CHAPTER 3 - TAXATION PLANNING

Income Tax - Capital Gains Tax (CGT) - Fringe Benefits Tax (FBT) - Company Tax - GST

TAXABLE INCOME = ASESSABLE INCOME – ALLOWABLE DEDUCTIONS

Assessable Income:

- Salary
- Wage
- Rent
- Dividend
- Sales Revenue
- Interest
- Annuity
- Youth Allowance
- Family Tax Benefits
- Disability support
- ABSTUDY
- Carer allowance

Allowable deductions: expense incurred that is necessary to gain/earn assessable income.

- Travel for work
- Magazine subscription
- Interest associated with making income

Tax offsets reduce tax payable, more valuable than deductions.

- LITO
- Imputation credits
- Senior Australians Pensioners Tax Offset

- Income tax rates for Australian resident adult individuals for 2014/15 are:

Resident Individuals – 2014/15

Taxable income	Tax payable
0- $18,200	Nil
$18,201 - $37,000	19c for each $1 over $18,200
$37,001 - $80,000	$3,572 plus 32.5c for each $1 over $37,000
$80,001 – $180,000	$17,547 plus 37c for each $1 over $80,000
> 180,001 and over*	$54,547 plus 45c for each $1 over $180,000

* for 2014/15 an additional Debt Levy of 2% applies for income > $180,000

Medicare Levy – 2%

Companies: 30%
Superfunds: 15%
Non-complying superfunds: 45%
Partnerships at MRT

If tax offsets > tax due, do **not** get a refund unless:

- Franking credit offset
- Private health insurance offset

Low Income Tax Offset (LITO)

- Max offset = $445 for incomes up to $37,000
- LITO reduces at 1.5c for every dollar above $37,000
    - Cuts out at $66,667

20,542
-18,200
2,342 x 0.19 = 445

Medicare Levy

- 2% of taxable income
- Low income threshold at $20,542

- Applies if income > threshold and you (and dependents) don't have appropriate private patient hospital cover

	Base Tier	Tier 1	Tier 2	Tier 3
Singles	≤ $90,000	$90,001-105,000	$105,001-140,000	≥ $140,001
Families	≤ $180,000	$180,001-210,000	$210,001-280,000	≥ $280,001
Aged under 65	29.04%	19.36%	9.68%	0%
Aged 65-69	33.88%	24.20%	14.52%	0%
Aged 70 or over	38.72%	29.04%	19.36%	0%
Medicare levy surcharge	0%	1.00%	1.25%	1.50%

For families with children, the thresholds are increased by $1,500 for each child after the first.

Tax on Minors

Minor: unmarried, under 18 and not in full-time work.
Unearned: rent, interest, dividend etc.

- First $416 tax free
- 66% from $416 to $1307
- 45% above $1307

Employment income taxed at normal MRT

Tax and Interest-Bearing Securities

- Generally not tax-effective
- Pay income tax on interest **earned**.
- Can defer interest to years of lower MRT

Example:
Jeff earns 8% on the money market and pays 49% tax (45% marginal rate plus medicare levy 2% plus debt levy 2%).
What is after-tax return on investment?
Solution:
After-tax return: (1-0.49) x 8% = 4.08%

Dividends

- Franking credits attached

Franked Dividend	57.06
Franking Credit	24.45
Taxable Income	81.51
(Other income of $50 000 ∴ MTR of 32.5%*)	
Tax Assessed @ 32.5%	26.49
Less Franking Credit	24.45
Tax payable	2.04
Net Dividend	55.02
Unfranked Div.	57.06
Tax Assessed @ 32.5%	18.54
No franking credit	-
Net Dividend	38.52

* Ignoring Medicare Levy

Franked Dividend	57.06
Franking Credit	24.45
Taxable Income	81.51
(Other income of $30 000 ∴ MTR of 19%*)	
Tax Assessed @ 19%	15.48
Less Franking Credit	24.45
Tax refund	8.97
Net Dividend	66.03

Excess franking credits can be used to offset other income / refunded to the shareholder

* Ignoring Medicare Levy

Franked Dividend	57.06
Franking Credit	24.45
Taxable Income	81.51
(Other income of $90 000 ∴ MTR of 37%*)	
Tax Assessed @ 37%	30.16
Less Franking Credit	24.45
Tax payable	5.71
Net Dividend	51.35

* Ignoring Medicare Levy

$$Franking\ Credit = Dividend\ Recieved \times \frac{Company\ Tax\ Rate}{1 - Company\ Tax\ Rate}$$

$$Franking\ Credit = Dividend\ Recieved \times \frac{0.3}{0.7}$$

SEE EXAMPLE 5.3
SEE TABLE 3.3

*Off-market share buy-backs may be tax effective
**Different treatment if share trader vs investor in terms of capital gain

Bonds
Capital gain/loss on sale
- Assessable for CGT (if you are an investor and have held the asset for more than 12 months)
- Assessable as income if you are a trader
  - Not capital gains tax
  - Allowable deduction against income if sold at a loss

Capital Gains Tax (CGT)
Not a separate tax: part of income tax.
Only on **realized** capital gains and if acquired after 19 September 1985
Capital loss can **only** be offset against capital gain

Capital gains events:
- Sell/give away asset
- Asset is lost/destroyed
- Shares are cancelled/surrendered/redeemed
- Enter agreement not to work for period of time
- Company makes payment (not dividend) to you as shareholder
- Your financial instruments declared worthless
- Stop being Australian resident
- Dispose of depreciating asset

Three main methods for CGT:
1. Indexation
2. Discount

3. Other

Indexation option if:

- Acquired before 21 September 1999
- Allows asset **cost base** to be increased by CPI to adjusted sale date
- CPI frozen September 1999

Discount Method:

- Applies if acquired after 21 September 1999
- Net gain discounted according to entity type:
    - Individuals/most trusts: 50% taken off gain
    - Superfunds: 33.33% taken off gain
    - Companies get no discount

Other:

- Acquired and disposed of in under 12 months
- Net gain forms part of assessable income

EXAMPLE:

In December 2010 Juanita sold a parcel of shares for $30771. The shares were purchased for $20000 in June 1995 with brokerage costs of $500. What is the capital gain?

- ✓ ***CGT event – sale & after 19/9/1985***
- ✓ ***CG calculation choice, purchase before 21/9/1999***

	1	2	3	4	5	6	7
ELEMENTS OF THE COST BASE OR REDUCED COST BASE	Amount	Amounts to be deducted for cost base[10]	Cost base (1–2)	Amounts to be deducted for reduced cost base[10]	Reduced cost base (1–4)	Indexation factor[11]	Cost base indexed (3x6)
Acquisition or purchase cost of the CGT asset[7]	20,000		20,000		20,000	123.4	
Incidental costs to acquire the CGT asset	500		500		500	116.2	
Incidental costs that relate to the CGT event[8]						x (1.062)^	
Costs of owning the CGT asset[9]							
Capital expenditure to increase or preserve the asset's value or to install or move it							
Capital costs to establish, preserve or defend title to, or a right over, the CGT asset							
	Cost base unindexed		$ 20,500				
			Reduced cost base		$20,5000		
					Cost base indexed		$ 21771

CAPITAL GAIN CALCULATION					
Indexation method		Discount method		'Other' method (CGT asset held less than 12 months)	
Capital proceeds[12]	$ 30,771	Capital proceeds[12]	$	Capital proceeds[12]	$
less: cost base indexed	$ 21,771	less: cost base unindexed	$	less: cost base unindexed	$
Capital gain (a)	$ 9,000	Capital gain (b)*	$	Capital gain	$

* In choosing between capital gain (a) or (b), remember that the CGT discount will not apply to (a) but it will reduce the amount of capital gain remaining after capital losses are deducted from (b).

CAPITAL LOSS CALCULATION	
Capital loss	
Reduced cost base	$
less: capital proceeds[12]	$
Capital loss[13]	$

$\frac{10,271}{2}$ =5,135

SEE ILLUSTRATIVE EXAMPLE 3.7 p111

Real Estate Tax

Assessable when rent > allowable deductions

Deductions include:

- Interest paid
- Repairs
- Depreciation
- Govt charges/levies
- Agent fees

Capital works deduction on investment property if construction commenced:

- Before 17 July 1985: 0%
- 17 July 1985 to 15 September 1987: 4.0%
- After 15 September 1987: 2.5%

Partnerships advantages:

- Split income
- Direct assets/income to partner with lower MRT
- Loses distributed to partners offset against other income
- Easy administration

<u>Trusts</u>

Advantages:

- Direct income to beneficiaries at low MRT
- Can half the capital gain with discount

Disadvantages:

- Losses trapped inside trust, can only be offset against future income
- Admin costs
- Retained income taxed at highest MRT + ML
- No main residence exemption

Superfunds

Advantages

- 15% tax rate
- Reduce capital gain by 1/3
- Removal of income tax and unrealized capital gains after retiring

Salary Packaging options include:

- Superannuation, phones, laptop, cars, school fees

Fringe benefits tax at 47%, year from April 1 to March 31. Calculating steps:

1. Determine taxable value of benefit
2. Apply gross up rate = fringe benefits taxable amount
3. Apply FBT rate at 47% = FBT Payable

*If company can claim GST credits, use 2.0802

** If company not entitled to GST credits, use 1.8868

Fully taxed fringe benefits: actual cost/value of benefit is fully assessable for FBT. Includes mortgage loans, school fees etc.

- Generally no financial benefit; if on MRT less than 47% then you are worse off.

Taxable value of benefit	$10 000
FBT on grossed-up amount	$10 000 x 1.8868 x 47%
FBT	$8 867
Charge against package	$10 000 + $8 867 = $18 867

Concessionally taxed: taxable value of benefit less than actual monetary value. Biggest tax advantage, usually done on cars.

Car

- Impact on employee package varies by value & use
  - e.g. company car valued at $55 000 **travelling 20 000 km** with operating costs of $15 000 p.a.

$$(\text{Operating Cost} \times [100\% - \text{Proportion Business Use}]) - \text{Employee Contribution}$$

Operating Cost: Own the car:

Depreciation 25% if purchased > 10/5/06

$$\frac{\text{Depreciated Value} \times \text{Depn. Rate} \times \text{Days Available Private Use}}{\text{Days in FBT year}}$$

plus imputed interest 5.95% 2014/15 (7.8% 2012/13, (6.65% 2011/12)

$$\frac{\text{Depreciated Value} \times \text{Benchmark interest rate} \times \text{Days Available Private U}}{\text{Days in FBT year}}$$

SEE EXAMPLE 3.11 ON p125

$$\frac{\text{Car Value} \times \text{Statutory Rate} \times \text{Days Available Private Use}}{\text{Days in FBT year}} - \text{Employee Contribution}$$

Statutory Method	
Taxable value of benefit	$55 000 x **20%**
FBT on grossed-up amount	$11 000 x 2.0802 x 47% (including Medicare)
FBT	$10 755
Charge against package	$15 000 + $10 755 = $25 755

Exempt Fringe Benefits; attractive to salary sacrifice.

- Laptops
- Phones
- Protective clothing

Excluded Fringe Benefits: SUPERANNUATION. FBT not payable, but subject to 15% contribution.