Bite magazine

Building trusts

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Tax savings can make trusts an appealing option for dentists but it’s essential to set up the structure well—or the tax office will be watching. By Kerryn Ramsey

SETTING UP A TRUST THE RIGHT WAY (WITH THE RIGHT ADVICE) CAN PAY SIGNIFICANT DIVIDENDS.

Setting up a trust—and choosing the right one—can easily be put in the ‘too hard’ basket. However, a well set-up trust can pay rich dividends for dentists and their practices. It can be used to run dental surgeries, to provide services to dental practices or to just hold investments.

Practice trusts are the simplest and easiest way to run a practice. But before you make a commitment, it’s important to be aware of some recent developments. For example, the Australian Taxation Office (ATO) earlier this year set up a trusts taskforce to look into trust arrangements which “conceal income, mischaracterise transactions and artificially reduce income and tax payments”.

“The Commissioner of Taxation wants to see a reasonable amount in the tax return of the professional—which means an amount commensurate with their skills and responsibilities as a practitioner,” explains Terry McMaster of McMasters’ Accountants, Solicitors and Financial Planners.

Jonathan Harris, managing director of Harris Freidman Lawyers, concurs, noting that it’s essential to get advice from financial specialists before setting up a trust. “Accountants who specialise in the dental industry are familiar with the level of mark-ups the ATO will find

acceptable for service trusts," he says. "Most dentists are able to meet their expenses plus more, in which case there are not many downsides to a trust."

The only tricky aspect is choosing the right type of trust and having a trustee company rather than individual persons as trustees.

' *For a dentist running a solo practice (that is, a business for income tax purposes)*: A discretionary trust (also known as family trust) is a popular option as income can be distributed to beneficiaries, such as a partner or children if aged over 18—in low-tax brackets. "The trustees make the decisions about what the trust invests in and who gets the income," says financial specialist Chris Wren of Highland Financial. It's important to note that the trustee in charge of the trust can also be a beneficiary.

Undoubtedly, a solo practice is likely to expand so the discretionary trust can grow with you.

McMaster explains: "As the practice grows, a part-time dentist may join for two days a week and a hygienist four days a week, for example. This growth brings the practice within the ATO's definition of a business. The trustee can then distribute the business income to beneficiaries other than the dentist. The ATO would still require that a reasonable amount is distributed to the dentist commensurate with their skills as a professional."

' *For a larger practice run by multiple dentists:* Unit trusts usually work best in this situation. The practice assets are owned by the unit trust which also employs the staff. Like a company, the trust's property (assets, business or investments) are divided into a number of shares called units. The number of units you hold will determine your share of the unit trust's income, capital gains and the number of votes you have.

Jonathan Harris explains how this can work for a dental practice: "When you have a large premises, maybe four or more surgeries, a unit trust can lease or own the premises and a dentist can buy units in the unit trust. This would entitle each dentist to an equity interest in the assets of the trust that operates the practice. The dentist would still work privately and earn the income themselves and would pay a portion of their income to the trust in return for the trust providing the premises, equipment, staff and other services to the dentist."

' *For solo or group practices with trusts-behind-trusts:* Where you have a number of dentists or specialists, the dentists could all own a specific number of units in the unit trust, then each of the dentists will have their own discretionary trusts—and the unit trust will distribute income to the discretionary trusts.

"What you are doing is effectively creating a flow or cascade for the income to ultimately end up at the person or people who pay the least amount of tax," explains Chris Wren.

To choose the right option, it's essential to get advice from a solicitor or accountant. "You need a structure that you can understand," says business adviser Belinda Hudson of William Buck Chartered Accountants & Advisors.

It's also important to stay on the ball when nominating where the money is paid. Any income that isn't distributed is taxed at the highest marginal tax rate.

“This is why the tax office doesn’t like trusts,” explains Wren. “When there are a number of beneficiaries, they could be on different tax rates. It could be a dentist working in a practice, and in his trust he may have his wife as a beneficiary. If his wife isn’t working, her tax rate could be nil, which means the total money distributed to her is taxed at a lower rate.”

One attraction of trusts for dentists, or any professional, is that if a client takes legal action and attempts to get some sort of settlement, the dentist may not own assets personally. The assets are owned by the trust.

So, while trusts are definitely appealing, there are a few negatives to watch out for, particularly the cost to run and establish. “I’ve seen situations where trusted professionals have charged $50,000 to set up multiple structures which, in turn, created an ongoing compliance bill of $40,000 a year—all in the name of trying to save tax,” says Wren. “That’s not a good reason to do it if tax is the primary motivator.”

Jonathan Harris points out that it’s not always easy to change structures once you’ve established your practice in a trust. “The ATO can be concerned about your reasons for changing entities,” he says. A trust also needs to be reviewed on a regular basis.

“You need to look long term and be aware that the laws can change,” says Belinda Hudson. “So, make sure your trust deed has flexibility in it and it is reviewed every two to three years. Whatever the law says today may not be in practice in 30 years’ time.” ≤