2014

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# Guide to Tax Planning


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# No Advice Warning

The information in this eBook is general information only. It has been prepared without taking into account your personal situation and goals. Therefore, you should not rely on or act on information provided in the eBook without first seeking advice from a qualified financial planner. Frontier Wealth Group and related entities accept no responsibility for any loss suffered as the result of reliance on the information provided, if we have not provided personal advice in a Statement of Advice.

# Letter from us

Dear Reader,

We are delighted to provide you with a free copy of this eBook and hope that you will find it very useful.

At Frontier Wealth Group, we believe in empowering you with the information you require to make sound and reasonable decisions about your money and your financial future.

As an investor, you know quite well that taxation is one of the primary considerations you have when investing. Every dollar of tax paid is a dollar that could have been invested. Your net-worth is only increased through after tax additions to your portfolio, both income and capital.

This guide provides you a summary of the general principles of income tax, including the policy rationale for income tax. It also provides a general appreciation about some of the strategic planning issues you need to consider as an investor. It is however, no substitute for tailored and personalised advice.

If you need advice, please call us. Our in-house Certified Financial Planners™ and Chartered Tax Advisers™ work together as a team, to help you maximise your future financial outcomes.

Have a great day, and we hope to talk to you soon.

Best regards,

**Sekou Seasay** (CFP®, CTA®)
Director

# Why Do We Pay Tax?

In a small business tax presentation in 2012, I asked my audience: “who likes to live in a world class country, with world class infrastructure, transport, education and health services?” The show of hands was one hundred percent. Everyone likes to live in a world class country with world class public services. I then asked: “who likes to pay world class taxes?” This time there was not a single show of hands. Paying tax is one of the conundrums of modern society. We like to get excellent services from our governments, but we don’t necessarily like paying for them by way of the tax system. One possible reason is that unlike many service providers, governments don’t have a clear mandate to apply tax revenue in specific ways and they can’t be easily sacked or substituted.

But imagine if governments did not levy tax on society. Who will pay for public infrastructure, schools and hospitals? One option is to let the market solve the problem. In concept, a perfectly competitive free market will drive entrepreneurs to provide and improve societal infrastructure and hospitals for a profit, whilst restraining them from charging exorbitantly for their services. The market would know and provide what society wants through the mechanism of supply and demand. Demand, which is revealed to markets through a system of prices, is like the retina or sensor through which a freely competitive market discovers what is lacking and provides it through the mechanism of supply.

The eye of markets “prices”, however, is often not the perfect way to perceive what society needs since not everyone can afford market prices. Like the naked eye, therefore, a market can often have blind spots which render it unable to see very important objects, especially those that cannot be properly expressed through a pricing system. Some have argued, that this aspect of the market is one of the primary reasons taxes are collected. That is, taxes are levied to pay for services that the market often fail to reveal to governments because the need for them isn’t easily conveyable using a market price mechanism.

# The Australian Income Tax System

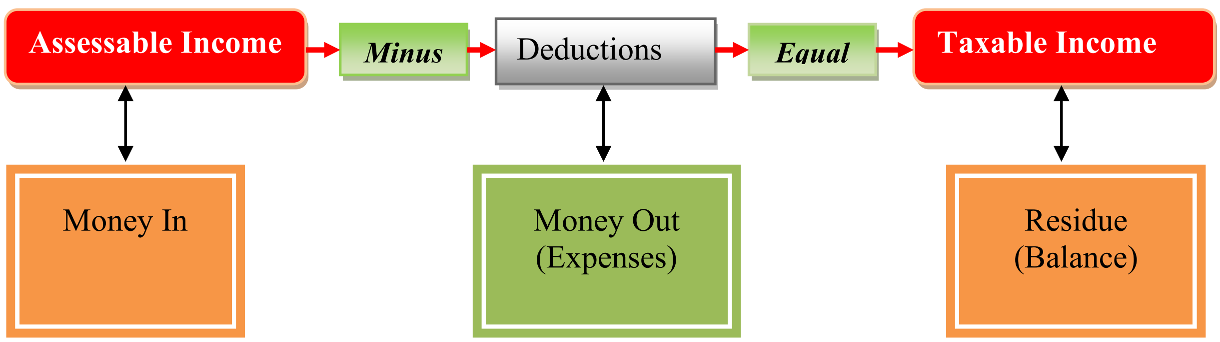
There are many taxes imposed by Australian tax laws, including the following:

- The income Tax
- The Goods and Services Tax (GST)
- Stamp Duty

Under the income tax laws, tax is paid on money that flows unto the tax payer. Money flows to a person or entity in the following ways:

- In the form of income such as wages, profits and interest; or
- Increases in asset values such as capital gains.

In either case, expenses incurred to derive the income are taken away, and the residue is taxed at the taxpayer's marginal tax rate. The total amount of money that flows in is called "**assessable income**". The expenses incurred in the process of producing assessable income are called "**deductions**" and the residue of income when deductions are taken away is called **"taxable income**". This is diagrammatically explained below:




A tax rate is then applied to taxable income to arrive at the tax liability. The tax liability is then reduced by available tax offsets to arrive at actual tax payable.

## What Is a Tax Offset?

A tax offset is like a pseudo-dollar indirectly provided to you through the tax system and used to reduce your tax liability dollar for dollar. The offset never hits your bank account. You may receive a tax offset for many reasons, including:

- The tax is already paid on your behalf by someone else, like a company in which you own shares; imputation credits.
- The government wants to incentivise you to do something (e.g. Mature Age Workers Tax Offsets (MAWTO), Entrepreneur Tax Offset).
- Restitution based offsets which are designed to protect certain types of tax payers, ensuring that they do not pay too much tax like low income earners, those on certain social security benefits and senior Australians.

Tax offsets can be *refundable*, meaning the excess is paid to you in cash, or non-refundable, meaning un-used offsets are lost.

The mathematic for working out your tax is summarised in table 2.1 below:

**Table 2.1**

| |
|---|
| **Assessable Income** |
| **Less** |
| **Deductions** |
| **Equal** |
| **Taxable Income** |
| **Multiply**<br>**by**<br>**Tax Rates** |
| **Equal** |
| **Tax on Taxable Income** |
| **Minus** |
| **Non Refundable Tax Offsets** |
| **Equal** |
| **Net Tax Payable** |
| **Plus**<br>**HELP Liability, Medicare Levy, Medicare Surcharge** |
| **Equal** |
| **Income Tax Liability** |
| **Less** |
| **Tax Credits and Refundable Tax Offsets** |
| **Equal** |
| **Tax payable/Refund** |

The above table can be simplified into the following equation:
[[(Gross income – expenses) x tax rate] – offsets]= Tax Payable

## The Determinants of Tax Liability

From the above, we see that tax liability is affected by:

- Assessable Income;
- Deductions;
- The Tax Rate;
- Available Tax Offsets

Furthermore, the rate of tax payable is influenced by your tax structure. As a result, approaches to tax planning fall into one of the following categories.

- **Income reduction strategies**: this involves maximization of tax deductions, splitting taxable income or salary sacrificing to super.
- **Income swapping Strategies**: involving the swap of taxable for tax-free income.
- **Maximizing offsets**: involves obtaining tax offsets (credits) like imputation credits or new entrepreneurial tax offsets.
- **Arbitrage of tax entities**: this involves moving income away from a high tax paying entity to a low tax paying entity.
- **Deferral of tax strategies**: involving the deferral of tax or taking advantage of a more favorable tax rate.
- **Timing strategies**: involves the sale of assets in years that income is low

## Strategic Tax Planning

Strategic tax planning requires you to think ahead before making the investment, and consider the impact of tax on your investments and income now and in the future.


Every dollar of tax paid is a dollar that could have been saved for your retirement. Strategic tax planning ensures your taxes are prudent and legitimately minimized.
Strategic tax planning cannot be achieved by a last minute end-of-financial year dash to your accountant or following a whim with heavily promoted tax-driven investment schemes. Rather it is about foresight in planning your taxes, and being aware of opportunities that can allow you to reduce the impact of tax and create wealth on an ongoing basis.

When designing these strategies, one has to be aware of various integrity and anti-avoidance measures built into the income tax laws, which are designed to stop manipulation of the tax system. Before you implement a tax plan, we suggest you speak to a specialist tax adviser.

## Cardinal Principles of tax planning

Have you bought a pie recently? Would you have bought it if you knew it was void of meat, vegetables or chicken? A pie is good because of what is buried within the pie, so is your tax plan. Unless your tax plan adds to your current or expected wealth, it is worth nothing. Having helped many clients with varying levels of tax issues and mistakes, Frontier Wealth Group has developed the three cardinal principles of a great tax plan. Briefly put, your tax plan must be PIE!

The acronym "PIE" is derived from the three principles that should drive a well thought out tax plan as detailed below.

| | |
|---|---|
| **Principle 1:**<br><br>**The Pre-Emptive Principle (P)** | This principle states that a tax strategy must be pre-emptive to succeed. To be pre-emptive, the following rules must be obeyed:<br>• Cash flow must be dealt with at pre-tax levels and/or;<br>• Tax deductible expenses envisaged and planned before income is spent. |
| **Principle 2:**<br><br>**The Inflow Principle (I)** | This principle states that to be valuable, a tax strategy must result in an increase in one or more of the following:<br>• actual net income<br>• asset; or<br>• expected income and/or assets |
| **Principle 3:**<br><br>**The Economic Principle (E)** | This principle states that to be valuable, a tax strategy must have a very strong probability of producing an immediate and/or expected economic benefit, ordinarily via an increase in net worth and that total cumulative benefits must exceed the cumulative cost of the tax strategy. |

An example of where these principles might be violated is in high debt funding strategies, where the cost of debt, even after allowing for tax deductions, is too high to make the investment economically wise.

Frontier Wealth Group has developed the cardinal rules after years of experience dealing with a wide range of clientele. Implicit in these rules is the ability to link the tax plan to an investment or business plan that produces income and adds to immediate and/or future wealth. Therefore, it is important that when you are embarking on the road to strategic tax planning, you ensure that all your advisers are on the same page with what you are doing. You should fee free at any time to call our Certified Financial Planners™ and Chartered Tax Advisers™ who work as a team to provide you the advice you most need.

# List of Common Tax Planning Strategies

| Type of Strategy | Common examples |
|---|---|
| **Income reduction strategies** | • Negative gearing<br>• Income splitting<br>• Salary sacrifice to super<br>• Losses from other income generating activities outside of the Non-commercial loss regime<br>• Prepayment of  tax deductible expenses<br>• Borrowing to make concessional contributions (self-employed)<br>• Writing off bad debts at year's end<br>• Realised unrealised losses where there is a CGT issue<br>• Pay tax agent and ongoing financial planning fees before year end<br>• Don't derive dividend through a loss company<br>• Transfer income producing assets to non-working spouse<br>• Consider becoming an STS tax payer |
| **Income swapping strategies** | This involves the swap of taxable for tax-free income. Examples:<br>• Transition to retirement (TTR)<br>• Not deriving assessable income; live off savings |
| **Maximizing offsets** | Examples include:<br>• Dividend imputation credits<br>• Entrepreneurial tax offset<br>• Mature Age Workers Tax Offset<br>• Zone Offsets<br>• Dependent Spouse/Relative Tax Offset |
| **Arbitrage of tax entities** | This involves moving income away from a high tax paying entity to a low tax paying entity |
| **Deferral of tax strategies** | For example, owning income producing assets in a corporate structure |
| **Timing strategies** | For example, sale of assets in years income is low |

## Our core compensation advice services

| At Frontier Wealth Group, we can help to: |
|---|
| • **Explain how income tax laws will affect you now and in the future** |
| • **Work with your and/or your advisers to implement a comprehensive tax strategy** |
| • **Help in deciding the most appropriate tax structure for you** |
| • **Provide you advice about appropriate investments you need to have as part of your strategy** |
| • **Monitor your strategy in light of ongoing changes** |

## How do you contact us?

At any time where you would like to discuss your situation and how find out we can help you, please contact us on the following:

| | |
|---|---|
| **Mobile** | Sekou Seasay: (+61) 432 674 668 |
| **Email** | Sekou: sekou@epicpm.com.au<br>Home Loan Team: info@r2mhomeloans.com.au<br>Real Estate Team: info@epicpm.com.au<br>SMSF & Accounting Team: info@epictfs.com.au |
| **Contact Hours** | 9:00am – 5:00pm (Sydney time) |