BusinessPlus+ Newsletter

Collins Mellody

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"What If" Calculation to Establish Trades/Contracting Businesses Charge Out Strategies

Setting charge out rates to achieve a predetermined profit is an important strategy for trades/contracting businesses. The following is a summary of a "what if" calculation approach to planning business operations. We can assist you with the preparation of this type of calculation suitable for a trades or contracting business.

Last month we evaluated retail businesses and there are some similarities in the approach that we recommend but obviously there are significant variations because in a trades/contracting business the key income generator is charging out of team member's labour, whereas in a retail business the key activity is selling products that, in most cases, have been manufactured by someone else.

- The first activity which is similar to what we discussed relative to retail business operations, is to identify the labour costs and labour on costs that are applicable to the various categories of team members working in the business covering:
  - Annual Leave
  - Shift Worker Allowance (if applicable)
  - Statutory Holidays
  - Personal Carer's Leave
  - Superannuation
  - Payroll Tax (if applicable to this business)
  - Work Care/Workers' Compensation
  - Training
  - Long Service Leave Entitlement

  We utilise a template to enable team members in various classifications to be identified into the separate calculations being made.

  The calculation of the labour on costs and the labour costs will give the business a projected labour budget for the forthcoming 12 months.

  Let us assume that the total estimate for labour and labour on costs for the 12-month period was $835,000.

- A very important consideration in calculations for trades and contracting businesses is to determine realistic targets of individual productivity to be achieved by team members. In most cases there will be variations in achievable chargeable hours by the various categories and in some cases, there may be variations within a particular team category.

  The preparer of the report will need to insert the anticipated percentages for each classification within the labour budget so that chargeable individual hours is able to be calculated.

- The expected overhead costs for the 12-months operation of the business then needs to be estimated. This budget would include all expected business outlays excluding labour, labour on costs, direct material purchases, capital expenditure, loan repayments etc.

  For this exercise we've assumed the total budget for overhead costs will be $621,000.

- In a trades/contracting business, it is normal business practice for materials, that have been purchased for installation on to a client's job, to be marked up so as to recompense the business for the effort that has been made in securing the materials to be installed into a job.

- The preparer will need to identify the targeted mark-up percentage that the business will be utilising. For the sake of this exercise we have assumed a mark-up percentage on materials purchases of 10%.

  We have assumed that the materials purchase figure for the 12-month period will be $1,250,000.

- The next calculation to prepare is how much profit do you want to achieve from this business? This is normally based on a realistic return on investment.

  How much is the business worth? What rate of return would you like to achieve on this investment?

  We have assumed the business is worth approximately $450,000 and the rate of return you require is 20%. This would mean that the projected profit for the year, if everything works to plan, would be $90,000.

  Where this type of strategy will be very important is if last year the business only achieved a profit of $10,000 and you are seeking advice as to how you can earn a realistic profit from the effort that you are making to the business.

- The prime income source for a trades/contracting business is from the sale of labour. The next task is to calculate the targeted income from the sale of labour for the business.

  In this exercise the key figures would be as follows:

Total labour costs, including labour on cost	$ 835,000
Targeted net profit	$ 90,000
Overhead expenses	$ 621,000
Total labour to be recovered	$1,546,000
Less Budgeted Materials Mark Up	$ 125,000
Total Labour to be Recovered	$1,421,000

- Within the templates, a business overhead factor is determined. This is then utilised to multiply the base cost chargeable hours amount for each category to determine an acceptable charge out rate. The projected annual chargeable hours are then multiplied by the individual charge out rates that have been determined in the calculations to ascertain the amount of income to be generated from the sale of labour over the 12-month period.

  Based on these calculations the resultant figures will be approximately as follows:

Income		
Sales of:		
- Labour	$1,421,000	
- Materials	$1,375,000	
Total Sales		$2,796,000
Less:		
- Labour and labour oncosts	$ 835,000	
- Materials purchased	$1,250,000	
Cost of Sales		$2,085,000
Gross Profit		$ 711,000
Gross Profit Percentage	25.4%	
Less:		
- Overhead expenses		$ 621,000
Profit		$ 90,000

- This type of "what if" calculation will assist trade/contracting businesses to determine whether appropriate charge out rates are being utilised so as to achieve a targeted net profit for the business.

- There are a number of variables which need to be monitored on a regular basis including:
  - number of team members
  - categories of team members
  - labour on costs applicable to various categories of team members
  - rates of pay for the various categories of team members
  - hours to be worked by individual team members
  - productive hours actually being achieved by individual categories of team members
  - materials being purchased and, in particular, is the budgeted mark-up percentage being achieved on all materials purchased?
  - business overhead expenses - are they running within the budgeted figure?

  We are able to assist trades/contracting businesses to establish appropriate strategies relating to charge out rates to achieve a targeted profitability and then to assist in the monitoring of the actual performance on a month by month basis so that, if variations need to be made, they can be considered.

  If you would like to have a discussion with us relative to the establishment of a charge out rate strategy for your trades/contracting business, please do not hesitate to contact the accountant in our firm which whom you normally deal.

Employer Grants Can Be Beneficial

The Australian government offers a number of grants for the benefit of employers, including:

- <u>Apprenticeship Incentives</u>
  There are a number of initiatives which will assist employers who agree to employ an apprentice, particularly where the apprentice is hired by a business in a trade experiencing a skills shortage which has been identified in the "National Skills Needs' List".

  There are different programs for the employment of apprentices, as follows:
  - school based apprenticeships
  - existing workers who become an apprentice
  - apprentices with disabilities
  - adult apprentices
  - apprenticeships for indigenous Australians

  These programs are in addition to the standard apprenticeship incentives.

- <u>Job Active</u>
  Job active helps employers find the right staff for the business, at no cost to the employer. A local job active provider does this by recommending a shortlist of "screened and job ready" candidates while offering professional recruitment services across all industries.

  Employers need to register with job active.

- <u>Restart Wage Subsidy</u>
  Businesses that provide employment to people aged 50 years or older could be eligible for a subsidy.

- <u>Employer Support Payment</u>
  The employer support payment provides financial assistance to eligible employers of reservists when the reservist is absent on eligible periods of defence service. Self-employed reservists can also access the employer support payment.

  For full-time employees, employer support payments are made at a set weekly rate equivalent to average weekly full-time adult ordinary times earnings (AWOTE).

- <u>Wage Subsidy Scheme – Disability</u>
  The wage subsidy scheme provides a financial incentive to eligible employers when considering the employment of jobseekers with a disability or with some other barriers to employment. Wage subsidies payments are made to employers to help cover the costs of wages and training in the first few months of employment of a person with a disability or a person experiencing other barriers to employment.

What's It Mean?

- **The audit exemption for a Crowd Sourced Funding Company** means…
  The exemption ceases when the company has raised an aggregate of $1 million of capital.

- **The maximum group turnover for a Crowd Sourced Funding Company** means…
  $25 million annually.

- **The maximum group gross value of assets for a company to be classified as a Crowd Sourced Funding Company** means…
  $25 million

- **A Crowd Sourced Funding Intermediary** means…
  An organisation or an individual who holds an Australian Financial Services Licence to provide a Crowd Sourced Funding Service.

- **Crowd Sourced Funding Offer Document** means…
  The document that a Crowd Sourced Funding Company needs to produce to the CSF Intermediary for checking before the capital raising process commences.

- **The Crowd Sourced Funding Cooling Off Period means…**
  For a retail investor, 5 business days after making an application for shares in a CSF company.

- **Retail Investor means…**
  An investor who is not classified as a "sophisticated investor".

- **Sophisticated Investor means…**
  An investor who has net assets of, at least, $2.5M or a gross income for each of the last two financial years of, at least, $250,000 a year, certified by an accountant.

Taxation Treatment of Holiday Homes

A holiday home is a property that a person owns, and they rent out, but this rent is quite often not for the full year, but only for the period of time the person and their friends and family are not staying in that holiday home. The traditional holiday home is often a unit near a beach on the Gold Coast or some other tourist location but can basically be any property that is rented for most of the year, but certain times of the year the owners of the property or their friends, family and children stay in the property and it is no longer available to the public at large.

The Australian Taxation Office is always on the hunt for rental properties that they do not believe are genuine or where the taxpayer is incorrectly or falsely claiming tax deductions that they are not entitled too. This could simply be from the taxpayer not being aware of these rules, to the taxpayer actively making claims for tax deductions when the property is used for personal use with no adjustments being made. The ATO reminds taxpayers of these rules that deductions can only be claimed where the property is genuinely rented out or, if not, on a commercial basis that deductions can only be claimed up to the amount of income received. The problem with holiday homes is that taxpayers purchase these assets and are often unaware of these rules and unless their tax agent specifically states these to them during the yearly return, people may never learn about this. The ATO have concerns about this knowledge gap and the fact that the majority of rental properties are negatively geared, have concerns that people are inappropriately making claims for tax deductions they are not allowed.

Obviously, a taxpayer who holidays in fabulous tourist locations across Australia love the idea of owning a rental property that they can holiday in and claim tax deductions for; the problem lies in is it genuinely available for rent. The ATO actually check these details and upon investigation find that there is little intention of renting by the taxpayer or significant personal use. This can be done by simple searches on the various listings for property websites that are easily accessible by the ATO or contacting the renting agent direct for instructions from the taxpayer about advertising and renting the property out. This is an area of continual surveillance by the ATO and the consequences of not accurately recording these can be as simple as a written warning, to a reduction of expenses claiming in the taxpayer's return, to having the rental property being completely removed from being claimed in the taxpayer's income tax return with interest and penalties being applied.

If you would like to have a discussion about holiday homes, please do not hesitate to contact the accountant in our firm with whom you normally deal.

SME Turnover Levels For Various Matters

SME TURNOVER LEVELS FOR VARIOUS MATTERS

From 1.7.18	Business turnover less than $2M	Business turnover between $2M & $10M (small business entity)	Business turnover between $10M and $50M (base rate entity)*	Business turnover greater than $50M
Small business CGT concessions	Yes	No	No	No
Company tax rate	27.5%	27.5%	27.5%	30%
$20,000 instant asset write-off (only available to 30.6.19	Yes	Yes	No	No
Immediate deduction for prepaid business expenses	Yes	Yes	No	No
Pooling for depreciating assets (15% for new assets, 30% thereafter)	Yes	Yes	No	No
Small business restructure rollover	Yes	Yes	No	No
Amendment period	2 years	2 years	4 years	4 years

** 27.5% corporate tax rate applies during year ended 30th June 2018 for companies with a turnover under $25M*

Contact us:

CMA Collins Mellody

P: 03 9836 1533

F: 03 9836 3025

E: admin@colmel.com.au

W: http://www.cmagroup.com.au

259 Whitehorse Rd, Balwyn, VIC, 3103