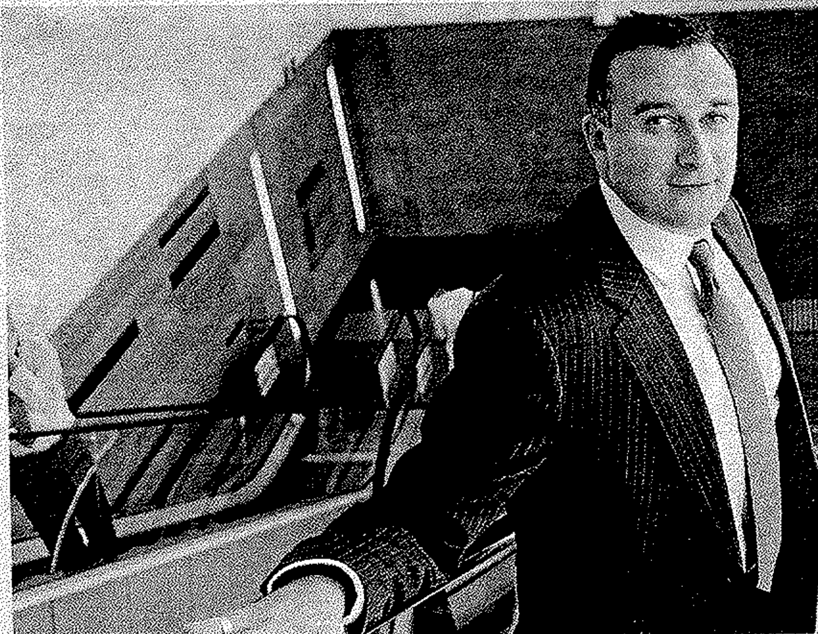
Plan to win

It's time to fine-tune your tax strategies for a special 2011-12 and for the long term.

BY CHRIS TOLHURST


"Taxpayers have to become smarter," says ICA tax counsel Yasser El-Ansary.

ANYONE over the age of 40 can remember the bad old days of income tax, when you didn't have to earn much more than the average wage to be taxed at 48.5 per cent. It's hard to believe that only 12 or 13 years ago Australians earning $50,000 or more paid the top marginal tax rate.

Of course, $50,000 bought a lot more in 1999 than it does today. Even so, the introduction of the goods and services tax proved to be a lucky break for most of us. The GST reduced the federal government's dependence on taxing capital profits and personal income and skewed the tax system towards paying as you go — literally. This is fairer and, hopefully, we'll never again see the Australian Taxation Office compel taxpayers to pay 60 cents in the dollar, the top tax rate of the 1980s.

Years of consecutive tax cuts have delivered big savings to the average taxpayer. If you've earned more than $37,000 in the 2010-11 financial year that ends on June 30, you'll pay a tax rate of 31.5 per cent (including the Medicare levy). Those earning between $80,001 and $180,000 have had their marginal rate cut from 39.5 per cent to 38.5 per cent. Only those earning more than $180,000 are paying the new top marginal rate of 46.5 per cent.

Does this improve our lives? It certainly does. The tax counsel for the Institute of Chartered Accountants in Australia, Yasser El-Ansary, says tax cuts have lowered average tax rates for everyone, as each change to the thresholds means more of your income is taxed at a lower rate.

The revamped tax system is also changing once-common practices, Mr El-Ansary says, with Australians now much less likely to embrace aggressive tax minimisation strategies. He says the days of people funneling money into olive and alpaca farms and other left-field investments that deliver tax benefits but no solid investment returns have largely vanished. "I think taxpayers have become smarter," Mr El-Ansary says. "They're less likely to put money into risky investments that have too much emphasis on the tax attributes."

Today it is superannuation, not shadowy olive groves, that has the big appeal as a central plank of tax planning. But gearing, tax structuring and exploiting opportunities for deductions also need to be top-of-mind as the financial year rushes to a close.

TIMING MATTERS

It typically made sense for taxpayers to defer income until July 1 and bring forward tax-deductible expenditure. But Mr El-Ansary cautions that 2011-12 will be a one-of-a-kind financial year and, for many, a polar-opposite strategy could deliver the best outcome. That's because of the federal government's flood levy on income for 2011-12, which will drive up tax rates. Those earning between $50,000 and $100,000 face a 0.5 per cent levy on their income. If you bring home more than $100,000, you'll pay $250 plus one cent for each dollar you earn over $100,000.

"This could create the unique situation where you might want to bring forward any big lump payments that are due to you so they are paid to you in 2010-11," Mr El-Ansary says.

Typically employees try to arrange to receive any year-end bonuses in July so tax is not paid on them until the next year. If you're in this position, talk to your tax adviser and consult with your boss before June 30. Those who are about to retire or are set to receive an eligible termination payment or unused annual leave payment should do the same.

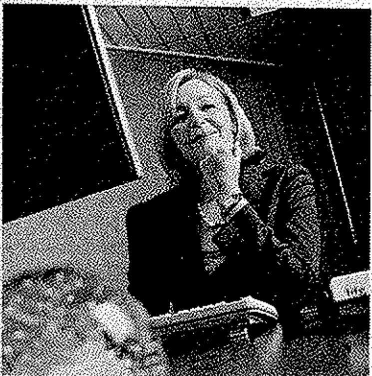
Mr El-Ansary says ratcheting-up deductions is an "important strategy" for millions of taxpayers.

Pre-paying interest on investment loans is a popular way to do this. You can pay interest up to a year in advance and, along with getting a deduction now, Mr El-Ansary says you can lock in current interest rates.

Income protection insurance is another deductible expense that can be paid in advance. Also look at bringing forward work-related expenses such as the purchase of equipment, financial planning fees and journal and professional subscriptions.

GEARING

The negative gearing of losses from investment properties against other income remains hugely popular despite falling tax rates. Remember, though, the Tax Office now subsidises a lower proportion of your expenses, so it is even more critical to ensure your nest-egg properties generate the rental returns and capital growth needed to justify your borrowing costs.



Take care with negative gearing, says financial planner Suzanne Haddan.

Dacian Moses, a financial planner with Waterfall Way Associates, a Coffs Harbour-based firm with clients spread from Tasmania to Queensland, says people in their 40s and 50s, who've largely paid off their homes, shouldn't fear borrowing money to invest. "The more disposable cash flow you have, the more options you have," he says. "If you can afford to continue to pay off the non-deductible debt [on your home loan] and take on deductible debt, that is not a bad idea."

Another planner, Suzanne Haddan, managing director of BFG Financial Services, says negative gearing works most successfully if you're earning more than $80,000.

People earning below this threshold, she says, only get back 31.5 per cent of the losses they incur on a property that's negatively geared. In contrast, Ms Haddan notes, a high-income earner who's in the higher tax bracket gets back a greater percentage (based on the top marginal rate) of 46.5 per cent. "It reduces the high-income earners' risk because they get more [of their losses] paid by the Tax Office," she says.

PROPERTY ISSUES

Negative gearing is great in principle but watch out for potential drawbacks in practice. To get a deduction for the interest on a loan, you have to part with real dollars to pay that interest, says chartered accountant Sue Prestney, principal of MGI Melbourne.

"The valuable property losses are the ones you can generate without having to pay extra dollars — they are your building depreciation and building write-off allowances," she explains.

A large percentage of property investors have the potential to write-off depreciation against their taxable income, but they haven't been given the proper paperwork on depreciation allowances by their property's previous owner. "Often the new owner misses out all together in claiming these deductions," Ms Prestney says. Still, she adds, a new owner can remedy the situation by paying for their own quantity surveyor's report on a property's outstanding depreciation.

INVESTMENTS

If you've sold shares or other assets and realised a capital gain, take time to review your investments. You may have loss-makers that can be sold before June 30 to offset your gain.

Mr El-Ansary says this is especially useful if you've made a gain on an asset owned for less than 12 months, for which you don't receive the 50 per cent capital gains tax (CGT) discount.

"If you have investments that haven't been performing well for a long period, this could be the time to sell them and crystallise the losses," he says.

Watch out, though; Sue Prestney says you have to be careful about selling shares to realise a loss and then buying them back shortly after. The ATO takes a dim view of this ruse. With its growing data-matching capabilities, the Tax Office is likely to catch you out, she warns.

The run-up to July 1 is a good time to review income-splitting arrangements you may have with a spouse or partner. It could be time to think about changing the ownership of assets, especially if there has been a decline in an asset's value and you won't be creating a big CGT liability if ownership changes. You may want to do the sums on whether income-producing investments should be transferred to the lower-earning spouse's name or to a trust or to super.

Investors who do their own tax need to take care to recognise and declare the tax-free franked component of share dividends. Mr El-Ansary says tax agents report this as an area where self-assessing taxpayers make errors and end up paying more tax than they need to.

SUPERANNUATION

You can access your super tax-free from age 60, so super remains a terrific way to grow your personal wealth and save tax, despite the lower marginal tax rates. Deductible contributions are taxed at 15 per cent rather than at your marginal rate. Earnings within the fund are taxed at a maximum 15 per cent, which means your money grows faster.

Don't put too much into super, though, and risk triggering a bill for the ATO's excess contributions tax (ECT). If you're over 50 you are permitted to contribute $50,000 a year into super; younger people can pump in $25,000. Mr El-Ansary says the ATO is zealously applying the ECT to those who exceed these limits. "Be vigilant that you maintain a reasonable buffer between what you contribute and your limit," he says.

If retirement is approaching, you also need to assess having investment properties as a large component of a self-managed superannuation fund. The same applies if property accounts for a big slice of the general investment funds you've set aside to bankroll retirement. Owning quality assets that can be turned into cash quickly becomes more important when you're older. "Logic says that if you are at an age where you might be starting to access your benefits, having everything tied up in a property is not what you need," Ms Prestney warns.