Tax Planning Strategies

FORTUNA
ADVISORY GROUP
Be ambitious

Contents

Contents:

What is Tax Planning?

Why is Tax Planning done ?

For Whom is it relevant ?

When is Tax Planning done ?

How is Tax Planning done ? (SOME STRATEGIES)

Important Changes FY ‘19 onwards

FORTUNA
ADVISORY GROUP
Be ambitious

Disclaimer

The material in this presentation does not represent a recommendation of any particular security, strategy or investment product.

The author's opinions are subject to change without notice. This article is distributed for educational purposes and should not be considered investment advice or an offer of any security for sale.

Investors should seek personal advice from a qualified advisor before making any investment or tax planning decisions.

FORTUNA
ADVISORY GROUP
Be ambitious

What is Tax Planning?

- Legitimate methods to bring tax efficiencies
- Through legal and morally acceptable strategies

Unlawful methods are categorised as either:

Tax Avoidance: where accounting structures and strategies are used to abuse a loophole resulting in large tax deduction claims or take advantage of some benefit which was not intended for use in a particular way. (IN OTHER WORDS AGGRESSIVE TAX PLANNING – THIS COULD OR COULD NOT SURVIVE THE ATO AUDIT)

Tax Evasion: where tax payer deliberately hides income from ATO through means such as not recording transaction in books

FORTUNA
ADVISORY GROUP
Be ambitious

What is Tax Planning ?

Ejusdem Generis
(Buyers Beware)

Boundaries between Tax Planning, Avoidance and Evasion are thin

Just because some self-assessed expert told you it is possible doesn't make it possible. ATO has heavy penalties for misappropriation including imprisonment and fines (Tax Schemes)

Be careful if a strategy sounds 'too good to be true'

Therefore, it is important that you consult someone duly qualified and knowledgeable.

FORTUNA
ADVISORY GROUP
Be ambitious

What is Tax Planning ?

TAX HEAVENS

Superannuation system in Australia

Tax havens designated by OECD

Tax paradises
1. Bahama Islands
2. Bermuda
3. The Cayman Islands

Tax shelters
4. Hong Kong
5. Panama
6. Liberia
7. Nauru
8. Niue

Tax resorts
9. The Netherlands
10. Switzerland
11. Luxemburg

Source: OECD / Finance Ministry

Graphic by Nam Kyung-don

FORTUNA
ADVISORY GROUP
Be ambitious

Why is Tax Planning done?

Individual Tax Rates in Australia FY 2019 (Resident)

Taxable income	Tax payable*
$0 to $18,200	Nil
$18,201 to $37,000	19c for each $1 over $18,200
$37,001 to $90,000	$3,572 plus 32.5c for each $1 over $37,000
$90,001 to $180,000	$20,797 plus 37c for each $1 over $87,000
$180,001 and over	$54,097 plus 45c for each $1 over $180,000

** Medicare levy of 2% may also apply*

Other General Tax Rates in Australia FY 2019

SMEs (< 50 mn revenue p.a)	27.5 %
SMEs (only investment)	30%
Superfunds	15%

FORTUNA
ADVISORY GROUP
Be ambitious

Why Tax Planning ?

Tax planning should only ever be done with a view to increasing your 'usable' wealth' or in conjunction with wealth building.

There are some people that enter into all sorts of dubious arrangements in order to obtain a tax deduction, including trying to minimise their income.

Minimising your income is silly, what you want to do is increase your assets and/or after tax income.

E.g.: Negative gearing for tax vs cash flow negative

FORTUNA
ADVISORY GROUP
Be ambitious

Why Tax Planning?

In Australia - Higher your Income; Higher Tax you Pay

But minimising your income isn't something you want

Tax Planning Helps save taxes; leaves more wealth in your hand

Some Tax Planning Strategies may be very popular but a good strategy is tailored to your short term and long term goals (keeping cash flow in mind)

In short, a good strategy needs to consider several aspects viz, investment strategies, wealth maximisation, retirement planning, succession etc.

FORTUNA
ADVISORY GROUP
Be ambitious

Whom is Tax Planning relevant for?

Clearly, if you are in the lowest bracket(s) of taxes and you are not expecting to be in the higher brackets, it is not for you

It is mandatory for those who have discretionary trusts (Profit Distribution)

It is smart for those who may not have discretionary trusts but are high net worth tax payers to still plan their taxes.

Because, ideally:

NO ONE WANTS TO GIVE THEIR HARD EARNED MONEY TO THE TAX DEPT

IF YOU HAVE MORE CASH IN HAND, YOU COULD PLAN AND LIVE LIFE BETTER…

So What is the Secret Formula for the 'Super Rich'

FORTUNA
ADVISORY GROUP
Be ambitious

Whom is Tax Planning relevant for?

The Secrets of the Super Rich

People generally get wealthy **not** by using some flashy "secret" technique, but because they were good at building a business or investing wisely

Gurus promoting the idea of "secrets" are usually conmen. Most wealthy people scoff at such seminars

There's only one big secret of becoming wealthy – employ a very good adviser/Mentor to challenge your thought process. A qualified adviser knows how to best combine these strategies for overall results

Strategies are almost always the same; it's just about how they fit those strategies into your current situation

FORTUNA
ADVISORY GROUP
Be ambitious

When is Tax Planning ?

Financial Year is E.g. from 1st July 2018 to 30th June 2019. Tax Returns are due latest by 15th May 2020

If you have a discretionary trust, trust minutes need signing latest by 30th June 2019.

Therefore, the ideal time to do tax planning is before 30th June but start as soon as possible in the month of June to be able to implement strategies in right time.

To achieve best results, qualified accountants therefore suggest between end of May and end of June.

There is however, no rule which says you can’t plan your taxes at any other time.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

Tax Deductions vs. Tax Credits

Tax Deductions	Tax Credits
REDUCE	REDUCE
TAXABLE INCOME	INCOME TAX
A $1,000 Tax Deduction in a 35% tax bracket saves you $350 in taxes	A $1,000 Tax Credit in ANY tax bracket saves you $1,000 in taxes

Tax Deductions

Tax offset

Gives benefit of (tax rate x deduction claimed)

i.e. if your marginal tax rate is 47%, then for a deduction claimed for $100, benefit = $47

1. Shifting income from higher tax paying entity to lower tax paying entity
2. By adjusting profit/ loss between years, either to defer tax or to take advantage of a particular rule/ rate.
3. Achieving a lower capital gains tax on sale of investments by planning the actual sale event (defer or bring forward or use various concessions or restructuring options)

Offset is a credit against your tax payable

i.e. if your tax offset is $100, your tax liability is reduced by the total $100.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Shifting income to lower tax paying entity

Entity could include individual, company and SMSFs

a) Simply, if there's a husband and wife; husband is on a higher tax bracket and the couple wants to invest in shares, buy the shares in wife's name.

b) Strategies could also involve distributing business income through setting up of discretionary trusts in a way that tax liability is optimum.

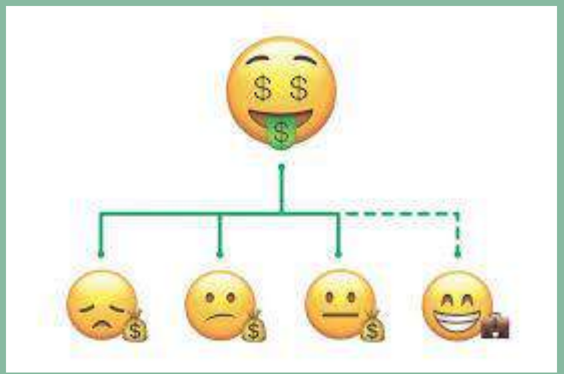
Discretionary trust distributions could also be made to companies or other similar trusts. Good structuring is often an important element of tax planning

c) SMSFs can also be utilised efficiently to minimise tax liabilities through lower marginal tax rates and income streams

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Impact



E.g.

Smith Family has Mr Smith, Mrs Smith and adult son Smith who doesn't earn anything

Situation 1:
Mr Smith run a business under as Sole Trader; make a profit of $270,000
Total Income Tax Liability will be: $100,132

Situation 2:
He established a Family Trust before 30th June and on discretion, distributes money in the following manner:
Mr Smith: $96,000
Mrs Smith: $87,000
Son Smith: $87,000

Total Income Tax Liability will be: $25,072 + $21,562 + $21,562 = $68,196

REASON: Because Australia has Progressive Tax Rates

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Moving Income between Tax Years

There are many ways to move income between tax years.

If you are working now but will likely not be working in a few years, then you may defer the sale of any assets trading at a capital gain until the later years

You may wish to adjust your income or payments by bringing forward or deferring

E.g. – Deferring billing if on accrual or payments / receipts if on cash

A powerful way to move income from this tax year into a tax year that may be many years from now is to invest in an agribusiness scheme (Farm Deposits)

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- More Tax Efficient Investing

One of the biggest issues successful investors hate is capital gains tax (CGT)

A CGT discount applies if you hold the asset for more than one year, so medium to long term investments are vastly more tax efficient than shorter term investments.

Small Business CGT Concessions: A lot of people are not aware of how this can work in their favour

Business restructure under Div 328-G

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Managed Funds and Tax Efficiency

It pays to check on the tax efficiency of any managed fund you are thinking of investing in.

Some funds have a relatively low portfolio turnover and tend to actively manage their taxable distributions to reduce the tax burden of their investors.

Other funds trade excessively, and make huge distributions every year, much of it non-discountable short term capital gains.

Obtaining such information isn’t easy if you are a general member of the public, this is where a good financial advisor can be of assistance.

Or have you considered a SMSF?

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Tax Offsets

There are so many different tax offsets that you should talk to an accountant to see which ones you can claim suiting your personal or business circumstances.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Australian Tax (recap from earlier)

Personal income is taxed in Australia on a marginal tax rate system. Capital gains on assets are added to your personal income

Most SME companies - 27.5%. No capital gains discounts apply if entity is a company.
Companies for sole investment purposes - 30%

Superannuation funds - 15% and in effect 10% on long term capital gains. A surcharge may also apply for contributions for high income earners

GST is arguably a separate tax system, but is outside the scope of this discussion

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Companies

High income investors often buy investments in the name of a Pty Ltd company so they will be taxed at a maximum 30% on income

Be mindful, however, that companies don't get CGT discounts on Capital Gains which would otherwise be available to individuals. (Small Business CGT concessions may be available)

Companies are distinct tax entities, and can retain income and assets in their own name and need to lodge their own tax returns.

A common tax planning strategy is to retain and reinvest income in a company, only drawing a dividend when the shareholder's tax bracket equals 30% or less (Franking Credits utilisation).

Companies can be used as an efficient "parking" vehicle to defer personal income tax.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Trusts and other structures

- Unlike a person, company or a superannuation fund, trusts are not entities that pay tax. A trust is a "fiduciary obligation" between a trustee and the beneficiaries.
- Investments can be made in the name of a trust, but all income and capital gains must be distributed to beneficiaries every year or the trustee will pay tax at the top marginal tax rate on undistributed income.
- A "fixed" trust is set up so that all beneficiaries get a fixed entitlement to the income, capital gains and capital of the trust.
- "Discretionary" trusts give the trustee a lot of flexibility in determining how to make distributions and offer significant tax planning opportunities.
- Beneficiaries of trusts can be people, companies, partnerships and other trusts.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Superannuation

- Although the superannuation system is complicated and many people do not trust it, super is still one of the most tax efficient ways to build wealth.
- You only pay 15% tax on income in a super fund and the capital gains tax rate on assets held for more than a year is 10%.
- Another advantage of super is that this is one of the most difficult assets for a creditor to get his hands on, so superannuation is ideally suited to business owners and professionals wanting a protected place to store their long term savings.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Withdrawing from Super : Income Stream

- Income streams are taxed at marginal tax rates, minus a 15% superannuation pension tax offset. The earnings within the fund itself are tax free once the fund begins paying an income stream (Pension Phase).
- Main Milestones
  - > Preservation Age
  - >Age 60 (and cease employment)
  - >Age 65

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Strategies for Obtaining Tax deductions

- Salary packaging or direct deductions of business expenses (if eligible).

  Special FBT concessions for not-for-profit, health sectors etc

- Negative gearing

- Deductions associated with property (depreciation allowances etc).

- Agribusiness.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Salary Packaging

- A “salary sacrifice” arrangement is a deal agreed to between an employee and an employer to swap some cash salary for another type of non-cash benefit.
- You would do this because taking remuneration in the form of a non-cash benefit often means you don’t have to pay income tax on that benefit.
- When you negotiate a remuneration scheme with an employer that includes salary sacrifice, this is called a “salary package”.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Salary Packaging continued

- You can salary package virtually anything, but to stop abusive arrangements there is an extra tax paid by the employer called Fringe Benefits Tax (FBT)
- The amount of FBT paid on items that attract the full rate of FBT is calculated such that the employer pays the same amount of tax as if you had received it yourself and paid the top marginal tax rate (47%).
- Naturally, the employer will have to pass this cost on to you and so you would gain no benefit on many packaged items.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Salary Packaging Continued

- Some benefits attract no FBT, some attract a partial amount of FBT and some the full rate of FBT. There is a tax saving if you take FBT exempt items or items that attract FBT at a concessional rate.
- Common FBT exempt benefits: superannuation, employee share schemes, laptop computers, mobile phones and many benefits that would be "otherwise deductible".
- The most commonly packaged benefit that attracts a concessional rate of FBT is a car.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Negative Gearing

- “Gearing” is the practice of borrowing money for investments like shares or property.

- “Negative gearing”- Income < Interest expense (100% tax deductible)

- “Positive Gearing” – Income > Interest expense (Taxable)

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Negative Gearing Continued

- Negative gearing is not a tax planning strategy as such, it is a tax efficient wealth building strategy.
- It is important to note that when you borrow to invest you introduce extra risks related to your ability to service the debt and a greater level of exposure to market risk due to the larger portfolio. Some forms of borrowing introduce other risks as well, like the risk of margin calls.
- Unless you borrow vast amounts of money it is unlikely that the size of the tax deductions will be large enough to make a serious dent on your assessable income. That is why many do not classify this as a pure tax planning strategy.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Gearing and Risks

- Although the profits can be fantastic, the risks of gearing should not be ignored.
- Borrowing $100,000 to invest means you have $100,000 at risk in the market. If there is a decline of 30%, and declines of this size are common in both shares and property, you would lose $30,000. If you need to sell the investment you may end up with a debt you can't afford to pay back.
- There is also interest rate risk, if rates rise significantly people can get themselves in lots of trouble if they have borrowed too much.
- It is important to always consider whether you are in any position to accept the chance of losses before you invest.

How is Tax Planning done?

- Pre-paying Interests

- It is legal to claim a tax deduction on expenses for interest as much as 1 year ahead provided it is paid for.
- A common strategy that people use toward the end of the financial year is to pre-pay interest to a lender. This results in bringing forward tax deductions that would otherwise be incurred in the next financial year (but since the dividends from the investment haven't been received they won't add to assessable income until next year).
- Most lenders that allow you to pre-pay interest also give a discount on the interest for doing so, so not only do you save tax, you also pay less interest.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Deductible Super Contributions

- Employees can't claim a tax deduction on their personal contributions, they must use salary sacrifice.(This rule has changed since 1 July 2017)
- If you are self employed, or "unsupported", you may be able to claim a tax deduction on some or all of your superannuation contributions.
- A common post-retirement strategy is for people to liquidate their ordinary investment portfolio and claim a tax deduction on contributions to superannuation, to eliminate their capital gains tax liabilities.
- The same strategy could be employed to reduce the tax liability on the harvest from an agribusiness project.
- Note that rules apply specifying who can and can not make contributions to superannuation, there are a variety of tests of age and employment activity.

FORTUNA
ADVISORY GROUP
Be ambitious

How is Tax Planning done?

- Super Co-contributions

- An incentive introduced to encourage lower income taxpayers to make voluntary contributions to their super.
- This scheme is called the “co-contribution”, and involves the government matching your contributions up to a maximum of $500pa.
- There are two co-contribution income thresholds:
  - a lower threshold ($37,697 for 2018–19)
  - a higher threshold ($52,697 for 2018–19).
- If your total income is between the two thresholds, your maximum entitlement will reduce progressively as your income rises.
- If your co-contribution is less than $20, you will receive the minimum amount of $20.
- The obvious beneficiaries would be lower income employees, but the main beneficiaries are likely to be part-time working spouses and semi-retired people.

FORTUNA
ADVISORY GROUP
Be ambitious

Possible Downside of Tax Planning

- Before implementing any tax planning strategy, you need to consider the costs of doing so. Such costs include accounting, legal and advisor fees.

- The benefits of implementing a sophisticated strategy may not be worth the bother in terms of time and money spent on creating and maintaining the strategy unless you have a fairly high income and/or a big portfolio. (Especially when creating tax structures like companies and trusts.)

- On the other hand, there are a number of simple strategies that can be relatively easily and cheaply implemented.

FORTUNA
ADVISORY GROUP
Be ambitious

Important changes (FY '19 onwards)

- **Immediate tax relief for low- and middle-income earners.**
  - The budget increases the maximum benefit from $530 to $1,080 for singles, or up to $2,160 for dual income families for the 2018-19 to 2021-22 income years.
- **Tax cuts for small and medium-sized businesses**
  - The company tax rate for small and medium-sized companies with an annual turnover of less than $50 million has been lowered to 27.5 per cent
- **Relief for small business owners**
  - The Government is increasing the instant asset write-off threshold to $30,000 from $25,000 and expanding access to medium-sized businesses with an annual turnover of less than $50 million
- **Reprieve for individual taxpayers**
  - According to the budget, the government plans to make structural changes to the tax system in 2024-25, by reducing the rate of the middle tax bracket ($45,001-$200,000) from 32.5% to 30%.

Summary

- There do exist legal and acceptable methods for reducing tax, but tax planning should only ever be of secondary importance behind wealth/retirement planning.
- Some tax planning methods are very powerful, a combination of negative gearing, salary packaging and agribusiness can reduce the amount of tax paid to very low levels, but it is important to use the right strategies that suits your circumstances providing long term benefits.
- An accountant and a financial adviser can assist in implementing all of the strategies mentioned here, plus many others.

FORTUNA
ADVISORY GROUP
Be ambitious

Thank you

Amit Sundrani, *CA, MPA, MBA, B.COM*

Fortuna Advisory Group, BALCATTA

E: amit@fortunaadvisors.com.au

P: 08 9240 4211