Calculating financial capacity for business owners 277-04060000

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Sub-topic

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This page outlines the process for calculating the financial capacity of a customer who is a business owner

On this Page:

Calculating financial capacity for a customer who is linked to or associated with a business owner

Calculation of financial capacity

Table 1: This table details the process for calculating the financial capacity of a customer who is linked to or associated with a business.

Collapse table

Step	Action
1	**Calculate financial capacity** - Read more [1] A customer's income and financial resources may not be accurately reflected in the Child Support assessment if they are linked to or associated with a business.

	The financial resources may provide the customer with a greater capacity to financially contribute to the support of the child(ren). See the Child Support Guide 2.6.14: Reason 8 - a parent's income property, financial resources, or earning capacity
	
	A customer 'linked to' a business is involved in the ownership of the business. A customer 'associated with' a business is involved beyond that of an ordinary employee but is not legally involved in the ownership of the business.
	
	Determining a customer’s income and financial resources may include:
	
	• determining how they generate an income
	• investigating any businesses they are linked to or associated with, including:
	  o reviewing the financial statements of the businesses
	  o determining any personal benefits or financial resources the customer may receive from the businesses
	Note: the length and detail of the investigation depends on the individual circumstances of the customer and will vary from case to case. Consider making a decision rather than extending the investigation if a reasonable income for the customer, which is reflective of the financial resources available to them, can be determined.

2	**Investigate financial circumstances** - Read more [2] Conduct an analysis of the customer’s financial circumstances including any businesses they are linked to or associated with. Analysis may include: • reviewing tax information of the customer and businesses, see Business tax information • reviewing the business structures to determine if they are providing a personal or financial benefit to the customer, see Business structure analysis • reviewing the financial statements to determine if any business income, expenses or assets provide the customer with a financial resource, see Financial statement analysis. **Note**: requesting at least three consecutive years of financial statements will assist in determining a more reliable representation of the financial resources available to the customer • determining the profit to be attributed to the customer. see Attributing profit to a customer • determining if the customer has received any funds from a businesses, see Funds received from a business • determining if any depreciation expenses represent a financial resource for the customer, see Depreciation
3	**Determine if profit or funds received should be considered** - Read more [3] When the financial analysis is completed, determine if profit attributed to the customer or funds received by the customer from a business should be considered as the customer’s financial resource. • if the customer has received funds significantly more than the profit attributed to them, consider using the funds received as the financial resource for the customer:

	o depreciation expense or other non-cash expenses should not also be considered as a financial resource o if the funds received were from retained earnings or undrawn profits from prior years, consider if the assessment has been subject to a COA, court varied assessment or an agreement, in which these funds have already been considered. If the funds have already been considered it may not be appropriate to consider the funds received as a financial resource. • if the customer has received funds less than or similar to the profit attributed to them, consider using the profit The income and financial resources to be attributed depends on the circumstances of the customer and will vary from case to case. A decision can vary from the above steps if the circumstances of the case support this. • Only the profit attributed to the customer or funds received should be considered as a financial resource of the customer. Including a combination of both may result in double counting the financial resources of the customer.
4	**Determine any other financial resources** - Read more [4] Determine if the customer receives any other financial resources from businesses they are linked to or associated with. These include but are not limited to: • depreciation expenses which are available to be taken by the customer. **Note**: if the funds received are to be considered as a financial resource of the customer, depreciation expense or other non-cash expenses should not also be considered as a financial resource • business expenses which provide the customer with a financial resource or personal benefit, see Step 4 in Financial statement analysis • any use of business assets that provide the customer with a personal benefit
5	**Calculate the income and financial resource** - Read more [5] After analysis and consideration of all income and financial resources available to the customer from businesses they are linked to or associated with, the financial resources of the customer is either: • the profit attributed to the customer plus any other financial resources available to the customer, including financial resources available through non-cash expenses, or • the funds received by the customer plus any other financial resources available to the customer, excluding financial resources available through non-cash expenses.

Business tax information

Analysing business tax information

Table 2: This table provides details to assist with analysing business tax information to determine a customer's financial resources.

Collapse table

Step	Action
1	**Business tax information** - Read more [6] Reviewing information from the Australian Taxation Office (ATO) may assist in determining the financial resources available to a customer. Tax information which should be considered includes: • tax returns, go to Step 2 • Special Taxation rules, go to Step 3 • Business Activity Statements, go to Step 4
2	**Tax returns** - Read more [7] A business tax return may provide information also found in the financial statements for a business, such as: • income and expenses • depreciation expenses • total assets and liabilities • statement of distributions for partnerships and trusts See the ATO website for more information. This information can be used along with the financial statements or other information obtained during the investigation to determine the financial resources of a customer. See Business tax returns in Resources for details of information located in a business tax return.
3	**Special Taxation Rules** - Read more [8] The ATO may introduce special rules, for certain periods of time, to support government initiatives, such as: • Accelerated depreciation for certain assets purchased in specific periods • Small Business tax offsets • Entrepreneur’s tax offset (applied to income years up to 2011-12) The rules may reduce the customer's income however not the financial resources available to them. If any special taxation rules are identified see the ATO website for more information. Consider any Special Taxation rules when determining the financial resources of a customer.
4	**Business Activity Statements** - Read more [9] Businesses registered for Goods and Services Tax (GST) must lodge Business Activity Statements (BAS) with the ATO either monthly, quarterly or annually. See the ATO website for more information. The BAS is used to advise the ATO of activities such as: • GST payments, go to Step 5 • Pay as You Go (PAYG) income tax instalments, go to Step 6

	• PAYG tax withheld, go to Step 6
5	**Goods and Services Tax (GST)** - Read more [10] GST is a tax paid on most goods and services purchased which is collected by the business that provides the goods or services. Certain goods and services are GST free, for example most basic food, some education courses, some medical, health and care services. GST paid by a registered business in the purchase of goods and services is claimable and offsets any GST payment from GST collected. A business must register for GST if: • the business turnover exceeds the GST turnover limit • it provides taxi travel as part of the business, regardless of the GST turnover See the ATO website for more information A GST registered business will report their: • total sales • export sales • GST–free sales • capital purchases • non-capital purchases for the BAS period • total salary, wages and other payments
6	**PAYG income tax instalments or PAYG tax withheld** - Read more [11] The BAS includes: • PAYG income tax instalments, which are instalments the business pays towards their own income tax obligations • PAYG tax withheld, which are tax payments withheld from payments made by the business to others. The PAYG tax withheld reported in the BAS may include total salary, wages and other payments and the amounts withheld from the payments. The section includes amounts withheld from payments to other individuals or entities where no ABN is quoted. See the ATO website for more information
7	**Using the BAS** - Read more [12] The BAS can be used to: • compare annual turnover in past income tax returns and/or financial statements of the business with turnover of a more current period reported in the BAS • check the financial performance of a business if tax returns have not been lodged • determine wages paid to employees • obtain up to date information on the performance of the business The BAS may not include: • all business income such as interest received, dividends received, trust or partnership distributions and other income that does not attract GST

	• all overseas transactions • all business expenses as they do not all contain GST such as superannuation expense, interest expense and depreciation expense **Note**: a business may use the cash based accounting method for BAS and the accruals based method for its financial statements. This can result in a difference between the information reported in the BAS and the financial statements for the same period. Consider which accounting method is used to ensure income and or expenses are not omitted or double counted when calculating the financial resources of the customer. To use the BAS to assist in calculating or verifying the financial resources of a customer: • determine the performance of the business from the information in the BAS using the BAS analyser in the Capacity To Pay (CTP) tool suite macro. **Note**: sales may be reported in the BAS with GST excluded • compare the information with information from the business tax returns or financial statements such as: o most recent turnover or sales with past turnover or sales o most recent expenditure with past expenditure. **Note**: the BAS may not include all of the business expenses • if there are significant variances between the information, investigate the reason for the variance to determine which source of information should be used in calculating the financial resources of the customer
	BAS information should only be used as the sole source of information if no other reliable information such as up to date tax returns or financial statements are available.

Business structure analysis

Analysing business structures

Table 3: This table provides details to assist with analysing business structures to determine a customer's financial resources.

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Step	Action
1	**Business structure analysis** - Read more [13] Business structures can provide an avenue for customers to minimise their taxable income. Examples of how income financial resources may be understated for a customer are dependent on the type of business structure: • Sole trader, go to Step 2 • Partnership, go to Step 3 • Companies, go to Step 4 • Trusts, go to Step 5

	For information about the types of business structures see Business Structures and Financial Statements for Child Support debt recovery.
2	**Sole Trader** - Read more [14] A sole trader's income and financial resources can be understated if payments are made to or on behalf of a related person, for example a spouse or entity, such as: • wages • sub-contractor amounts • consulting fees • private expenses paid via the business for a related person • an amount recorded as a loan from the business to a related party An individual operating as a sole trader is entitled to the profit of the business. The profit or loss made by the sole trader business must be reported in the individual's income tax return. A customer trading as a sole trader may have greater income and financial resources than that reflected in their taxable income due to: • private use of a business asset such as a motor vehicle • business paying for private or living expenses • making payments to other persons disproportionate to their contribution to the business including paying more than the compulsory superannuation contribution. See Step 5 in Attributing profit to a customer • drawings taken from the business, see Funds received from a business • reporting a profitable business as a hobby • reporting a loss making hobby as a business • if they are an employee earning a salary or wage, using a loss making business to minimise their taxable income
3	**Partnership** - Read more [15] A customer linked or associated with a partnership can understate their income and financial resources if payments are made to or on behalf of a related person, for example a spouse or entity, such as: • a partnership distribution • wages • sub-contractor amounts • consulting fees • private expenses paid via the business for a related person • an amount recorded as a loan from the business to a related party The partners are entitled to receive the profit of the partnership with the amount dependent on the 'Partnership Agreement'. Each partner is required to report their own partnership distribution in their individual income tax return.

	A customer with links to a business operated through a partnership may have greater income and financial resources than that reflected in their taxable income where: • the distribution of the partnership's net profit does not fairly represent each partners contribution of capital, assets, expertise and/or skills to the business, see Step 5 in Attributing profit to a customer • drawings are taken from the business, see Funds received from a business • the business lists spouses or other associated persons as employees but they do not make any actual contribution to the business or receive payments that do not reflect their contribution to the business see Step 5 in Attributing profit to a customer • they have private use of partnership's assets • the partnership may be paying for the customer's private expenses
4	**Company Income** - Read more [16] A customer linked or associated with a company can understate their income and financial resources if payments are made to or on behalf of a related person, for example a spouse or entity, such as: • dividends • wages • sub-contractor amounts • consulting fees • private expenses paid via the business for a related person • an amount recorded as a loan from the business to the related party The shareholders of the company are entitled to receive the profit of a company which is paid as a dividend. The level of profit distributed to each shareholder will depend on the class of share and the individual's ratio of the overall shareholding, for example if a shareholder holds one of three ordinary class shares in the company they would ordinarily be entitled to receive a third of the total dividend payments. Each shareholder is required to report the dividend they receive in their individual income tax return. A customer with links to a business operated through a company may have greater income and financial resources than that reflected in their taxable income due to: • retaining profits in the company rather than distributing it in the form of salary and wages, dividends and/or director's fees, see Attributing profit to a customer • distributing profits by loaning money to shareholders or directors, see Funds received from a business • the allocation or ownership of shares so some shareholders receive a greater distribution of profits disproportionate with the labour and assets they contribute to the business, see Step 5 in Attributing profit to a customer • selling or transferring shares to another person for less than their commercial value for example, shares being transferred to new spouse at a nominal price that presents the spouse as the sole or major shareholder

	• the business paying for the personal expenses of the customer, shareholders, directors or related parties for example, providing a motor vehicle to their spouse or paying the customer's rent • paying salary or wages to associated persons disproportionate with the labour or assets they contribute to the business, see Step 5 in Attributing profit to a customer • paying more than the required compulsory superannuation amount for an employee or related party
5	**Trust Income** - Read more [17] A customer linked or associated with a trust can understate their income and financial resources if payments are made to or on behalf of a related person, for example a spouse or entity, such as: • distributions • wages • sub-contractor amounts • consulting fees • private expenses paid via the business for a related person • an amount recorded as a loan from the business to the related party The beneficiaries of a trust are entitled to receive the profit of the trust. The Trustee must distribute profits in accordance with the trust deed to the beneficiaries. A beneficiary of a trust is required to report the trust distribution in their income tax return. A customer with links to a trust may have greater income and financial resources than that reflected in their taxable income due to: • lending money to beneficiaries or related parties, see Funds received from a business • distributing profits to beneficiaries in a manner disproportionate to the true value of their real connection or involvement in the business for example, children, spouse, step children or other entities made beneficiaries, see Step 5 in Attributing profit to a customer • the business paying for the personal expenses of the customer or related parties for example, providing a motor vehicle to their spouse or paying the customer's rent • paying salary or wages to associated persons disproportionate with the labour or assets they contribute to the business,see Step 5 in Attributing profit to a customer • paying more than the required compulsory superannuation amount for an employee or related party

Financial statement analysis

Analysing financial statements

Table 4: This table provides details to assist with analysing business financial statements to determine a customer's financial resources.

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Step	Action
1	**Financial statement analysis** - Read more [18] Financial statement analysis involves reviewing the financial statements of a business to determine the income, property or financial resources of a customer. For information on the: • Profit and loss statement, go to Step 2 • Balance sheet, go to Step 6
2	**Profit and Loss analysis** - Read more [19] A Profit and Loss (P&L) is a summary of income and expenditure over a period of time. The P&L may have three components: • the income, go to Step 3 • the expenses, go to Step 4 • the net profit or loss, go to Step 5 • See Business Structures and Financial Statements for Child Support debt recovery.
3	**Income component** - Read more [20] The income component may include the following: • **Sales and general business income** – usually comprises of the primary income of the business • **Gross Income & Cost of Goods Sold (COGS)** – the direct costs incurred to purchase or produce the items sold by a business (COGS) may be deducted from the business' total sales when calculating the business' Gross Income. The details of the costs of sales may be included in a separate trading statement. Note: not all businesses will incur COGS. Generally businesses that manufacture or buy and resell a product will incur COGS • **Interest and dividend income** – indicates if the business has or had an investment such as term deposit, bank account, shares etc. that produced income during the period reported on. • **Gains on sales of assets** – indicates if the business has made a profit on the sale of a business asset. • **Employee contributions to offset FBT**– indicates if one or more employees of the business received a non-monetary benefit from the business. The amount they contribute is effectively a reimbursement to the business for providing this benefit. • **Grants, rebates and other benefits and subsidies** – indicates if the business has conducted activities or incurred expenditure that entitles them to a grant, rebate or other form of benefit. An example is the Diesel Fuel Rebate which indicates that the business operates motor vehicles or machinery that used diesel fuel in connection with primary production or other eligible business activities. • **Other income** – other income of the business that does not come under one of the specific headings listed above. **Note**: there is no requirement for a business to use these exact headings.

	Analysing the income component
	
	The income component should correspond, but may not exactly match with information in the:
	
	• Business Activity Statement
	• business tax return
	• business bank statements of the business
	
	The gross sales can provide an indication of the gross profit or turnover trend of the business. The turnover trend can be an indicator if the business is growing or contracting.
	
	When reviewing the business income, consider:
	
	• what has caused any significant income change (increase or decrease) since the previous year
	• if the costs of sales is a reasonable proportion of the gross turnover of the business. **Note**: the Australian Taxation Office (ATO) prepares benchmarks for certain industries. See ATO benchmarks
	• the reasons why any increase/decrease in purchases of COGS does not match increase/decrease in business activity. COGS, stock or materials that do not indicate a reasonable proportion of the gross turnover or increase/decrease in purchases that do not match increase/decrease in business activity may indicate:
	  o the customer is not declaring the whole business income or is drawing a cash income
	  o the business stock is being used by the customer for personal use

4	**Expenses component** - Read more [21] Expenses have the effect of decreasing profit. Consideration must be given to whether the expenses are reasonable and necessary in producing income. Expenses vary from business to business and may include: • accounting fees • advertising • bank charges • bad debts • depreciation • employee amenities • insurance • interest • motor vehicle • stationery • salary /wages • subscriptions/seminars/travel • superannuation • telephone/internet

- workcover

Note: there is no requirement for a business to use these exact expenses.

S 47E(d), S 37(2)(b)

	S 37(2)(b), S 47E(d)
5	**Net Profit or Loss** - Read more [22] Net profit equals gross profits less expenses. How the net profit of a business is distributed depends on the structure of the business: • a sole trader business earns its net profits for its owner/operator. The net profit or loss is attributable to the owner and will be included in their tax return. A sole trader may offset a business loss against other sources of income such as a salary or wage from an unrelated party • a partnership distributes all its net profits and losses to its partners. It does not pay tax itself; its partners do by including their share of the partnership net profit as their income. Partnerships may distribute the loss to each partner and the loss reported may reduce the taxable income the partner receives from any other source of income • a company pays company tax of 30% on its net profits. A company cannot distribute a loss but may distribute profit as dividends or retain the earnings. A company's loss may offset past or future taxable income • a trust usually seeks to distribute all its net profits to beneficiaries. A trust cannot distribute losses. A trust loss can only be carried forward to offset against the trust's income in future years See Attributing profit to a customer, for further information on how to attribute net profits or losses.
6	**Balance Sheet analysis** - Read more [23] The Balance Sheet provides a summary of the value of: • assets, go to Step 7 • liabilities, go to Step 8 • owner's equity, go to Step 9 • at a particular point in time and is usually prepared on 30 June of each year. The Balance Sheet represents the accumulated value of assets and liabilities of the business since its inception.
7	**Assets component** - Read more [24] The assets component should report all the assets owned by the business. The fair value of these assets can indicate potential income, property or financial resource of the customer. The assets component may include: • current assets • non-current assets **Current Assets** Any asset expected to be used within one year is considered a current asset and includes: • **Cash at Bank** – indicates how much cash the business has on the day the Balance Sheet is generated. The bank statements of the business

over a period of time may provide a better indication of the amount of cash available to the business

- **Trade Debtors (Accounts Receivable)** - money owed to the business from past sales, that is made on credit
- **Other Debtors** – money owed to the business from past non-trading operations
- **Closing Stock on hand** – indicates the value of stock, inventory or products held by the business to be sold or made into saleable items

Non-Current Assets

Any asset expected to last for more than one year is considered a non-current asset and includes:

- **Motor vehicles** – indicates the motor vehicles owned or used in the business. It is useful to establish how the vehicle is used in helping produce business income
- **Office Equipment** – office equipment can vary from new desks, networked computers and equipment
- **Tools, Plant and Machinery and other assets** – the nature and condition of plant and machinery can vary widely. Verify the nature, type, link to income production, cost and value of all plant and equipment if there is any doubt about its relevance and fair value or personal use
- **Property** – property (homes, buildings and business premises) is usually reported at cost price. Buildings may include any improvements and revaluations or improvements and revaluation may be reported separately. Buildings and improvements may be depreciated
- **Land** - land may be reported in a separate account at its cost price or re-valued amount. Land cannot be depreciated
- **Loan to Director/s or others** - indicates a loan provided to a director, associated party or unrelated entity
- Other assets – may include details of shares in other companies, intangible assets such as goodwill, trademarks

When analysing the assets component consider:

- if the customer has derived a personal benefit from the assets, for example:
  - has the business made a loan to the customer or an associated person or entity, see Funds received from a business
  - has the asset been used to provide the customer with a benefit, for example the business owns a motor vehicle or real estate which is available to the customer for private use. Note: the value of the assets is not the value of benefit attributed to the customer. To determine the value of the benefit quantify what the benefit would cost the customer if it was not paid for by the business
- the level of cash reserves held by the business. If the cash reserves are in excess of what could reasonably meet ongoing business needs, then it is reasonable to assume the cash reserves may be available as an additional financial resource for the owners of the business. An increase in assets other than cash reserves may impact negatively on cash available to the business which may impact on the ability of the owner to distribute profits

	• accumulated depreciation, see Depreciation
8	**Liabilities component** - Read more [25] Liabilities are claims against the business' assets and can include money the business owes to others. The liabilities component may include: • current liabilities • non-current liabilities **Current Liabilities** Any liability expected to be paid within one year is considered a current liability and includes: • **Trade Creditors (Accounts Payable)** - money owed to suppliers for materials or other items used in the production of the products sold by the business • **Other Creditors** – money owed for goods and services purchased or used by the business. An example might be electricity that is payable quarterly, rates or telephone bills • **Payroll Liabilities** - may include other liabilities owed or accrued by the business such as Superannuation Payable • **GST and or Income Tax Liability** – the net amount owed to the ATO after calculating the net GST payable (may be an amount the ATO owes the business if this item appears in parentheses), PAYG Payable and other tax liabilities **Non-current Liabilities** Any liability expected to be paid over one or more years is considered a non-current liability and includes: • **Loans** – may include loans that have a contract or other form of agreement whereby repayment occurs over 12 months or longer. For example, loans from financial institutions, loans from the owners, directors, related or other unrelated parties to the business. **Note**: the amount may be owed to the business if this item appears in parentheses When analysing liabilities consider: • if the customer derives any financial benefit such as loan repayments and interest income from the business liabilities. If the business has made a loan to the customer or the customer has made a loan to the business, see Funds received from a business • if there has been any significant changes in the value of the liabilities that would affect the ability of the business to distribute profits. **Note**: reductions (payments) in liabilities will reduce cash reserves but not the profitability of the business
9	**Owner's Equity** - Read more [26] Owners' Equity reflects the financial value of the business for the owners and shows: • the contribution to a business by the owner, for example capital introduced

	• profits paid to/or money drawn by owners of the business • profits retained within the business, see Attributing profit to a customer • the equity held in the company by the owners Owner's Equity may include: • **Opening balance** - reports on the balance of owner's equity at the start of the period of the Balance Sheet • **Current Year / Net profit** – equals the net profit amount reported in the P&L for the business (assuming it ends on the same day that is used for the Balance sheet) • **Drawings** – drawings from the owner's investment in a business reduce an owner's equity. Drawings is any benefit (such as funds or goods) obtained from the business for the owners own personal use. Drawings only apply to sole traders and partnerships. A sole trader or partnership cannot employ themselves and therefore cannot pay wages. Drawings are their way to obtain a benefit for the effort they apply to their business • **Retained Profits / Earnings** – retained profits are the total of the net profit made over the time the company has been in existence which have not been distributed to the shareholders of the business through the payment of dividends. **Note**: retained profits most commonly relates to businesses conducted in a company structure however it is possible for businesses operated via a trust to also retain profits • **Total Equity, Shareholder's Equity or Closing Owner's Equity** – the balance of Owner's Equity as at the date referred to on the Balance Sheet. The equity of a partnership and trust may be referred to as the Partnership's funds or Proprietors' funds in the business tax return. The equity of a company is referred to as the Shareholders' funds in a company tax return. When analysing Owner's Equity consider: • if profits are being retained within the business • payments to the owners of the business. The term used for payments to the owner depends on the business structure: o Sole Trader – Drawings o Partnership – Drawings o Company – Dividend o Trust – Distribution

Attributing profit to a customer

Attribute business profit

Table 5: This table details the process for attributing profit to a customer.

Collapse table

Step	Action
1	**Attributing Profit to a customer** - Read more [27]

	A business may have net or retained profits which can provide a customer with an income or financial resource. To determine the profit that can be attributed to the customer as a financial resource from a business they are linked to or associated with, determine: • the net profit of the business, go to Step 2 • the net or retained profit available to be drawn by the customer, go to Step 4 • if any net profit has been alienated, go to Step 5 The profit that can be attributed to the customer is any net or retained profit that is available to be drawn plus any profit that has been alienated. To determine the net or retained profit, review the businesses: • profit and loss statements, see Financial statement analysis • balance sheets
2	**Determine net profit** - Read more [28] Determine the businesses the customer is linked to or associated with and if these businesses have derived a net profit or have retained profits.

S 47E(d), S 37(2)(b)

	S 37(2)(b), S 47E(d)
3	**Business losses** [- Read more [29]] If a business has reported a loss, consider: • if the current taxable income of the customer or business has been reduced by a loss from a previous year being carried forward • multiple businesses or business activities in the same entity where a loss from one business has reduced the net profit of another business • if the loss has been generated due to a non-cash expense such as S 37(2)(b), S 47E(d)
4	S 47E(d), S 37(2)(b)

S 47E(d), S 37(2)(b)

5 S 37(2)(b), S 47E(d)

S 47E(d), S 37(2)(b)

6	**Customer involved in multiple businesses** - Read more [32] If a customer has links to more than one business apply the steps above 1 to 5 to each business. If the customer is associated to or linked with businesses that are interrelated determine which business derives the initial or primary income. The business that derives the initial or primary income should be the business considered first when determining if any net or retained profit can be attributed to the customer. Then consider the other businesses in an order which follows the flow of profit between the entities. To determine the income to be attributed to the customer for each business entity, do not consider any wages, income or distribution of profit paid to the interrelated business to be alienation of income. Any income, wages or distribution of profit paid to other entities or persons should be considered when determining alienation of income. Examples of businesses that may be considered inter-related include: • transactions between related entities, for example Company A pays rent to a Company B and the customer has a business relationship with both companies

	• Company A may hold shares in Company B (identified on the Balance Sheet or MASCOT search) • an earthmoving company splits into two businesses, where one business operates the machinery and hires equipment and the other business undertakes the contract work • a parent franchise company that is the sole shareholder in three companies. The first company interacts with the franchisees, the second company holds the property that the business operates from and the third company operates its own franchise S 37(2)(b), S 47E(d)

Funds received from a business

Determine if funds received from a business are providing a financial resource

Table 6: This table provides details for determining if funds received from a business are providing a financial resource to a customer.

Collapse table

Step	Action
1	**Funds received from a business** - Read more [33] A customer may receive funds from a business they are linked or associated with, these funds may include: • drawings, go to Step 2 • dividends, go to Step 4 • loans, go to Step 5 • trust distributions, go to Step 6 S 47E(d), S 37(2)(b)
2	**Identify business drawings** - Read more [34] Only businesses operated as a partnership or sole trader can derive drawings from a business. See Business structure analysis. To determine if a customer has received drawings and the amounts review the business Balance Sheet. See Financial statement analysis. S 37(2)(b), S 47E(d)

	S 37(2)(b), S 47E(d)
3	**Grossing up drawings** - Read more [35] Drawings should be 'grossed up' if the funds withdrawn from the business provide the customer with a taxation advantage. For a customer to receive a taxation benefit through drawings, the value of the drawings they receive must exceed the net profit attributed to the customer from their business. See Attributing profit to a customer. S 37(2)(b), S 47E(d)

S 47E(d), S 37(2)(b)

4	**Calculate dividends** - Read more [36] To determine if a customer has received a dividend: • search the ATO systems, see the External Searches Guide • review the customers tax return • review financial statements of any businesses the customer is linked to or associated with A dividend is a payment of a share of a company's profits to its shareholders or members. Unfranked dividends have had no Australian company tax paid on the profits from which they are paid. Franked dividends are paid out of profits on which the company has already paid tax and includes a franking credit. A franking credit is a credit to a person owning shares for the tax that has already been paid by the issuing company on their dividends. A dividend may be paid to a customer because they: • are investors who have shares in publicly listed companies such as BHP, Telstra, Woolworths etc. If a customer has shares in a public company no further action is required as any dividends will be reported in the customer's tax return • have shares in a company where their relationship goes beyond that of financial investment, that is they are involved in the operation and management of the business. The dividend is reported in the customer's tax return. If the dividend does not reflect the labour and assets the customer contributed the business, see Step 5 in Attributing profit to a customer. **Note**: if the dividend has been paid from profits from a previous financial year, consider if the dividend has been included in a previous decision The value of the dividend is: • if the dividend is unfranked, the total value of the dividends • if the dividend is franked, the franked dividend plus the franking credit
	Do not include dividend payments in the calculation of the customer's financial resources if the net profit of the business is going to be included in the calculation.

5	**Assess loans** - Read more [37] A customer may make a loan to a business. Repayments of the loan by the business to a customer may represent a financial resource. If the business is claiming an interest expense that relates to the loan the interest received by the customer may be considered as a financial resource. A business may lend money or assets to a customer. To determine if a customer has received a loan from a business: • review the financial statements of the business. A loan may be reported on: o the Balance Sheet as an non-current asset showing the customer owes an amount to the business o on the Profit and Loss Statement (P&L). The income component of the P&L may show the business is receiving interest payments which could indicate there is a loan between the business and the customer or another party • review the business bank statements. Money paid between the business and the customer may indicate a loan arrangement • verbal evidence from the customer or third party, such as their accountant or the other party, may provide information which suggests that there could be a loan arrangement in place **Note**: loans refer to loans made by a business that the customer is linked to or associated with, not a loan from a financial institution. To determine if a loan is a financial resource of the customer consider: • the purpose of the loan. For example if the business provided the customer money for a specific purpose such as to purchase a home or go on a holiday this may indicate there is a formal loan arrangement in place. If money is drawn by the customer over a period of time this may indicate the loan is being used by the customer to draw a wage from the business • the terms and repayments schedule, if can they can be obtained. A written loan agreement specifying the interest rate and term of the loan is more likely to be treated in the same manner as a loan from a traditional lender which is not a financial resource **Note**: under Division 7A of Part III of the Income Tax Assessment Act 1936 (Division 7A) loans to shareholders or their associates are, unless they come within specified exclusions, treated as dividends. This may result in a customer reporting the payment of a dividend on their tax return which may not be reflected in the distribution of the net profits of the business for the same period. Only the loan or dividend should be included in the calculation of the customer's financial resources and consideration given to the period the dividend or loan relates too. For further information about Division 7A see the ATO website. If a loan is considered a financial resource, to determine the value of the resource consider: • the increase of the loan from the last financial year on the balance sheet, or • the amount of funds transferred from the business bank account to the customer's bank account
6	**Identify trust distributions** - Read more [38]

	To determine if a customer is receiving trust distributions: • review the financial statements of the business • review the tax return of the business and customer The value of the trust distributions is the amount reported on the customer tax return or financial statements of the business. **Note**: profit alienation may occur in the profit distribution of a trust, see Step 5 in Attributing profit to a customer.

Depreciation

Determine if a business depreciation expense is providing a financial resource

Table 7: This table provides details for determining if a business depreciation expense is providing a financial resource to a customer.

Collapse table

Step	Action
1	**Depreciation** - Read more [39] Depreciation is the process of a business expensing an asset that has a life span of more than 12 months. The depreciation expense is a 'paper based' or 'non-cash' expense. It has the effect of reducing the recorded value of an asset and increasing the expenses of the business. As depreciation is a non-cash expense, some businesses may use part of or all of the amount to reduce debt, purchase assets or put aside part or all of the cash amount into a bank account to purchase a replacement of the asset. See Child Support Guide 2.6.14: Reason 8 - a parent's income, property, financial resources, or earning capacity for more information. Consider if there are any current special taxation rules for depreciation, see Step 3 in Business tax information.
2	**Methods of calculating depreciation** - Read more [40] There are several methods for a business to calculate the depreciation expense: • Straight line or Prime Cost method - the depreciation expense is the acquisition cost spread equally over the useful life of the asset • Diminishing Balance or Diminishing Value method - this method assumes that the decline in value each year is a fixed percentage of the remaining value and produces a progressively smaller decline over time • Simplified depreciation – small businesses can immediately expense assets costing less than $6,500. Assets costing more than $6,500 are depreciated at the annual rate of 30% except in the first financial year where they are depreciated at a rate of 15%, regardless of the date of acquisition.
3	**Considerations for determining if a depreciation expense is a financial resource** - Read more [41] To determine if a depreciation expense is a financial resource:

	• Consider if the depreciation amount is being applied to other business purposes. If so, it is not considered a financial resource of the customer: o any amount of the depreciation expense allocated to a capital replacement fund or a depreciation fund or provisioned for asset replacement purposes is not considered a financial resource of the customer. This can be determined if: ▪ the business' Balance Sheet shows an 'Asset' account indicating money has been put aside for the replacement of the business assets or has resulted in a corresponding increase of the cash assets ▪ if the business has a separate business bank account where they have put money aside to replace assets in the future o any amount of the depreciation expense applied to the reduction of business debt may not be considered a financial resource. This can be determined if the business' Balance Sheet shows a reduction in one or more of the liability balances o any amount of the depreciation expense used to purchase new assets for the business is not considered a financial resource. This can be determined if the business' Balance Sheet shows an increase in either the asset balances other than cash and bank assets or receivables (Debtors). Compare any new assets to any new liabilities reported on the balance sheet to determine if the assets have been purchased through a loan. • Determine if the depreciation is a reasonable representation of the actual depreciation of the asset by considering: o if the asset is being depreciated over a reasonable period of time. Use the Australian Taxation Office effective life table, from the ATO website to test reasonableness. If the asset is not being depreciated over a reasonable period of time, the excessive depreciation expense can be considered a financial resource o if the depreciating asset is being used for private purposes. If so a portion of depreciation expense that reflects the private use can be considered a financial resource o if the depreciating asset was purchased by the business from the customer or an associated person or entity, consider if the original value of the asset is reasonable. An exaggerated purchase value could lead to an increased depreciation claim. The excessive depreciation expense can be considered a financial resource
4	**Determine if a depreciation expense is a financial resource** - Read more [42] The depreciation amount can be considered a financial resource if: • the depreciation amount is not being applied to other business purposes or a depreciation fund, go to Step 3 for more information • the depreciation is not a reasonable representation of the actual depreciation of the asset for business purposes, go to Step 3 for more information S 37(2)(b), S 47E(d) If the depreciation represents a financial resource and the business is operated:

	• as a sole trader, then all the depreciation will be the financial resource of the customer • as a partnership, company or trust, then the depreciation should be split at the same rate that any profit attributed to the customer from the same business has been. If no profit has been attributed to the customer then the financial resource should be split in accordance with the customer's entitlement to receive the business net profit