Tax Minimisation Strategies

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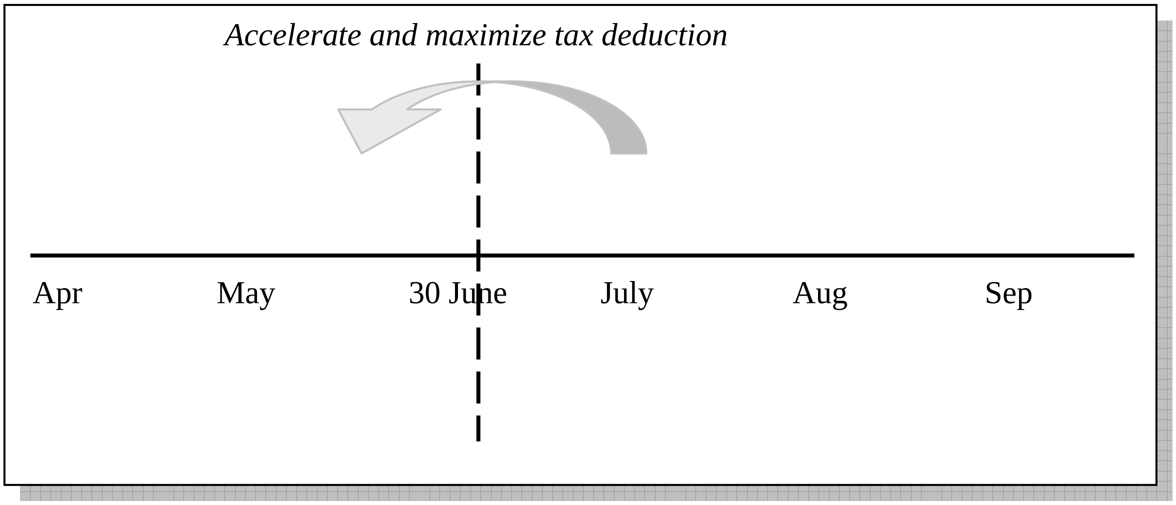
Preface

Although tax laws are complex and constantly changing, there are always opportunities for you to increase your tax refund and minimise your tax liability. What you are about to read is a collection of fundamental tax strategies used by wealthy individuals and big business operators throughout Australia. You will gain an insight into legal tax-reduction strategies and knowledge of how to implement these strategies with the goal of increasing your disposable income.

Tax planning is a widely used practice in the commercial world but there are still many businesses and individuals who fail to fully-recognise their potential tax savings. As a Partner in an accounting firm, I have come across many clients who have been paying more tax than necessary over the years. With the right knowledge and a good plan you will avoid overpaying the Tax Office. It is also important that you receive advice from a qualified tax professional before preparing and implementing a taxation strategy. Australian entertainer Paul Hogan once confused tax planning with tax avoidance - don't let this be you. These strategies will keep you on the right side of the law - you won't be reading about Caribbean tax havens here.

Some of the following strategies are designed to be implemented immediately and, by using them effectively, you will save on tax this year. If you are interested in putting together a tax plan or if you are just looking for a few extra tips, then here is a great place to start.

Strategy 1
Bring Forward Your Tax Deductions



A tax strategy that you can implement immediately involves maximising your tax deductions this financial year with the aim of reducing your taxable income. By bringing forward your tax deductions into the current financial year, you reduce your taxable income. Less income equals less tax!

Here's a practical example: Business owners often purchase gifts for their employees, clients and suppliers, for occasions and in appreciation of their working relationship. If these purchases are anticipated and made prior to 30 June the deductions can be claimed this financial year which reduces taxable income and ultimately reduces the amount of tax to be paid.

Does anything need repairing in a rental property or business premises? If the repairs are brought forward it allows you to write off the expense in this financial year. However, don't confuse 'repairs' with 'improvements and renovations' as these are handled in a different way and are usually written-off over 25 or 40 years.

Can you fill up the office supplies and stationery cabinet before year-end? Think about paying subscriptions to professional journals and memberships to professional associations before the end of the financial year. If you intend travelling for business next financial year, consider booking and paying for the airfares and accommodation before 30 June. Speak to your travel agent! Adopt the same strategy with seminars and conferences that take place after the end of the financial year.

It's a well known fact that a cash-poor business will struggle to survive so check your cash-flow forecast to determine what deductions you are able to bring forward. Decide whether prepaying motor vehicle registration and compulsory third party insurance is feasible. Consider prepaying insurance premiums such as workers compensation, building insurance, income protection insurance, professional indemnity and keyman insurance. Smart investors and entrepreneurs also prepay rent on their rental properties and business premises.

Are you thinking about leasing or buying an asset? Assets include plant and equipment, office equipment and motor vehicles. Assess the alternative finance options before year-end and if cash flow permits, purchase the asset outright or prepay the lease. If finance is required, talk to a finance specialist about leasing, a hire purchase agreement, or a chattel mortgage before 30 June.

A big deduction is available this financial year for interest paid on investment loans. Speak to your bank manager or financier to benefit from paying interest in advance. If you prepay interest you are in a very strong position.

Directors' fees and employee bonuses are deductions that form part of a good year-end tax strategy for business owners. A resolution should generally be made by the shareholders (not the directors) by 30 June.

Business owners are able to reduce taxable income using superannuation. A full tax deduction is available for all superannuation contributions made on behalf of employees and paid into a complying superannuation fund by 30 June. This strategy can save you thousands.

Before giving a gift or donation to a charitable organisation, confirm that the organisation is registered on the Australian Business Register website, www.abr.gov.au. A donation made to a registered organisation is deductible. It must be noted that a gift or donation is not an allowable tax deduction if you receive some benefit in return (eg. dinner and entertainment). One exception is a gift or donation valued at more than $250 given at an eligible fundraising event. Consider giving donations towards the end of the financial year.

Is your accounts receivable department busy chasing debts? Analyse your debtors ledger before 30 June to identify bad debts. A bad debt is a debt to which you are presently entitled, but one which your customer is not likely to pay. Make a genuine attempt to recover the debt by year-end so you can decide whether or not the debt is 'bad'. After taking every possible action to recover the debt, you are able to delete it from your debtor's listing. The key is to make sure that the debt exists and physically write it off prior to 30 June. This will ensure that you don't pay tax on income you didn't receive.

Do you do a stock-take each year? You may notice that large department stores are often closed on the 30th of June each year. Many businesses work overnight to prepare a stock-take because they know the value of the deductions related to trading stock. An example of the 'trading stock' at David Jones includes clothing and electrical appliances. You can claim a deduction for the purchase cost of your trading stock. I also suggest you undertake a physical stock-take at the end of the financial year to calculate the value of stock on hand. If the value of all trading stock on the first day of the current financial year exceeds the value of all trading stock on the last day of the current financial year then the excess amount will be deductible. The tax deduction will be determined by the valuation method you elect to use whether it is the cost, market value or replacement price. Valuing stock at cost usually leads to the best deduction. Another way to get a tax deduction for trading stock relates to stock that is deemed to be obsolete. In this situation you must determine a fair and reasonable value for this stock which will generally be below its initial value.

For a list of allowable tax deductions, visit www.mauricevasin.com.au.

Strategy 2
Use the Capital Gains Tax Discount

An asset generally increases in value over time – for instance, a house, a business or a share in a company. A 'capital gain' is the profit made when the asset is eventually sold. The increase in the asset's value is subject to tax which is appropriately called capital gains tax. The capital gain is treated as income and is taxable but there is a discount which can be applied to this tax. The discount percentage is available to individuals, trusts and superannuation funds but companies are not entitled to this discount. The discount is 50% for capital gains made by an individual or a trust and if the gain is made by a complying superannuation fund the discount is 33.33%. As an investor, you will need to hold an asset for more than 12 months to be entitled to the capital gains tax discount. By doing this the tax savings could be thousands, especially if the value of an asset has significantly increased. For capital gains tax purposes, I would suggest you own appreciating assets directly, or through a trust, rather than through a company.

Example:

Bill purchased a building in January 1989 for $1 million. He sold it in May 2007 for $5 million. His capital gain is $4 million. Bill owned the building for more than 365 days which entitles Bill to the 50% discount.

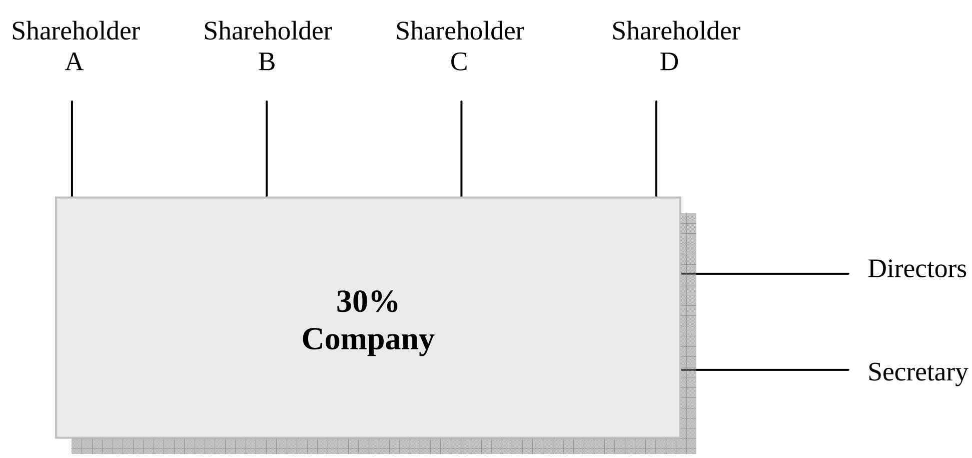
Purchase price	$1,000,000
Sale Price	$5,000,000
Capital Gain	$4,000,000
50% capital gains discount	$2,000,000

Therefore Bill will pay tax on $2,000,000 instead of $4,000,000.

Small business can also take advantage of the small business capital gains tax concessions. If a small business disposes of their organisation, which could also include goodwill, it is able to use the small business capital gains tax concessions which could potentially reduce the capital gain to nil!

Strategy 3
Set Up a Company

A company is a separate legal entity altogether from its members and its directors. Therefore, in a legal sense, you are not your company and your company is not you. A company will have its own assets and pay its own tax. A company should also have its own bank accounts separate to the accounts of the owner(s). The company tax rate is 30% which is more attractive than the 46.5% (including the Medicare levy) which is paid by individuals in the top marginal tax bracket. The 30% tax rate makes setting up a company a potentially important tax planning strategy. The core roles in a company are the director, secretary and shareholders. In small companies these roles can be performed by the same person.



A director is an officeholder that runs a company. The directors determine a strategic course for the company and make relevant decisions. They must act in the best interests of the company and make sure the company is able to pay its debts when they are due. If the company becomes insolvent, or broke, the company must cease trading. There are, however, ways in which the directors may be personally liable for the debts of the company. They may be liable for unpaid superannuation, workers compensation and Pay As You Go withholding tax if they are negligent in their roles as directors or trade whilst the company is insolvent. A private company must have at least one director and all directors must be at least 18 years old. As a director, you must take an active role in the management of the company. There is no such thing as a silent or passive director. Therefore, you have a duty to take an interest in the company and demand information on the organisation's financial state. You have a responsibility to ensure all financial records are up-to-date and that all transactions can be explained.

A secretary is appointed by the directors and is responsible for administering and maintaining the records and correspondence of the company. The secretary must be at least 18 years old and sign a consent form to act as a secretary which is held on record. The secretary needs to report any changes to ASIC (Australian Securities and Investments Commission). These include changes to the company's share structure, members register, directorship, company name, company-type and personal information of officeholders.

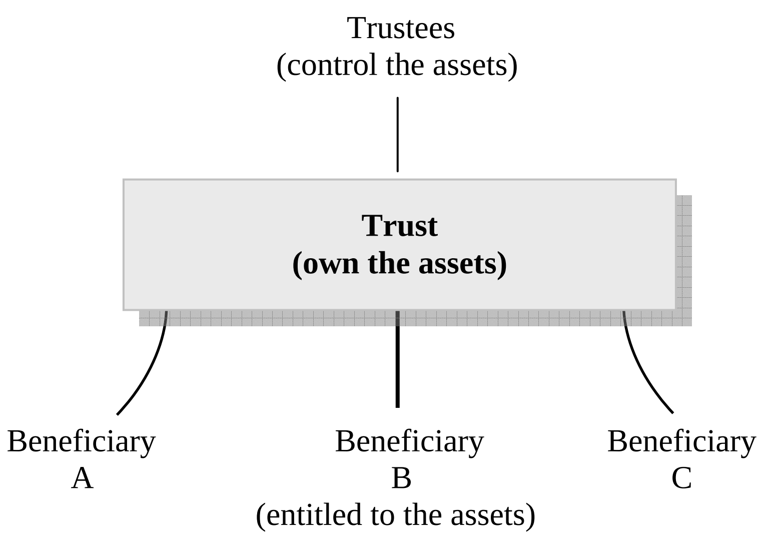
Shareholders each own a portion or share of a company. The shareholders do not own the company's assets and can't generally be held responsible for the company's debts. If the company is sued, the liability of shareholders is limited to the unpaid amount on their shares. As a shareholder you have a vested interest in the company as any growth in the company increases the value of your share and conversely, any decline will be reflected by a decrease in the value of your share. The shareholders also have the power to appoint or remove the directors. The type of shares, whether they are preference shares, ordinary shares, voting or non-voting shares, are also important when designing the share structure of a company.

A company may retain profits in order to fund operations and expansion or it may divide and distribute the profits to its shareholders in the form of dividends. It is up to the directors to determine the dividend amount which will be paid to shareholders**.** It is poor business practice for shareholders and directors to strip a company of its funds. Remember, a company is an operation in its own right and should be treated with diligence and respect.

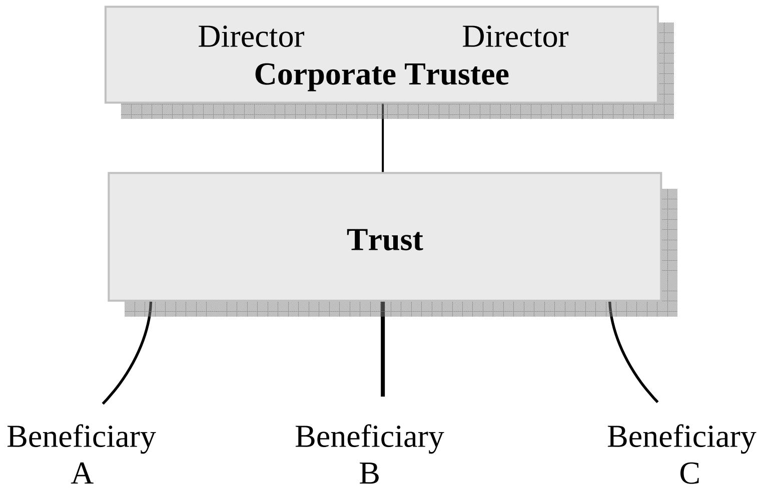
A company structure can provide many beneficial tax deductions but it is not always the optimal structure. A good tax plan will weigh up the options effectively. There is often a loss of tax benefits under a company structure, in particular when your company disposes of an asset such as goodwill, shares or business premises. Even if a company holds an asset for more than 12 months, it is not entitled to the 50% discount on capital gains which is available to individuals and trusts.

Strategy 4
The Trust – Divert Income and Protect Your Assets

A trust is a structure used as part of a tax planning strategy that offers tax effectiveness and asset protection whilst still providing flexibility. A trust does not have any true owners as such, but it does have an appointed controlling trustee. This means that any asset that is owned by your trust can't be taken from you as you are not the legal owner. You yourself could 'own' almost nothing so that you have no assets available to be seized by creditors if the situation were to arise. While holding assets in a trust you, as a beneficiary, still remain entitled to the assets and any income derived from the trust's holdings. This is an asset-protection strategy used by many wealthy individuals.



It is perfectly legal for an individual to appoint themselves as the controller of the trust but I'm not a big supporter of this practice. What I propose is to have a corporate trustee which means appointing a company as the trustee. As a company is somewhat immortal, it will remain in tact following the death of any directors. In this scenario, your beneficiaries become major shareholders of your company and, as the new directors, they have complete control of the trust's assets. This is a great way to transfer your wealth to your children and your children's children.



There are various types of trusts for differing circumstances and the most commonly used are the discretionary trust and the unit trust. A discretionary trust is the business vehicle I recommend when a family group needs the flexibility to distribute income amongst each other.

It works like this; at the end of the financial year the trustee decides who will receive the income from the trust. The income is distributed amongst the beneficiaries each year in order to spread the income. As each benefactor will be required to pay their respective amount of tax and as each has their own rate of taxation, the overall tax payable is reduced. The objective is to divert the trust's business and investment income to people on lower personal tax rates. This strategy works well when you have dependant children (over 18 years old). Diverting income to minors (under 18) will prove costly and is discouraged as minors will be taxed at exorbitant tax rates.

Under a fixed trust, each beneficiary is entitled to a fixed share of the income from the trust. A unit trust is a type of fixed trust in which the beneficiary of the trust's income is determined by the number of units they own.

If you are involved in high-risk businesses you could consider using independent trustees when setting up a trust. Before doing this you must weigh up the benefits of protecting assets against the potential that you could lose control over your affairs.

A discretionary trust should not be used if you use negative gearing and asset protection. I am aware that many people employ negative gearing as a tax planning strategy and in these situations a unit or hybrid trust is the answer. Don't get caught out using a trust that doesn't align well with your taxation strategy.

Strategy 5
Use Tax Offsets and Rebates

Offsets and rebates should be at the front of your mind when executing tax planning strategies. The more offsets you report, the less tax you pay. Here are a few of the more common offsets and rebates:

1) Franking credits

A shareholder is entitled to a tax offset equal to the franking credit when a franked dividend is distributed by a publicly listed, or a private company. The credit represents company tax already paid by the company to the Tax Authorities. Then the company tax is passed onto a shareholder in the form of a franking credit along with the dividend. A shareholder can be an individual, company, trust, partnership, or superannuation fund. It is wise to invest in companies that pay franked dividends.

2) Medical Expenses Offset

This offset entitles you to claim 20% of your net medical expenses if they exceed $1,500 in a financial year. Medical expenses include payments to legally qualified medical practitioners such as doctors, dentists, nurses, chemists and hospitals. Unfortunately, naturopath and masseuse expenses do not qualify for the discount. My advice is to make sure you keep all medical receipts because they can add up to more than you think. To claim the expenses you will need to obtain a statement of benefits from both Medicare and your private healthcare provider. This statement is not automatically provided and you will need to specifically request it in each case.

To gain the maximum benefit, ask your pharmacy for a yearly summary showing the prescriptions that have been paid for by you and your family during the financial year. Your pharmacy should oblige.

Example:

Throughout the 2007 financial year, Adam incurs doctors' bills of $13,000 relating to his spouse and expenses of $5,500 for his daughter's dental treatment. Adam is a member of a health fund which paid refunds on both bills totalling $8,800.

	$
Net medical expenses ($13,000 + $5,500 - $8,800)	9,700
Less threshold	1,500

	8,200
Tax offset = 20% x $8,200 =	1,640

Thus, by using this offset, Adam reduces his taxable income by $1,640

3) Spouse Superannuation Contribution Rebate

Consider making superannuation contributions on behalf of your spouse if they earn less than $13,800. There is a rebate of up to $540 available. This rebate is beneficial if you have a non-working or low-income earning spouse below the retirement age of 65. Seek advice before making the superannuation contribution to see if you are eligible for the rebate.

4) Foreign Income Tax Offset

Did you, or your associated entities, earn income or make a capital gain, from abroad and pay foreign tax on it? The foreign income tax offset will reduce the Australian tax that would be payable on foreign income by an amount equal to the foreign income tax paid. The offset is subject to a limit but leave the calculation to an experienced accountant.

4) Mature Age Workers Tax Offset

If you are aged 55 or older and still working then you may be able to claim a tax offset of up to $500. If your net income (income less expenses) from working in the financial year is less than $63,000, then you are eligible. The $500 rebate is offered for net incomes up to $53,000 and reducing partial rebates are available for incomes between $53,000 and $63,000.

5) Entrepreneur Tax Offset of 25%

The Entrepreneur's Tax Offset is available to business groups (that is, your business and any related entities) with a net income of up to $75,000. A 25% discount is offered to business groups with an annual turnover of $50,000 or less. A reducing discount is available on annual turnover up until $75,000 after which the discount is not offered.

There are many other rebates and tax offsets for which you, or your associated entities, could be eligible. Maximise the use of these discounts as they will reduce your tax.

Strategy 6
Self-manage Your Superannuation

Superannuation is used by everyone as a way of saving for the retirement years. There is a concessional tax rate of 15% on superannuation earnings which is generally lower than the tax rate for an employee or business owner. There is the option to place your superannuation with an independently run, institutional superannuation fund or you can manage the fund yourself.

As a general rule of thumb, when your superannuation exceeds $250,000 you should consider setting up a self-managed superannuation fund. With a fund under $200,000, the establishment fees, auditing, accounting and administration costs will not make this strategy commercially viable. Unfortunately, I hear of people who have been advised to set up a self-managed superannuation fund without being told of the time and costs involved in its operation. As a tax planning strategy, a superannuation fund needs to be worthwhile or it won’t achieve the desired results. If you only have $50,000 in superannuation, a self-managed superannuation fund is not for you (yet). Inheritance, golden handshakes and wealth accumulation over many years are all good reasons for setting up self-managed superannuation funds. I like self-managed superannuation funds because they give you a control of your retirement savings in a way that is not possible with institutional superannuation funds.

Superannuation funds operate as trusts. The fund’s assets are held in trust for the benefit of its members. The assets are usually controlled by a corporate trustee which is a company, with appointed directors, that control the assets of the superannuation fund.

Trustees

The trustees are responsible for the operation of their superannuation funds and the decision-making, specifically in crafting and executing investment strategies. As a trustee, you must lodge an income tax return, lodge a member contributions statement and appoint an auditor to assess the fund’s financial statements.

Members

The sole purpose of a superannuation fund is to provide benefits to members or their dependants upon sickness, death or retirement of the member.

This is how I structure self-managed superannuation funds for my clients:

- All the fund members must be trustees (or directors of a corporate trustee) and all trustees (or directors of a corporate trustee) must be fund members.
- Sole member funds without a corporate trustee must have at least 2 individual trustees, one of whom is the sole member.
- A self-managed superannuation fund must not have more than 4 members.

Once the trust has been established I suggest all trustees carefully read the trust deed. It is an important document that contains the guidelines for operating the superannuation fund and the trustees' duties and responsibilities. The trust deed also lists the names of the trustees and outlines how they are appointed or removed. The next step is to get the fund a tax file number and an ABN (Australian Business Number) which can be obtained from the Australian Business Register, www.abr.gov.au.

Whenever I recommend establishing a self-managed superannuation fund, I always recommend that an accompanying investment strategy is drafted. I also advise that insurance is imperative (eg. income protection insurance, life insurance) and should be revised each year.

The rules governing superannuation are cut-and-dry and you can't operate a business in a self-managed superannuation fund. The reason for this is that the sole purpose of the fund is to finance the retirement of its members using a calculated, long-term approach.

Here's a tax planning strategy: If you are an employee, or a company director, and approaching retirement, you may sacrifice part of your salary into superannuation. This is called salary sacrifice. In this arrangement you accept superannuation in lieu of salary. This strategy will reduce your tax and increase your superannuation pay-out.

Strategy 7
Claim All Possible Car Expenses

The way to get the greatest deduction from your motor vehicle is to prepare a log-book. A log-book should document each journey during a continuous 12-week period. Start maintaining a log-book for your car if you don't already use one. It might take motivation to keep a log book, but the tax deductions make it a worthwhile activity.

For each journey, the log book must show the:

- Date on which the journey began and ended
- Odometer readings at the start and end of the journey
- Number of private kilometres travelled during the journey
- Number of business kilometres travelled during the journey
- Purpose of the journey

Vehicle Registration: _________________

Period covered by Log Book: From___________ To_______________

Odometer readings for period: Start____________ End ______________

Date of Journey: Start ___________ End ______________

Odometer Readings per journey: Start____________ End_______________

Km's travelled: ____________________

Purpose for journey: ______________________________________
____
____

Total km's for period ________________km's

Total business km's: ________________km's

Business %	____________%

The deduction calculation incorporates the annual car expenses and the proportion of which the car was used for business purposes. Make sure you keep all relevant receipts.

Example:

Emma is a sales professional. She uses a company car to perform her work duties. She maintains a log book for a 12 week period which shows the motor vehicle is used 83% of the time for business purposes. The annual expenses are listed below:

	($)
Petrol	3,200
Repairs	400
Services	1,500
Insurance	2,800
Lease costs	9,000
Tyres	440
Battery	140

Total	17,480

We know that the proportion of business use is 83%, based on the current log book, and therefore the car expense deduction is $14,508 (83% of $17,480).

My clients often ask me whether it is possible to claim motor vehicle deductions without receipts. The answer is, "Yes, it is possible". The way to achieve this is to reasonably estimate the number of business kilometres you travel each year for business or work-related purposes. A simple way to do this is to estimate how many business kilometres you travel in a week and multiply that figure by 48 (the working weeks in a year). Remember, your calculation can't include travel to or from work. If you are ever audited you will need to be able to prove how you arrived at your estimation.

Other methods exist for claiming your motor vehicle, but if you use the strategy of keeping a log-book, you will receive a healthy tax deduction.

Strategy 8

Use Negative Gearing and Positive Gearing

Negative gearing is a common strategy used by property-investors to reduce income and create leverage. Many of my clients set up a negative gearing strategy. I have personally done this and, as a result, I pay significantly less tax each year.

A negative gearing strategy is commonly used by high-income earners entering the property-investment market. Generally the initial rental income is not sufficient to cover the costs of financing and maintaining the property so there is a negative profit, or loss, on the property. This loss offsets against the investor's income to reduce their taxable income. Conversely, positive gearing occurs when rental income surpasses the rental expenses. To minimise tax, a positively geared investment should be placed in either a low-income earners name, a company or a trust.

Let's focus on negative gearing. The example below illustrates how a negative gearing investment strategy works.

Example:

Michael is a project manager and earns $320,000 over the 2007 financial year. Michael buys a residential property in Sydney as an investment. The tenant pays Michael $65,000 annually in rent. Michael pays $90,000 in interest on his mortgage and he also incurs other expenses, which relate directly to the property, amounting to $35,000 (eg. property agent fees, advertising, council rates, water rates and land tax).

Rental Income from property	$65,000
Interest expense paid on loan	($90,000)
Other running and maintenance expenses	($35,000)

Rental Loss from property	($60,000)

By using negative gearing, Michael's rental loss on the property will reduce his taxable income to $260,000 ($320,000 - $60,000). This means that $60,000 of his income is effectively tax-free.

Do not purchase an asset in a discretionary trust if negative gearing is your strategy. Any resulting loss from the negatively geared asset will be quarantined which means the loss will be carried forward to future income years and offset against future income. Trust losses incurred are trapped in the trust and are not distributed to beneficiaries. If your strategy involves purchasing a negatively geared asset for a trust, use a unit trust.

Strategy 9

Salary Sacrificing into Superannuation

A salary sacrifice arrangement is a great way to generate significant tax savings for employees as it diverts salaries away from the high rates of income tax. Employees include those who are paid a salary, a director's fee and/or a bonus. A salary sacrifice arrangement typically involves accepting a non-salary, or non-cash benefit, in lieu of salary. These can include a vehicle, mobile telephone, laptop computer, superannuation or a bonus of a similar value. If you are in the top marginal tax bracket, 46.5%, this will bring about a significant tax saving. You should consider salary sacrificing, if it is not part of your current strategy, as superannuation contributions are taxed at just 15%.

The process is simple:

1. Approach your employer to draw up a contract of employment that states the salary or wage to be periodically sacrificed. This contract can't be backdated so if you're thinking about doing it then sooner is better than later.
2. The superannuation contributions must be made into a complying superannuation fund. This can be an industry super fund or a self-managed superannuation fund that complies with ATO guidelines.

By salary sacrificing superannuation contributions up to the $50,000 limit, you will have a much larger retirement fund when the time comes to collect. Superannuation contributions must be ‘paid’ into the relevant superannuation fund by 30 June, each year. Employers will derive the benefit of the tax deduction in the current financial year.

Strategy 10
Plan for Your Taxes and Reap the Rewards

Some business owners and employees neglect to plan for their taxes and end up rushing madly to lodge their tax-return in time. By having a thorough and tailored tax strategy and a commitment to implementation, you will notice a reduction in the tax you pay each year. The taxation system may appear complex, but it can be navigated and you should never pay more tax than necessary.

Don’t get caught out! You should always budget for your tax each year. It is not uncommon for investors and business owners to find themselves in arrears with tax debts. I am not an advocate of payment arrangements with the Tax Office, nor do I encourage staggered payments. Interest charged on your account with the Tax Office may escalate and can become overwhelming. Tax bills need to be a part of your budget.

Here are some planning suggestions:

- If you haven’t already done so, give your tax file number to all your employers, superannuation funds and banks.

- If you are a high income earner and you do not have private health insurance, get it. This way you can avoid the Medicare levy surcharge. The surcharge is 1% of your taxable income and there is a point at which private health insurance becomes the more affordable option. To be exempt from the surcharge it is required that you, your spouse and any dependants all have hospital cover.

- Negatively geared investments should be held by the higher-income earning family members, whilst interest-bearing investments, such as term deposits, should be held by lower-income earners.

- Take into account that your actual figures may be different to your forecasted figures which will have an impact on your tax budget.

- Keep good records using an electronic accounting system. This way you can keep a close eye on revenue, purchases and operating expenses. Your records should always be kept up-to-date and by outsourcing the bookkeeping function you can concentrate your time on growing the business.

- Always comply with taxation laws to avoid penalties.

Now that these tax planning strategies have been revealed, apply them to your business and tax affairs immediately to achieve the best results. If you need any further advice or assistance with any of the strategies mentioned or any other accounting matter, please speak to one of our Partners at Maurice Vasin & Associates on 02 9371 4394 or visit www.mauricevasin.com.au