

Building Cost Write-Off – are you taking advantage?

Marcus Plaisted
Manager

Do you own commercial, residential or agricultural real estate which you're leasing out? If so, utilisation of the 'Capital Works Deductions' provisions, sometimes referred to as 'Building Cost Write Off', could be a way of increasing the after-tax rental returns on your property during the period of ownership.

What are Capital Works Deductions?

Capital works deductions are essentially income tax deductions a property owner can claim for the decline in value of a building and other items that are regarded as being fixed to the property. It works in a similar way to the way a business claims depreciation for the decline in value of their plant, vehicles and other fixed assets. As a result, claims can be substantial depending on the value of the structure, it's age and the nature of the fixtures.

What can I claim?

The deductions for fixtures associated with a commercial property are largely made up of the building itself, or the 'bricks and mortar' structure, and apply to buildings constructed after July 1982. However, they can also extend to other fixtures, including carparks, kitchenette and amenities fitouts, built-in workstations, mezzanines, glass partitions and shelving. This is not limited to the initial cost of installing the fixture – it can also include the costs of fixtures installed during renovations performed after the building was constructed, where these improvements were performed after February 1992.

How do I calculate my claim?

Where you haven't built the building, calculating the cost and amount claimable is best done by a qualified quantity surveyor or independent qualified person. This is important, as there are different deduction rates available depending on the nature of the fixtures and when they were installed/constructed. A quantity surveyor can also assist with calculating an estimated construction cost of buildings and fixtures, which is particularly useful when the property has an existing building that was constructed by a previous owner.

How could it benefit me?

Generally, the biggest benefit to a property owner is the improved after-tax cash flow on an income-producing property during the period of ownership. To help highlight the potential cash flow advantages, consider the below hypothetical scenarios for Andrew and Sasha. Firstly, we'll assume that they purchase a property for $1,000,000 and sell this property 5 years later for $1,600,000 (a gain of $600,000). We'll also assume that the property generates $60,000 in rental profits after outgoings each year, and that they each have a personal income tax rate of 39%.

If Andrew and Sasha decide not to utilise the capital works deduction provisions, they will not require the services of a quantity surveyor. Instead, they will pay income tax based on their $60,000 of rental income, and pay capital gains tax on the capital profit in the year they sell the property. As they have owned the property for more than 12 months at the time of selling, they are eligible to halve the amount of the capital profit they are taxed on. Their circumstances may look something like this:

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Scenario 1:	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Total
Rental Profit	$60,000	$60,000	$60,000	$60,000	$60,000	$300,000
Capital Gain					$600,000	$600,000
Less 50% Capital Gain Concession					-$300,000	-$300,000
Total Taxable Income	$60,000	$60,000	$60,000	$60,000	$360,000	$600,000
Tax at 39%	-$23,400	-$23,400	-$23,400	-$23,400	-$140,400	-$234,000
After-Tax Income	$36,600	$36,600	$36,600	$36,600	$219,600	$366,000
After-Tax Cash Flow	**$36,600**	**$36,600**	**$36,600**	**$36,600**	**$519,600**	**$666,000**

Let's now assume Andrew and Sasha engage a quantity surveyor to calculate their eligible capital works deductions. The quantity surveyor estimates a total construction cost of $600,000 and, using a capital works deduction rate of 2.5% p.a. this allows them to claim a tax deduction of $15,000 per year. While this means the remaining cost base of their property is slightly higher when they come to sell (due to the capital works deductions claimed in years 1-5), their situation would look something like this:

Scenario 1:	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Total
Rental Profit	$60,000	$60,000	$60,000	$60,000	$60,000	$300,000
Less Capital Works Deductions	-$15,000	-$15,000	-$15,000	-$15,000	-$15,000	-$75,000
Capital Gain					$675,000	$675,000
Less 50% Capital Gain Concession					-$337,500	-$337,500
Total Taxable Income	$45,000	$45,000	$45,000	$45,000	$382,500	$562,500
Tax at 39%	-$17,550	-$17,550	-$17,550	-$17,550	-$149,175	-$219,375
After-Tax Income	$27,450	$27,450	$27,450	$27,450	$233,325	$343,125
After-Tax Cash Flow	**$42,450**	**$42,450**	**$42,450**	**$42,450**	**$510,825**	**$680,625**

As a result, Andrew and Sasha have a cash flow improvement of $5,850 each year by utilising the capital works deduction provisions, and are $14,625 better off over the period of ownership.

The scenarios and information provided above are not financial or specific advice, and independent advice should be sought if you feel this could be beneficial for your circumstances. UBTA would be happy to assist you with estimating the tax and cash flow implications, and can put you in touch with quantity surveyors to assist you in calculating your capital works deduction if required. Please don't hesitate to contact your UBTA Account Manager or call us on 1300 567 819 to discuss further.

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