"MADA NEWS" NOVEMBER 2005

Medical and Dental Accounting

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INTRODUCTION

Welcome to the very first edition of MADA News. We aim to provide you with information on topical issues on a regular basis.

Ms Jo Dawson of Hillross (our recommended financial planner) and Mr Jim Doumakis of Jose & Associates (our recommended IT specialist) have also contributed to our newsletter and will continue to contribute on a regular basis.

If you have any comments in relation to the contents of MADA News, please do not hesitate to contact either Caroline Poon or Elaine Hinds at our Elwood office on (03) 9531 6666 or Michael Waycott at our Kew office on (03) 9819 7308 or email us at caroline@madabayside.com.au; elaine@madabayside,com.au; or michael@madabayside.com.au.

TOPICS COVERED

1. Service Trusts Update
2. Abolition of the Superannuation Surcharge
3. BankLink
4. Can you afford to retire?
5. Superannuation Splitting between Spouses
6. Data Backup – Why do we backup our data?

SERVICE TRUSTS UPDATE

Most if not all clients would be aware that the Australian Tax Office ("ATO") released a Draft Ruling on Service Trusts arrangements in May 2005. The ATO then released a set of guidelines in June 2006 which provided safe harbour mark-ups on service entity arrangements (this is discussed in detail below).

Before we mention the changes to service trust arrangements brought about by the ATO's draft ruling, let's revisit why service trusts have been a useful tax planning and asset protection tool to date.

What are the benefits of using a Service Trust?

Utilising a service trust to run a medical or dental practice's administrative side means the assets used by the practice entity are owned by the service trust and not the billings entity (practice partnership, company or individual associate doctors) itself. In this way the assets used in the practice are protected from creditors in the event that the practice entity is sued or incurs debts and liabilities that cannot be paid.

Similarly, the billings entity is protected from any debts or liabilities that are incurred by the service trust in relation to the provision of the services. For example, the billings entity will not be responsible for liabilities arising for workers compensation or unfair dismissal claims made by employees of the service trust as these claims will be made against the service trust.

Traditionally a service trust is run through a unit trust where each owners/partners' family trusts are the unit holders. The service trust incurs all practice operating costs including but not limited to rent, wages, superannuation, medical supplies, electricity, and phone and office stationery. The service trust charges a monthly service fee with a mark-up in accordance with the service trust's service agreement that at a minimum covers the practice's operating costs. The mark-up received each month on the service fee the service trust receives is then distributed to its unit holders (family trusts). The distribution of income to the family trusts will in many cases result in lower tax being paid by the family or the doctor or dentist concerned.

New Draft Ruling and features of a Service Trust identified as being acceptable

1. The service trust is independent from the billings entity.

    - The service trust would be in the business of providing the contracted services regardless of whether the services were provided to the billings entity.
    - The service trust has employees who can be recognized as carrying out the service trust's business.
    - The service trust's recruits and trains individuals.

- The service trust employs staff on a permanent basis, with day to day supervision of the staff being the responsibility of the service trust.
- The billings entity acquires real value and benefit from the arrangement, which could not have been achieved by contracting with the staff directly.
- The service trust fulfils its own tax, superannuation and workers' compensation commitments.

2. The service fees are commercially realistic.

- The billings entity can identify how the service fees were calculated.
- The service fees paid by the billings entity are comparable to commercial rates charged by other service providers or are in line with ATO's safe harbour rates (discussed later).
- The service fees paid by the billings entity relate to the services provided by the trust**.**

3. There is a service agreement in place.

- There is a signed service agreement in existence that clearly states the contractual benefits passing to the billings entity pursuant to the agreement.
- Contained in the agreement must be the computation of the monthly service fee paid by the billings entity that is commercially acceptable and in line with other similar service providers or the safe harbour rates released by the ATO.

4. Other Documentation

- A tax invoice is prepared by the service trust on a monthly basis that shows the service fee amount plus mark-up plus GST. Shown on the tax invoice must be the service trust's ABN and applicable month.

ATO's Service Fee Safe Harbour Rates

As mentioned above, subsequent to the issue of the Draft Ruling, the ATO issued a guidance document on 29 June 2005, in which it sought to outline in a practical sense what practitioners needed to do to ensure their service arrangements would be accepted by the ATO. In particular, the emphasis in the guidance document is that rates charged by the service trust need to be commercially realistic.

The Tax Commissioner sets out the following *safe harbour* rates which will be accepted as being commercially realistic:

- labour hire – temporary staff – net mark-up of less than or equal to 5%
- labour hire – permanent staff – net mark-up of less than or equal to 3.5%
- recruitment – net mark-up of less than or equal to 5%
- equipment hire – return on assets of less than or equal to 9% of the written down value of the assets

The above safe harbour rates released by the ATO in its guidance document have caused great angst amongst professionals currently using service trusts. We, like other accountants and professional bodies such as The Institute of Chartered Accountants and the Australian Medical Association (AMA) feel that the safe harbour rates are unrealistic and fail to take into consideration an appropriate mark up for the services being provided by the service trust. We are aware that the AMA, The Institute of Chartered Accountants and The Certified Practising Accountants Association are lobbying for changes to be made to the ATO's safe harbour guidelines and such amounts as 35% on salaries or between 40% to 60% of billings have been bandied around. However we understand on good authority there may be little change to the draft ruling when the final ruling is released.

An interesting point is made by Michael Heraghty (partner with TressCox Lawyers) who wrote a paper for the AMA regarding the Draft Ruling. In it he states:

"In my view there is an alternative approach to that taken by the ATO when it comes to service arrangements involving doctors. There is a wide spread practice whereby large corporate medical centres such as Mayne and also small private practices engage medical practitioners on the basis that the medical centre or private practice will provide the premises, staff and equipment necessary for the medical practitioner to conduct his or her practice, with the service fee being charged for these services based on a percentage of fees billed or billed and collected by the medical practitioner. These rates are struck between independent parties negotiating at arms length. Therefore if the relevant rate charged by a Service Trust to a principal of a medical practice is comparable in terms of the services provided and the rates charged by other similar practices in an arms length situation, then I cannot see that the Commissioner of Taxation can say that such a service fee is commercially unrealistic."

The service fees charged by large corporate medical centres generally range between 35% to 50%.

What to do now?

The ATO has stated that professionals using service trusts have a 12 month moratorium that ends on 30 June 2006. This means all tax payers who have entered into a service trust arrangement should review their current service arrangement to ascertain if, to start with, they should have a service trust arrangement and then, whether their arrangement will pass scrutiny with the ATO if audited. In other words, clients using a service trust have 12 months to make changes to the current service arrangement and service agreement if the service fee charged is not commercially realistic and not in line with the ATO's suggested safe harbour rates.

While preparing our clients' 2005 financials and tax returns we will be reviewing all clients' service trust arrangements. Any changes to the current structure and the trust's service agreement will usually be explained in detail in a face to face meeting. If you have not already met with or spoken to either Caroline Poon, Michael Waycott or Elaine Hinds regarding the Draft Ruling, please do not be concerned. We will ensure that we speak to or meet with every client currently using a service trust before 30 June 2006 to ensure their house is in order.

It is important to point out the ruling is in draft form only at present and there is no indication when the final ruling on service trusts will be released. Like other accountants and professionals we are awaiting the outcome of the lobbying efforts by the AMA and other professional bodies, so at the moment, it is watch this space. The most important thing to do between now and 30 June 2006 is to ensure that a review of your current service trust arrangement is undertaken by Caroline Poon, Michael Waycott or Elaine Hinds and to make changes where appropriate.

It should be noted that whether or not the ATO changes its stance on appropriate mark-ups, the Commissioner's view may mean that a sole practitioner will no longer be able to operate with a service entity arrangement in place, especially where that entity employs only one or two staff members who are under the direct control of practitioners. Further, doctors or dentists who are really consultants or contractors to a practice will also not be able to benefit from such an arrangement.

There have been some accountants suggesting it is business as usual for the year ended 30 June 2006 as well. This could not be further from the truth as audits of service trust arrangements will commence from 1 July 2006 and the year in question to be audited will be 30 June 2006. If such arrangements do not pass muster, it is likely the Commissioner will go back and look at past income tax returns and amend accordingly.

ABOLITION OF THE SUPERANNUATION SURCHARGE

In a welcome move and in line with the Federal Government's more relaxed policy in relation to superannuation matters and taxpayers funding their own retirement, it was announced in the 2005 Federal Budget that the superannuation surcharge would be abolished from 1 July 2005.

Contributions to a superannuation fund are taxed at 15%. This is commonly referred to as the "contributions tax".

The superannuation surcharge was essentially not a surcharge but an additional contributions tax paid by high income earners on superannuation contributions and certain termination payments received from employers. For the financial year ending 30 June 2005, the surcharge applied from the point when a person's adjusted income (taxable income plus superannuation contributions plus reportable fringe benefits added together) reached $99,710, with the maximum rate of 12.5% applying when the income exceeded $121,075.

Opportunities arising from the abolition of the super surcharge

With the abolition of the superannuation surcharge there has also been a concurrent increase in tax thresholds. The threshold for the top marginal rate of income tax increased to $95,000 from 1 July 2005 and increases to $125,000 from 1 July 2006.

Does the increase in the personal tax threshold for the top marginal rate make contributions to superannuation less attractive notwithstanding the demise of the superannuation surcharge? What should you be doing?

We have compared making a pre tax (employer) superannuation contribution subject to surcharge of $15,000 with the alternative of deriving the $15,000 as additional taxable income. The respective net amounts are invested in a similar manner. We have assumed an earnings rate of 7% per annum whether inside or outside the superannuation environment.

Individuals on both the 47% and 42% tax rates were better off contributing to superannuation and paying the surcharge than receiving taxable income.

Believe it or not, everyone previously paying the full surcharge on super contributions will be 17.24% better off on every dollar contributed after 1 July 2005.

Excess Benefits

Even if the contributions create an excess benefit, for the top marginal tax rate of 47%, individuals are better off making the contributions than deriving taxable income now that the superannuation surcharge has been abolished. A benefit arises from Year One. Previously, with the surcharge, the

excessive contribution needed to be in superannuation for around 6 years before benefits were realised.

In summary:

- Everyone who previously paid the full surcharge will be 17.24% better off on each dollar contributed after 1 July 2005.

- Everyone on the top marginal tax rate will always be better off contributing to superannuation, even if the contribution immediately gives rise to an excess benefit.

BANKLINK

Do you wish doing your Books was less taxing?

For those clients who do not have a Practice Manager or Bookkeeper to prepare their accounts and who do not want to spend hours pouring over figures, cashbooks and GST calculations, there is an alternative. Our firm has been using a product called BankLink that can assist clients in this predicament.

How Does It Work?

With your permission and under strict security measures, a copy of your bank or other financial statement information is e-mailed to us. The information goes directly into our accounting system and, depending on your requirements; we can send you a report identifying which transactions we need more information on. This could be sent either by mail, fax or e-mail. You fill in the necessary details and return the report to us.

From this information, we therefore provide you with monthly financial statements, quarterly BAS, etc.

If you would like more information please call ***Frank Gonano*** at our Kew office on 03 9819 7308 or email Frank on frank@mada.com.au.

We expect BankLink to save clients many hours in bookkeeping fees if they do not use a software programme such as MYOB or QuickBooks to provide us with the necessary information to prepare financial accounts and tax returns.

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CAN YOU AFFORD TO RETIRE?

We all grow old and most of us one day hope to retire, or at least have the choice to retire. However, gone are the days of relying on the aged pension to meet our cost of living in old age. However, ever increasing research shows that many of us may not be able to afford to retire.

In 2004 research by the Association of Superannuation Funds of Australia (ASFA) and ANOP Research Services regarding community attitudes to retirement found:

- One in three retirees were disappointed with their financial security in retirement.
- Only one in eight people believed their savings would be enough to fund their retirement.
- Over half of the respondents believed their current savings would not be enough to provide the retirement income they would like.
- Eight out of ten were considering working during retirement to bridge that gap – if they could find suitable work.

This year research by Citibank reveals:

- Around one in two retirees claim you need as much income - if not more in retirement.
- 30% are not confident their retirement savings will last the distance.
- Around one in three over 65s didn't seriously start saving for retirement until age 55.
- 1.3 million retirees wish they'd started saving earlier for retirement.

Both surveys show people are more aware of the problems associated with providing a reasonable retirement income. Secondly, a lot of people have a lot of planning, saving and investment to do before they can retire.

So how much is enough. Let's take a look at Ron and Carol. Both are aged 50 and hope to retire at age 65. Having paid off their mortgage and finished funding their children's private school education, their investments are $180,000 of superannuation in Ron's name and an investment property owned by Carol worth $450,000, on which there is a mortgage of $270,000. Their home is valued at $600,000 and they intend to live there long term.

Ron and Carol hope to retire with an income of $80,000 per annum after tax, indexed by inflation and the debt on their investment property repaid. By 2020 they will need approximately $116,000 per annum to maintain the purchasing power of $80,000 in today's dollars. To achieve this they are going to need approximately $1,860,000 at retirement. One possible strategy is contribution to superannuation. To achieve their goals they should be contributing $40,000 per annum from before tax dollars which should allow them to meet their retirement goals. Our estimates are based on the income being required until

age 90. (An earning rate of 7.5% and inflation of 2.5% per annum have been assumed along with the use of certain strategies).

What should you do? It is never too late to start. Work out how much your retirement lifestyle is going to cost, including the cost of your retirement activities. Are you going to need to purchase the Winnebago or 4 wheel drive and caravan or are you going to travel overseas each year. Then take a look at how you are going to achieve the level of assets required. It's better to start planning today than to leave it for another 5 years.

SUPERANNUATION SPLITTING BETWEEN SPOUSES

The Federal Government has finally introduced legislation into Parliament which, when passed, will permit contributions by a member of a superannuation fund to be split with their spouse. The legislation will apply to contributions made from 1 January 2006. If passed without change, the legislation will permit members to request that contributions (up to 100%) made in the previous year be split with their spouse.

Splitting of contributions will assist couples to maximise the superannuation benefits available to them. It will particularly benefit low income or non working spouses allowing them superannuation assets under their own control and providing income in their retirement. Further, it provides a couple access to a second low rate ETP threshold and reasonable benefit limit which will mean less tax payable in retirement.

Is this needed by everyone? The answer is no. Many MADA clients due to their existing employment arrangements may already have structures established that allow for deductible superannuation contributions to be made on behalf of both spouses and therefore the benefit may be limited if a couples superannuation balances are of equivalent amount. The benefits of this strategy arise where, one or both of the following circumstances exist:

- One member of a couple is facing an excess reasonable benefit limit (RBL) problem and this strategy can be used to minimize the impact of such a situation.
- Where you have a spouse with little or no superannuation and you are an employee of an organization or operate as a sole trader cannot contribute to superannuation in their name. Contribution splitting may be able to be used to equate balances over the long term.

The main points of the legislation include:

1. All Contributions made after 1 January 2006 will be able to be split with a member's spouse.

2. The following amounts are not allowed to be split, employer eligible termination payments and rollover amounts.

3. The request by the contributing member will only apply to the previous financial year's contribution. An implication of this is that members will only have 12 months in which to request their contributions be split.

4. When requesting a split the member's spouse (the receiving spouse) must provide a statement that they are not retired, permanently incapacitated or over age 65.

5. This split can be done by either making the receiving spouse a member of the fund or rolling over or transferring the split contributions to another fund.

6. Multiple transfers can be requested but cannot exceed the amount of contributions made in the previous financial year.

7. Contributions that are split are to be treated as preserved benefits unless the trustee is satisfied that they are not preserved benefits.

8. This measure is a voluntary measure. Superannuation funds are not required to offer contribution splitting to members.

9. Defined benefit members will not be eligible to split contributions.

10. Where a benefit is subject to a family law payment split or flag no transfer of benefits may occur.

What should you do? If you are facing an excess RBL problem or inequitable superannuation balances at retirement you should consider using this opportunity as one of your strategies for long term wealth accumulation and increased tax efficiency. We are happy to discuss individual circumstances with you one on one or assist in the implementation of this strategy.

The above information is of a general nature only. No account has been taken of the investment objectives, financial situation or particular needs of any person. Before making any investment decision, individuals will need to consider, with or without the assistance of a financial planner their own particular needs, objectives and circumstances to avoid the risk of making inappropriate investment decisions.

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DATA BACKUP - WHY DO WE BACK UP OUR DATA?

The focus of this article is not technology and the backup process. Most practices have the necessary technology and some sort of backup process in place. However most practices go through the motions of backup without a clear understanding of the ramifications of their actions.

When conducting IT Risk Management assessments, the common theme amongst most practices is the heavy reliance on their IT provider for most information including their backup strategy. This is very surprising, as the value of any medical practice is in the patient data, therefore most practices need to have systems (IT and Human Processes) implemented to protect their data. More importantly, it is these internal human processes that will retrieve their data in case of an emergency, after all this is why we backup in the first place.

I can understand the reliance for all technical matters and support, however the practice must have a detailed understanding of their internal backup strategy/recovery procedure and any possible shortcomings. In this regard the question that needs to be asked is, "How accountable is your IT Provider if your data is lost or destroyed as a result of their action?" What checks and balances do you have? ***As a minimum, ensure your IT provider has PI cover*** and ask to see a copy of this. I guess the theme of the above is to find a balance between external expertise and having someone internally who understands the basics. We love it when we have a practice manager who develops IT Savvy skills over time and questions the intricacies of our work.

The business needs to understand ***what data is important to the business***, what data is being backed up, where it is being saved and some proof it has been backed up. From there you can build an effective backup and recovery model. When asked this question during an IT Risk Management Assessment, most users make plenty of assumptions or simply do not know. This guess work often includes patient data, practice management data, administration files and accounting files - a little unnerving considering the obvious negative ramifications.

The **main purpose of performing any backup** is being able to **restore your data in case of an emergency.** It is therefore critical to have a well understood recovery mechanism implemented and tested. Although very basic but effective, the easiest strategy is to have at least the data tapes/CD test restored on a monthly basis, to verify the data can be recovered in case of an emergency. This should be performed by either your service provider or by an internal staff member with a process to monitor what data and storage media has been restored. (The data that should be tested is the one that is located offsite on a permanent location).

Any practice must have an **effective media rotation policy.** (One tape for each trading day for a two week period). There ***must be at least one tape offsite at any point of time,*** day or evening. The most effective strategy is to have a fireproof safe onsite and have at least one tape is a safety deposit box or Post Office. It is important to limit the "hand bag strategy!". The media rotation policy must be clearly understood by all parties concerned. In addition, the practice must a daily backup log to verify who performed the last backup worked the following day. Some backup applications (Non Generic) email you daily if the backup has been successful. If you are using a tape drive, ensure you are cleaning your drive every week.

Always remember the backup process is dynamic and needs to be constantly tested and updated.

In Summary

Understand:

- What data is being backed up.
- What data is important to the business.
- Where the data is located.
- What data can be retrieved in case of an emergency
- How data be retrieved and restored in case of an emergency.

Have an internal process to constantly verify the above.

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