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report

A Dividend Streaming Strategy for Business Owners

Theo Marinis runs through the virtues of dividend streaming - a little-known bonanza for private business owners.

By Theo Marinis
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One of the great revelations for business owners is the realisation that they can run their private company as an additional tax-free income stream.

This statement comes with the qualification that ‘they’ are:

a) a retired couple aged between 60 – 64 who have each maxed out their superannuation Transfer Balance Cap (TBC) of $1.7 million; and

b) each has established an Account-Based Pension (ABP) providing tax exempt income at the usual ‘minimum’ rate of $68,000 pa each.

They could, I suggest, live quite comfortably on their combined minimum pension payments of $136,000 pa, with this income increasing in line with the prescribed age-based minimum ABP payment amounts.

If that were the end of the story, there would be no need to lodge personal tax returns. As their ABP income of $68,000 is tax exempt, they have nil taxable income.

If, however, the couple has no other taxable income from assets or investments other than, for the sake of this example, $2 million invested in their private company, they can also pay themselves, very tax effectively, fully-franked dividends from their company, as required.

Whilst they would be aware that the more income they take as ‘traditional’ fully-franked dividends from their private company the higher their taxable incomes will be, with a carefully-planned private company franked dividend streaming strategy, this need not be the case.

The following age-based examples demonstrate how dividend streaming strategies can work for each taxpayer:

Profile 1: Retirees aged 60 – 67, eligible to make personal Concessional Contributions

Assumptions:

- Private company tangible net worth: $2,000,000.
- Each retiree is paid a franked cash dividend of $38,250 pa over and above their ABP minimum income of $68,000 (gross cash received $106,250 – with ABP income tax exempt).
- Each makes a personal concessional super contribution of $27,500 (CCs can still be made until age 67, but eligibility for non-concessional contributions ceases on reaching the TBC of $1.7 million).

Franked amount	$38,250
Imputation credit	$12,750
Gross amount	**$51,000**
Less: Personal concessional contribution	$27,500
Taxable income	**$23,500**
Tax payable*	**$0**

**Nil tax payable due to tax offsets, including the proposed 2021/22 one-off $420 tax offset (this offset plus the Low- and Middle-Income Tax Offset are being phased out from 1 July 2022).*

When lodging personal tax returns for this financial year, the retiree couple in the above scenario would a) pay no personal tax on their individual cash dividend and b) would each receive a 100 per cent refund of their private company imputation credit of $12,750. The only tax payable relates to the 15 per cent super contributions tax on their CCs – amounting to $4,125 per individual.

Cashflow summary per person:

Account based pension income	$68,000
Cash dividend	$38,250
Imputation Credit refund	$12,750
Gross cash flow	**$119,000**
Less CC	$27,500
Net cash flow	**$91,500***

**In addition, the $23,375 NET super contribution is accessible 100 per cent tax free. That is $114,875 pa net on total gross cashflows of $119,000. That represents approx. 3.5 per cent tax!*

Profile 2: Retirees over 67 – eligible to make personal CCs only on meeting the 'work test'

Assumptions:

- Private company tangible net worth $2,000,000.
- Not able to meet the 'work test,' therefore ineligible to make personal CCs to super
- Each retiree is paid a franked cash dividend of $21,730 pa over and above ABP minimum income of $85,000 (5% of $1,700,000).
- Gross cash received is $106,730 – with ABP income tax exempt.

Franked amount	$21,730
Imputation credit	$7,244
Gross amount	**$28,974**
Less: Personal concessional contribution	$0
Taxable income	**$28,974**
Tax payable*	**$0**

**Nil tax payable due to tax offsets including the Seniors and Pensioners Tax Offset (SAPTO) for those of pension age.*

When lodging their personal tax returns, the retiree couple in this scenario would also a) pay no personal tax on their individual cash dividend of $21,730 and b) each receive a 100 per cent refund of their private company imputation credit of $7,244.

Cashflow summary per person:

Account based pension income	$85,000
Cash dividend	$21,730
Imputation Credit refund	$7,244
Gross cash flow	**$113,974**
Tax	$0
Net cash flow	**$113,974**

Further, if their private company 'outlives' both owners, provided they correctly leave control to their beneficiaries, those beneficiaries can continue to stream fully-franked dividends on the same basis.

This would mean that following the death of the original business owners, their children can continue to receive imputation credit refunds representing the taxes paid by the private company, during their lifetime.

In anyone's book, that prospect represents a very nice estate plan.

The children can, of course, take larger fully-franked dividends from the company, but they will receive smaller imputation credit refunds. If the dividend in a financial year is too large, they may in fact, need to pay tax on the difference between their marginal tax rate and the imputation credit.

With no concessional super contributions and based on the 'tangible net worth' assumption used in the preceding examples, the use of a dividend streaming strategy can facilitate a cash dividend of approximately $80,000 pa. If there is no other taxable income, the imputation credit should ensure the payment of nil personal tax.

Those business owners who have not funded their ABP to the maximum $1.7 million could use a dividend streaming strategy (from 1 July 2022) to make further non-concessional contribution (NCCs) to boost their ABP balances to age 75.

When I explain these opportunities to business owners, they are delighted to "know what they don't know" – and to enjoy the very acceptable outcomes which can be achieved by employing a dividend streaming strategy.

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