Tax Planning

Strategies for Non-Business Entities

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Where to start?

The starting place is to gain an understanding into:

- The options available
- The tax value of those options
- The advantages and disadvantages of each
- The applicability of each to your scenario now and in the future

This is not an exhaustive guide on every tax deduction or item, but a summary of the major or most common deductions and the major issues for you to consider as part of your overall tax planning.

Basic tax deductions

The first option to reducing income is to obtain additional tax deductions – but as mentioned earlier – only the ones which make sense!

Superannuation

Super is paid by your employer currently at the rate of 10.5% of your gross income. You can also make additional contributions to your superannuation fund up to your concessional contributions cap. Note that the concessional contributions cap for the 2022/2023 financial year is $27.5k including superannuation guarantee contributions made by your employer.

Unused contributions up to the yearly limit are carried forward and can be used in subsequent financial years, for up to a maximum of 5 years. The first year eligible for this carry forward was 2018/19. The only catch is that the total balance of your super must be less than $500k. Below is an example of how this carry forward cap can work to increase you super contributions in the current year:

	Contributions made	Limit	Carry forward
2018/19	20,000	25,000	5,000
2019/20	19,000	25,000	6,000
2020/21	-	25,000	25,000
2021/22	-	27,500	27,500
Total unused cap carried forward			**63,500**
Add: 2022/23 contributions limit			27,500
Total allowable contributions in 2021/23 year			**91,000**

Insurances

Some insurances will be deductible while some are deemed to be personal in nature, and as a result non-deductible. The general rule is that insurance premiums are deductible to the extent that payouts made in relation to the insurance premiums will be treated as assessable income.

A quick table as per below:

Income Protection/Sickness and Accident	Deductible
Trauma	Not deductible
Life insurance	Not deductible
Total and permanent incapacity	Not deductible
Business expenses insurance	Deductible
Keyman insurance	Not deductible

Motor vehicle deductions

There are now two different methods for claiming motor vehicle deductions:

- **Log book method –** this entitles you to claim all costs of operating and ownership (interest and depreciation) based on the business use of your car which is determined by keeping a 12-week logbook which shows a calculation of business/employment related travel kilometres divided by the total kilometres travelled for that period to arrive at a logbook percentage that you can use to claim car operating expenses (including interest and depreciation).

- **Cents per km –** you get a deduction of 78c per km up to 5,000 and no questions asked – well almost.

  You don't need a logbook but you still need to show a reason for travelling that far. Some notes in relation to the above methods:

  - Depreciation is limited to the car limit of $64,741 regardless of cost
  - Interest on finance for the purchase of the car is deductible to the extent that the car is used for business/employment purposes based on the logbook percentage calculated under the logbook method
  - If either the cost of the car is high or you have a high work related use, then the log book method will usually result in the best outcome
  - If you are slack at keeping records or have low business use, then use cents per km method may work best for you
  - If you are using the log book method, you are eligible to use your log book for 5 years. There are different automated applications that link into smart devices that can track business use of your vehicle

Everyone's circumstances are different so you should choose the method that will work best for you to maximise your deductions.

Self Education & Training

The cost of furthering your education and training will be tax deductible provided that it can be related to your current employment activity. Courses that are provided by a private provider such as your governing body will be fully deductible. Courses subsidised by HELP will generally not be deductible; but other costs associated with study such as text books, equipment, parking, and travel will be deductible.

Travel

If you need to travel for work or study then this will also be a deductible expense. If there is a combination of work and pleasure then remember to keep a record of your travel, especially in the form of a travel diary if you are travelling away from home for more than six nights in a row.

Donations

Helping others is also another way to reduce your tax bill. Remember, if you get something in return it may not be deductible. Be careful with charity dinners and golf days ensuring there is clear separation between the donation and any activity that you may be enjoying.

Also ensure that the entities/organisations you are donating to are deductible gift recipients to ensure deductibility of donations.

Salary sacrificing – what is it?

Salary sacrificing refers to requesting that your employer divert some of your pre-tax income to pay for something.

For example, you can direct your employer to make an additional super contribution over the SGC rate (currently 10.5%) or you have them make a car lease payment on your behalf.

Why would you want to do this?

- For those in the top tax bracket (over $180,000), the tax savings could be as high as 32% of the amount sacrificed for additional superannuation contributions.
- By making salary sacrificing payment on deductible assets such as a car your employer will be able to claim GST credits on salary-sacrificed purchases.
- For those who don’t like paying super; salary sacrificing can decrease the amount that has to be paid into super by decreasing your taxable income on which SGC is applied.
- Employers cannot use salary sacrificing to reduce SG from 1 January 2020.

You should note that salary sacrificing generally only works for items where tax deductions are available such as superannuation and motor vehicles.

See **Appendix 2 & 3** for some numbers.

Negative gearing

We have all heard a lot about negative gearing. Despite the impression this represents a pot of gold for property owners, it is widely misunderstood.

In a nutshell the key points are:

- Negative gearing occurs because there is a loss.
- The maximum tax refund will be 47% of that loss.
- If your property value does not increase by more than your annual loss, you will not get your money back.

While tax is a factor, it should not be the reason for making a property investment (nor any investment). In assessing the appropriateness of geared property to your situation, the focus should be on your longer term expectations of price growth and rental income.

You should also understand that a tax loss may not equal actual cash flow as building depreciation is a tax deduction but you don't outlay cash for it. Therefore, you can have positive cash flow even though you have a taxable loss position

The important thing here is to remember negative gearing generally needs growth to work.

See the numbers at **Appendix 4 & 5**.

Tips and tricks for rental properties

- **Prepayments –** note that where you are borrowing to buy shares or property, you can prepay interest up to 12 months in advance. This can give you an additional advantage in the first year but be aware you will need to keep paying in advance if you don't want to lose the advantage.

- **Building Allowances –** depreciation on your building requires a Quantity Surveyor report to establish the value so make sure you get one when you purchase your property. Remember depreciation will keep coming off your asset value whether you claim or not! You can claim depreciation on initial building costs (for 40 years) but also on renovations or improvements.

  Major renovations may give you opportunity to write off existing capital works value as well as claim depreciation on new building, essentially double dipping.

  If you are going to conduct any renovations to your property, be sure you get a depreciation report once the works are complete.

- **Purchase deposits –** people often obtain purchase deposits out of existing home loans or other lines of credit they may have available. As it's common to forget about these deposits, don't forget you can claim an interest expense for any borrowings used to get your deposit!

Share investment and gearing

Similarly to negative gearing of property, it is possible to borrow money to purchase shares. Typically this will be done through margin lending or some other product.

The same principles apply unless your share portfolio is increasing in value; any losses you make will remain just that – a loss.

Whilst there are no depreciation type deductions which can provide a tax benefit, many listed companies will pay dividend income with franking credits attached. These credits will offset any tax payable on the dividends to the extent of 30%.

See **Appendix 6** for an example.

Tax advantaged investments = Growth for the future

As outlined on our first page, the advantage of investing in superannuation, shares, and property is that you can obtain tax deductions to decrease your tax payable, while at the same time increasing your asset portfolio

In turn, this is transferring your income production stream away from personal exertion into asset based income which, from a future perspective, will help you maintain your level of income when your body may no longer be up to making the money for you.

Asset protection – what should you do?

Holding personal assets should always be done in a way to protect the asset (particularly those of value) in a name or entity other than the 'at risk' individual. This is usually a spouse or a family/discretionary trust.

The catch with geared investments is that it's usually the high income earner who needs the tax deductions and needs to have these assets in their personal name to obtain the tax benefit planned.

What to do?

→ Look for other ways to structure to reduce the risk or considerable equity being exposed – this can be done by:

  - Keep gearing high on assets held by the 'at risk' person but don't confuse effective asset protection with inflated interest deductions, which are not tax deductible.
  - Investigate a trust gifting strategy as significant equity arises in the name of the 'at risk' person

→ Many events can be insured against which greatly reduce the risk of assets being lost.

Understanding the 'tax' value or benefit

When considering tax planning, people often misinterpret the real value of expenses that are tax deductible. The 'value' is essentially the tax refund or tax saved by incurring the tax deduction. It is not uncommon for one to assume the $1,000 tax deduction means $1,000 tax refund or saving.

The reality is that the value of a $1,000 deduction is:

For a tax payer on the 32.5% marginal rate	$325
For a tax payer on the 37% marginal rate	$370
For a tax payer on the 45% marginal rate	$450

Considering the options in this way should help keep the hunt for deductions into perspective.

Remember it makes no sense to spend $1,000 just to save $450 if there is no other benefit in the outlay

Tax rates

One of the main issues as a high income tax payer in managing your tax; is to understand how the marginal tax rates impact on you and the 'tax' effectiveness or value of any deductions or anticipated deductions.

In Australia, we have a marginal tax rate system. This means that our taxes increase as our income increases, but you are not taxed extra for income within a lower range. Therefore, if you earn $18,210 you are only taxed at 19% of $10 not 19% of $18,210 as the $18,200 remains at 0%.

Australian income tax rates for 2022/23 (residents)

Income thresholds	Rate	Tax on this income
0 - $18,200	0%	Nil
$18,201 - $45,000	19%	19c for each $1 over $18,200
$45,001 - $120,000	32.5%	$5,092 plus 32.5c for each $1 over $45,000
$120,001 - $180,000	37%	$29,467 plus 37c for each $1 over $120,000
$180,001 and over	45%	$51,666 plus 45c for each $1 over $180,000

** The above rates do not include the Medicare levy of 2%*

Now where do I go from here?

What can I do to reduce my tax bill?

Should I pay more super?		Should I buy a new car?		Should I salary sacrifice?		Should I negative gear into property or shares?	
Do you earn more than $241K pa?		Do you use it a lot at work?		Do you earn over $180K?		Do you earn over $180K?	
YES	NO	YES	NO	YES	NO	YES	NO
GO	GO			GO			
Refer **Appendix 1**	Refer **Appendix 1**	You can claim business use	No – but maybe salary sacrifice	Refer Appendix 2	Only for certain items. **Refer Appendix 3**	Depends upon the investment. Refer **Appendix 4-6**	

Appendix 1

Paying more into super

You can reduce your taxable income with super by entering a salary sacrifice arrangement with your employer, or by making personal super contributions.

The contribution limits are set at $27.5k per annum from 2022/2023, which means that once you are earning in excess of $241k, you may only have $2.2k of concessional contributions left for the year before you hit your limit. This is unless your total super balance is less than $500k and you have unused contributions from the 2018/19 or later financial years which have been carried forward and can be used in the current year.

Note: concessional super contributions are taxed at a flat rate of 15%. Earners with taxable incomes above $250k would have to pay an additional 15% of tax on their super contributions.

On the right is a calculation showing the tax savings on additional superannuation contributions:

Result

As can be seen the result is a tax benefit of $4,192 per annum for a salary of $150k topped up to the maximum superannuation contribution of $25k. Even better news is that the money you put in super is still yours!!

No additional super

Gross salary	150,000
Taxable income	**150,000**
Less tax on taxable income	(43,567)
Net financial benefit	**106,433**

Additional super

Gross salary	150,000
Less salary sacrifice / personal contribution	(11,750)
Taxable income	**138,250**
Less tax on taxable income	(38,984)
Take home pay	**99,875**
Add benefits sacrificed (after 15% super tax)	9,988
Net financial benefit	**109,254**

Appendix 2

Salary sacrificing a motor vehicle (over $180K income)

When you salary sacrifice a motor vehicle, you need to be aware that the cost of the car will impact the FBT payable by your employer, and as a result reduce your gross salary.

The benefit to salary sacrificing a car with low business use is that you can save tax by turning non-deductible car use into a tax deduction.

No salary sacrifice

Gross salary	250,000
Taxable income	**250,000**
Less tax	(88,167)
Net take-home	**161,833**
Less car purchase	(45,000)
Less car operating costs	(10,000)
Net savings	**106,833**

Salary sacrifice

Gross salary	250,000
Less salary sacrifice for car (ex GST)	(40,909)
Less FBT payable on car	(8,799)
Less salary sacrifice for car operating costs	(9,091)
Taxable income	**191,201**
Tax	(60,531)
Net savings	**130,670**
Additional financial benefit after tax	**23,837**

Result

By sacrificing salary into car payments the overall additional financial benefit after tax is $23,837 for the year.

Appendix 3

Salary sacrificing a motor vehicle (under $180K income)

When you salary sacrifice a motor vehicle, you need to be aware that the cost of the car will impact the FBT payable by your employer, and as a result reduce your gross salary.

The benefit to salary sacrificing a car with low business use is that you can save tax by turning non-deductible car use into a tax deduction.

No salary sacrifice

Gross salary	150,000
Taxable income	**150,000**
Less tax	(43,567)
Net take-home	**106,433**
Less car purchase	(45,000)
Less car operating costs	(10,000)
Net savings	**51,433**

Salary sacrifice

Gross salary	150,000
Less salary sacrifice for car (ex GST)	(40,909)
Less FBT payable on car	(8,799)
Less salary sacrifice for car operating costs	(9,091)
Taxable income	**91,201**
Less tax	(21,931)
Net savings	**69,270**
Additional financial benefit after tax	**17,837**

Result

Again, by sacrificing salary into car payments the overall annual tax benefit is $17,837 for the year.

Appendix 4

Negative gearing – the kind you need

When considering negative gearing, the two factors you need to consider are tax rates and cashflow.

In this example, we assumed the taxpayer who is on the top tax rate purchased an investment property for $260k and rents that property at $480 per week.

Rental income	25,000
Less: tax expenses	
Body corporate	6,000
Insurance	1,000
Mortgage repayments (interest portion)	12,000
Management fees	2,000
Rates and water	2,500
Depreciation	6,000
Building write-off	5,000
Borrowing expense write-off	400
Net rental loss for tax	**(9,900)**

Reconcile net rental losses to net annual cash flow	
Add tax benefit at 47% of net rental loss	4,653
Add non-cash tax expenses	
Depreciation	6,000
Building write-off	5,000
Borrowing expense write-off	400
Less mortgage repayments (principal portion)	(4,000)
Net annual cash flow	**2,153**

Result

As can be seen the end cash-flow is positive so even if the property does not go up in value for the year you are still making money!

Appendix 5

Negative gearing – cash flow negative

In contrast to Appendix 4, we have assumed a taxpayer on a lower tax rate of 39% rents a property which was purchased for $260k but only rents at $430 per week.

Rental income	22,360
Less: tax expenses	
Body corporate	6,000
Insurance	1,000
Mortgage repayments (interest portion)	12,000
Management fees	2,000
Rates and water	2,500
Depreciation	5,000
Building write-off	5,000
Borrowing expense write-off	400
Net rental loss for tax	**(11,540)**

Reconcile net rental losses to net annual cash flow	
Add tax benefit at 39% of net rental loss	4,501
Add non-cash tax expenses	
Depreciation	5,000
Building write-off	5,000
Borrowing expense write-off	400
Less mortgage repayments (principal portion)	(4,000)
Net annual cash flow	**(639)**

Result

The end cash-flow is negative so unless the value of the property increases more than this amount, the taxpayer will be losing money.

Appendix 6

Gearing into shares

Where gearing is used for shares, a slightly different equation arises as shares generate their tax benefits from dividends and franking credits.

Compared to property, shares can be more volatile so careful analysis needs to be undertaken in respect of dividend yield and growth.

In this example, we assume a taxpayer on the top tax rate borrows $100k at 6.5% interest p.a. to buy shares. The shares have a 5% dividend yield which is fully franked.

Result

This results in a tax benefit of $341 but care needs to be taken that the shares are also growing in value. Always consider obtaining financial planning advice when investing in shares.

Dividend income	**5,000**
Franking credits received	2,142
Interest	(6,500)
Taxable income	**642**
Tax payable at 47%	(302)
Add refundable franking credit offset	2,142
Net tax refundable	**1,841**

Cash flow status	
Dividend income	5,000
Cash expenses	(6,500)
Additional refundable tax credits	1,841
Net annual cash flow	**341**

Case study

Background

John is a lawyer at a large law firm where he is an employee. He is currently earning $200k per annum. He is a little frustrated with the amount of tax he is paying and would like also like to start investing for the future. He is considering investing in shares and a rental property to have some diversity in his investment base.

As his firm is a strong believer in employee retention, they have recently introduced a salary packaging option for their employees allowing packaging of motor vehicles and superannuation.

After speaking to a financial planner and an accountant, he has decided to invest in shares using a margin loan and use negative gearing to purchase a rental property.

Using his employers salary sacrifice option, he has decided to obtain a new motor vehicle for $50k through a novated lease arrangement and make additional superannuation contributions up to the maximum amount of $27.5k.

Arrangements

- John enters into a novated lease for a new car for $50k. His monthly lease payment of $800 and estimated running costs of $400 will be deducted from his pre-tax income.
- John will also salary sacrifice an additional $500 per month into superannuation.
- For investment, he has purchased a property for $274k which will bring in an income of $550 per week. The purchase price was 95% borrowed at an interest rate of 4.5% per annum.
- He has also entered into a margin loan for the purchase of $100k of shares in a publicly listed company. The shares will pay a dividend yield of 5% at the current time. John's LVR has remained at an acceptable level as not to trigger a margin call.
- As he would like to further develop his knowledge in intellectual property law. He has commenced a course in this area which will cost approximately $20k over the next two years. His firm will provide 50% of the funding.
- In addition, a friend in the USA works at a large tech firm in Silicon Valley. He has arranged for John to spend a week as an observer with their in-house lawyer who handles the security and processes around intellectual property.   John will have to self-fund this trip which will cost $7,000 for airfares, accommodation, and meals.

Salary sacrifice component

No salary sacrifice

Gross salary	200,000
Taxable income	**200,000**
Less tax	(64,667)
After tax income	**135,333**
Less monthly lease payment	(9,600)
Less running costs (inc. GST)	(4,800)
Net financial benefit	**120,933**

Salary sacrifice

Gross salary	200,000
Less monthly lease payment	(9,600)
Less running costs (ex GST)	(4,364)
Less FBT for $50k car	(9,777)
Less super contribution	(6,000)
Taxable employment income	**170,259**
Tax	(51,467)
After tax income	**118,792**
Super (after 15% tax)	5,100
Net financial benefit	**123,892**

Result

Salary sacrificing the car and additional superannuation benefits has reduced John’s tax bill from $64,667 to $51,467 resulting in his net financial benefit increasing by $8,973 (after super net of tax is taken into account).

Rental income component

Rental income	28,600
Less: tax expenses	
Body corporate	6,000
Insurance	1,000
Mortgage repayments (interest portion)	12,000
Management fees	2,000
Rates and water	2,500
Depreciation	5,000
Building write-off	5,000
Borrowing expense write-off	400
Net rental loss for tax	**(5,300)**

Reconcile net rental losses to net annual cash flow	
Add tax benefit at 39% of net rental loss	2,067
Add non-cash tax expenses	
Depreciation	5,000
Building write-off	5,000
Borrowing expense write-off	400
Less mortgage repayments (principal portion)	(4,000)
Net annual cash flow	**3,167**

Result

John has generated a tax deduction of $5,300 to offset against his income whilst still having positive cashflow on the property.

As John has decreased his taxable income on his salary to below $180k after salary sacrificing, his refund is calculated using a 39% tax rate. For a higher income earner the result would be even better.

Share investment component

Margin loan

Dividend income	**5,000**
Franking credits received	2,142
Interest	(6,500)
Taxable income	**642**
Tax payable at 39%	(251)
Add refundable franking credit offset	2,143
Net tax refundable	**1,892**

Cash flow status	
Dividend income	5,000
Cash expenses	(6,500)
Additional refundable tax credits	1,842
Net annual cash flow	**342**

Result

John is cashflow positive as a result of the franking credits being higher than the tax payable.

In this initial year, John could also choose to prepay interest for 12 months and double his interest deduction. However, as he will become eligible for a bonus next year, he has decided to wait for the extra income before utilising this option as the additional deduction can only be obtained once.

The final tax outcome

Original position

Taxable employment income	200,000
Less deductions:	
Intellectual property course	(4,750)
Travel to USA	(7,000)
Taxable income	**188,250**
Net tax payable	**59,144**
Average tax rate	**31.42%**

Result

By undertaking a combination of investment decisions and salary sacrificing, John has reduced his tax rate by 3.54% and saved over $16,315 in tax.

In addition to reducing his tax liability, he has also begun building an investment portfolio for the future.

Adjusted position

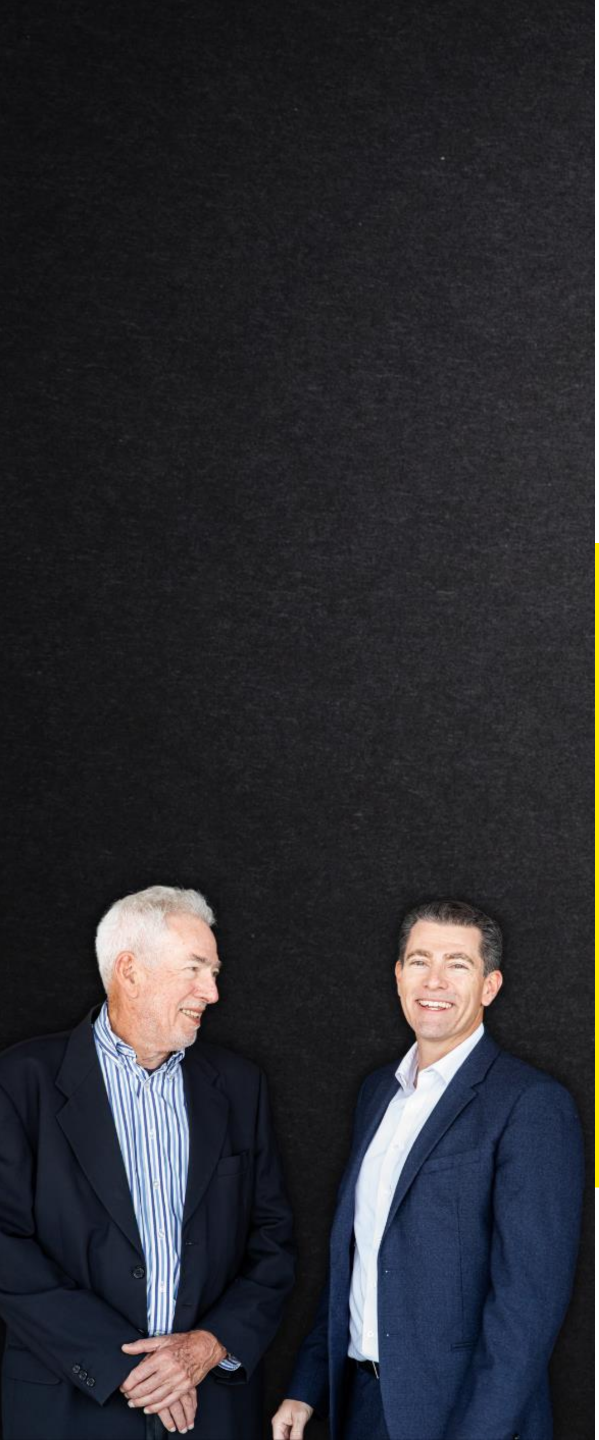
Taxable employment income (after salary sacrificing car and super)	170,259
Net rental loss	(5,300)
Dividend income after interest	(1,500)
Franking credits	2,143
Total income	**165,602**
Less deductions:	
Intellectual property course	(5,000)
Travel to USA	(7,000)
Taxable income	**153,602**
Tax on taxable income	44,972
Less refundable franking offset	(2,143)
Net tax payable	**42,829**
Average tax rate	**27.88%**

The final cash flow outcome

Item	Original position	Adjusted position	Difference
Taxable income	188,250	153,602	(34,648)
Tax expense	(59,144)	(44,972)	14,172
After tax income	**129,106**	**108,630**	**(20,476)**
Cash adjustments			
- Depreciation	-	5,000	5,000
- Building write-off	-	5,000	5,000
- Borrowing expenses	-	400	400
- Principal repayments	-	(4,000)	(4,000)
- Margin interest	-	6,500	6,500
Car payments			
- Monthly lease payment	(9,600)	-	9,600
- Running costs (inc. GST)	(4,800)	-	4,800
Net cash flow	**114,706**	**121,530**	**6,824**
Super benefit (net of tax)	-	5,100	5,100
Net financial benefit	**114,706**	**126,630**	**11,924**

Result

By undertaking a combination of investment decisions and salary sacrificing, John has reduced his tax bill by $16,315 and increased his total cash flow and net financial benefit by a total of $6,824 and $11,924 respectively.



ADDRESS

Unit 10, The Pegasus Centre, 42 Bundall Road, Bundall 4217

EMAIL

info@walshaccountants.com

PHONE

07 5592 3644

WEBSITE

walshaccountants.com