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Tax planning

Put simply, tax planning is the arrangement of a taxpayer's affairs so as to comply with the tax law at the lowest possible cost. A common mistake is to believe that tax planning is optimised when every opportunity to reduce tax is taken. This is because some opportunities to reduce tax rely on strained interpretations of the law. Therefore, tax planning involves much more than taking the option that at first appears to result in lower tax costs. It involves objectively assessing and actively managing tax risk.

Common tax planning techniques that can be deployed are deferring the derivation of assessable income and applying techniques to bring forward deductions. These techniques are discussed below.

It is important to realise that consideration may also need to be given to the general and any relevant specific anti-avoidance measures contained in the tax law.

Deferring assessable income

- The timing of when business income is derived depends on the method which a taxpayer uses. Depending on the nature of the business, income can be reported using either the cash or accrual basis. If the taxpayer is reporting income on an accrual basis, the income is assessable when a recoverable debt is created. If the taxpayer is reporting income on a cash basis, the income is assessable when it is physically received or applied on the taxpayer's behalf. However, an exception exists for income received in advance of services provided.
- If income is received in advance of services provided, it will not be assessable until the services are provided. However, the accounting records of the business must classify the unearned income separately from income already earned.
- Taxpayers who provide professional services may consider, in consultation with their clients, rendering accounts after 30 June to defer the income.
- Interest, rental income, dividends and royalties are not assessable until received (or otherwise paid or credited on the taxpayer's behalf).
- Generally, trust distributions are assessable in the year they are declared, notwithstanding the Commissioner's practice which allows a trustee up to two months after the end of the financial year to distribute the trust's income.

Maximising deductions

- An entity's debtors may be reviewed prior to year-end to identify and write off any debts which have gone "bad". A bad debt can qualify for a deduction subject to certain conditions being met.
- Certain business-related capital expenditure may be deductible. These expenditure include: establishment of business premises, research into likely markets or profitability of a business, due diligence reports, and liquidation and deregistration costs for a business.
- Consider writing off any depreciating assets which are no longer being held for use because a deduction may be available.
- Review the asset register to identify any low-cost and/or low-value assets that may be pooled together to access an accelerated rate of depreciation.
- Non-business taxpayers are entitled to an outright deduction for assets costing \$300 or less, provided certain conditions are satisfied.
- Business taxpayers are entitled to an outright deduction for assets costing \$100 (GST inclusive) or less.
- It is the GST-exclusive value of a depreciating asset that is used in calculating the depreciation, regardless of whether entitlement to input tax credits has been claimed.
- If an entity has carried forward losses, identify whether any net exempt income has been derived for the income year. Carried forward losses will need to be firstly offset against the net exempt income before being available to reduce any assessable income derived during the income year.
- Try to avoid making a donation in a year of losses. This is because a deduction for a donation cannot add to or create a tax loss.
- An entity that has been classified as a small business entity may consider choosing to apply the simpler depreciation concessions, which will provides an immediate deduction for assets costing \$1,000 or less (GST exclusive), and accelerated rates of depreciation.
- Trading stock can be valued at replacement value, market value or cost. The method does not need to be the same for each category of trading stock, therefore maximising deductions.
- Taxpayers may review their closing stock to consider whether any obsolete stock exists to obtain a deduction.
- If an entity has previously elected to use the trading stock concessions available to former Simplified Tax System (STS) taxpayers, consideration may be given to conducting a proper stocktake.
- Employers should ensure that superannuation contributions are paid to their employees' superannuation fund prior to 30 June 2008 to obtain a tax deduction and avoid any superannuation guarantee charge.
- A personal superannuation contribution is available to taxpayers if less than 10% of their total assessable income and reportable fringe benefits is derived from their employment.

Deemed dividends and private companies

- Certain loans, payments and forgiveness of debts by private companies to their shareholders and associates can give rise to unfranked dividends, which are assessable to the shareholders and associates. Try to repay any loans or payments by the earlier of the actual lodgement date or due date for lodgement of the company's return for that year. Alternatively, appropriate loan agreements should be in place.
- Review whether a trust has an unpaid present entitlement to a corporate beneficiary. Potentially, an unfranked dividend (from the company to its shareholders) can arise. Try to repay any unpaid entitlement to the corporate beneficiary by the earlier of the actual lodgement date or due date for lodgement of the trust's return for that year to avoid an unfranked dividend from arising.

Personal services income

- If an individual applies personal efforts and skills in performing services for third parties through an interposed entity (company, trust or partnership), the personal services income rules may instead deem the individual to be assessable on the income generated, unless one of the required personal services business tests is satisfied or a determination is obtained from the Tax Office.
- Identify any unusual circumstances that will prevent the tests from being satisfied. A determination will be granted only if there are any unusual circumstances.

Non-commercial losses

- A loss from an individual's business activity (whether carried on alone or in a partnership) may only be offset against other income derived in the same income year if the business activity satisfies at least one of the four commerciality tests or a determination has been obtained from the Commissioner. Consideration should be given to the relevant tests, as the individual's overtax position will be impacted when the loss is deferred.

Small business entities

- Consider whether an entity satisfies the requirements to be classified as a small business entity. A small business entity can access various tax concessions, such as the simpler depreciation and trading-stock rules. (The small business entity regime replaced the STS from 1 July 2007. The definition of a small business entity is broader than that of an STS taxpayer.)

Companies

- Ensure that all distributions to shareholders during the franking period are franked to the same extent to avoid a franking deficit tax.
- A private company has four months after the end of the income year to provide its shareholders with a distribution statement for dividends paid. In effect, the company can retrospectively correct any overfranking or underfranking of distributions.

Trust distributions

- If a trust has derived capital gains and the income and capital beneficiaries are different, consider whether an election needs to be made to avoid the anomaly if the former will be taxed on the capital gains rather than the latter.
- The trustee distributes the accounting profit, and not the taxable profit, of the trust.
- It is the Commissioner's practice that a trustee has up to two months after the end of an income year to distribute the previous year's net income. (The distribution is still assessable in the previous income year.)
- If a trustee is distributing income to a minor (i.e. under 18), the minor can receive up to \$1,667 in non-taxable distribution.
- If possible, consider distributing all the income of the trust to its beneficiaries. Income that is retained in the trust will be taxed at the 46.5%.
- If a company is owned by a discretionary trust, consider the necessity for the trustee to make a family trust election to ensure any losses or bad debts incurred by the company will be deductible.
- If shares are owned by a discretionary trust, consider the necessity for the trustee to make a family trust election to ensure any franking credits attached to the dividends will not be "wasted".
- If a family trust election has been previously made, try to avoid distributing outside the family group to avoid any potential liability to the family trust distributions tax.

Capital gains tax

- Consider crystallising any unrealised capital losses in the income year if you are anticipating a significant capital gain.
- Consider deferring the disposal of shortly-held assets. If an asset is held for at least 12 months, a 50% CGT discount may be available to reduce any capital gains.
- Consider whether a rollover relief is available to defer any capital gains.
- Consider the availability of the small business CGT concessions which can disregard, reduce or defer a capital gain arising from the disposal of an asset which has been used by an entity in the course of carrying on its business.
- Review any expenditure incurred on an asset to ensure maximising the cost base of the asset.
- If a significant capital gain has been made, an eligible taxpayer may consider contributing some or all of the gain to his or her super fund to reduce the tax payable. This is because a deduction is available for personal superannuation contributions.

Salary sacrifice arrangement

- Consider entering into a salary sacrifice arrangement with your employee for the coming income year, particularly since the repeal of the superannuation surcharge. Salary sacrificing part of your cash salary for non-cash benefits can potentially reduce your income tax liability and result in a better net cash flow.
- If you are expecting to derive bonus and/or commissions prior to the close of the income year, consider salary sacrificing these amounts to reduce your tax liability.

Superannuation strategies

- Consider splitting concessional superannuation contributions with your spouse to receive your combined super balances in a more tax-effective manner.
- Consider entering into a salary sacrifice arrangement with your employer to forego part of your cash salary into superannuation. This potentially can reduce your income tax liability and increase the level of savings in your superannuation account.
- Eligible taxpayers who make a personal contribution will receive the Government's superannuation co-contribution.
- If permissible, consider moving assets into a superannuation fund because of the lower tax rate.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this Bulletin. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Bulletin is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval.