NEWSLETTER

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NEWSLETTER

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This planner is written to assist in recognising issues and implementing strategies to maximise profits, wealth and minimise taxes payable. *This particular Newsletter should be read in conjunction with the March 2015 Newsletter.*

Increasing your personal wealth and reducing your taxes is what Strategic Planning is all about.

Equities, properties, taxes, superannuation, dividends and salaries all need to be considered as they are all an integral part of your Family's Wealth Creation Strategy. If the strategy is to work, all of the elements must be considered and kept in balance.

Planning for the above should be an essential part of your Family's Strategic Wealth Creation Plan.

We have just changed our website and we invite you to visit it at www.goodco.com.au

For additional copies of this Newsletter please:

- contact our office on +612 9232 1588; or
- send an email to *Contact@goodco.com.au*;

EDITORIAL

This Newsletter is a follow on of the topics deferred from the March 2015 Newsletter.

This Newsletter continues to cover strategies which parents should discuss with their children and have in place from the child's early adult years.

When your older children come of age they may meet a partner and cohabitate, think about getting married, buying cars, homes and acquiring investments.

It would be prudent for parents to discuss these issues with their adult children when they are in their late teens as their actions can impact on "***the family and its wealth***". If they understand the ramifications of their relationships to the family you will find it a lot easier to discuss all these issues when the circumstances in later years are at hand.

When children cohabitate with a partner for even short periods that relationship not infrequently ends up in the Family Court where the non-family member claims compensation from the breakdown.

At the end of the day the parents will usually be the ones funding the legal costs and settlement (as unfair as it is and usually just to make the other party "go away").

If asset protection is delayed until wealth is created a plan or structure can be expensive.

To implement a strategy once assets have been accumulated can take many years if the costs of implementation are to be minimised.

As a Member of Tax Discussion Group 9 of the Institute of Chartered Accountants, The Hon Peter Graham QC, Bob Oser and I have made submission on behalf of the Discussion Group on The White Paper currently under review by the Federal Government. The submission can be read at http://bettertax.gov.au/files/2015/07/Graham-Peter.pdf.

These seem to be the issues being discussed in the Tax Reform debate:

The Income Tax debate

Companies

From 1 July 2015 the company tax rate for large companies remains at 30% however for small companies (those with turnovers below $2.0 million) the rate of tax applicable is in fact 28.5%. This became Law at 1 July 2015.

Dividends by both types of companies can be paid to a maximum of a newly defined tax rate (for both) of 30%. Presumably for small businesses when the 30% franking credits are exhausted directors will be forced to pay unfranked dividends if the rate of cash dividends is to be maintained to shareholders.

Given time and the assumption that small business will consistently pay a percentage of after tax profit to its shareholders the franking account will rapidly be reduced. This will force small business shareholders to face the stark reality that savings made by the reduction of the small business tax rate must be made up by them personally. When the franking account is exhausted the 1.5% reduction will be funded by a 1.5% increase by the shareholders.

Small business can if it chooses effectively pay dividends at the Small Business Company Tax rate and should they do this the following is applicable.

Amount of Dividend Paid	Company Tax rate	Cash Dividend	Imputed Credit	Taxable Income	Gross Tax payable	Less Imputed Credit	Tax Payable / Refundable
70,000.00	30.00%	70,000.00	30,000.00	100,000.00	26,934.00	30,000.00	(3,066.00)
70,000.00	28.50%	70,000.00	27,517.24	97,517.24	25,965.72	27,517.24	(1,551.52)
				Less tax refunded to Shareholder			**(1,514.48)**
180,000.00	30.00%	180,000.00	77,142.86	257,142.86	95,934.00	77,142.86	18,791.14
180,000.00	28.50%	180,000.00	70,758.62	250,758.62	92,805.72	70,758.62	22,047.10
				More tax payable by Shareholder			**3,255.96**

Based on no other income earnt by the taxpayer

Given time this will clearly affect small business because the illusion is they would save 1.5% from their business taxes but when they start paying unfranked dividend (with no franking credits attached) after the franking account balances are extinguished then they will personally be paying for the so called small business discount.

Companies that inadvertently pay franking credits in excess of their franking account balance will be required to annually pay a franking deficits tax by 31 July each year to make up for the shortfall of franking credits distributed to shareholders.

Individuals

For the year ended 30 June 2015 the rates of tax were:

Taxable Income $	Tax on Taxable Income $	Percentage on Excess of Taxable Income in Column 2 %
18,200	Nil	19
37,000	3,572	32.5
80,000	17,547	37
180,000	54,547	45

To this must be added a Medicare levy of 2 .0% which is unchanged in the 2016 year

For the year ended 30 June 2016 there is a movement of the threshold on the bottom level from $18,200 to $19,400 however ***for all income over $37,000 but less than $80,000 there is a tax increase on those dollars of 0.5%.***

Currently the rates of tax for the year ended 30 June 2016 are as follows:

Taxable Income $	Tax on Taxable Income $	Percentage on Excess of Taxable Income in Column 2 %
19,400	Nil	19
37,000	3,334	33
80,000	17,534	37
180,000	54,534	45

To the amounts calculated above a 2% Medicare levy needs to be applied and of those taxpayers earning in excess of $180,000 a further 2% budget repair levy applies to all taxable income over $180,000. Exemptions to the Medicare levy that apply to taxpayers below a particular threshold are usually announced in the May Budget. Further levies are applicable to taxpayers who do not have private patient hospital insurance.

The Tax Return Lodgement Discussion

In the current technological climate the Australian Taxation Office receives from businesses a large amount of information that sits in each Taxpayer's Australian Taxation Office files (Pre-Fill Reports) and is compared to the tax return lodged. Tax Agents have access to this report. Taxpayers when they complete their own tax return online find that information is available pre-filled.

It would equally seem that many taxpayers and their tax agents just lodge returns based on the information retained by the Australian Taxation Office in the Pre-Fill Report and therefore one has to question why taxpayers below a particular threshold are required to go to the trouble and cost of completing tax returns when that information is already in the hands of the Australian Taxation Office.

For simplistic tax returns where the taxpayer does not have other deductions or their deductions are of such a small quantum that a general allowance for deductions could be applied and therefore the processing of Income tax payments and refunds would be streamlined and costs to taxpayers and the Australian Taxation Office would be reduced.

The taxpayer could receive say in October their return in a paper or electronic form and be given say 60 days to confirm or amend their taxable income for items not notified to the Australian Taxation Office. On receipt of the confirmation the Australian Taxation Office could either issue a refund or send out an assessment making it both easier and saving the government millions of dollars in processing costs.

If as we would suggest taxpayers were given the opportunity to amend and they were required to support any amendment with documentation then many of the "alleged but usually unsubstantiated deductions" generally claimed by the community would be eliminated.

The GST Debate

It may not be obvious to all but the "cash economy" has boomed since the introduction of GST. You will be aware that "tradies" tend to offer a cash discount of the GST (10%) and save themselves paying any income tax on the income derived from the work carried out.

The only way practically to achieve taxing the cash economy is to REMOVE ALL EXEMPTIONS to GST, increase it to 15% and to compensate all taxpayers and low income earners by adjusting the tax rates and the pensions.

This could be simply achieved by increasing the personal Income tax thresholds to all tax paying individuals and adjusting pensions so that as and when the "cash economy" spend money they are taxed at source. It will not get all unpaid taxes but it will tax a lot more untaxed income and far more than currently occurs. The cash economy spends large amounts of cash and taxing it at source (GST) is the only way tax revenue evaded can in some way be imposed.

The Superannuation debate (The Holy Grail of tax minimisation)

Why the Federal Government of the day and subsequent Governments did not realise that this would become a tax shelter for billions of revenue dollars that otherwise would have gone to Treasury is astounding.

The belief that superannuation would massively reduce pensions has turned out to be a bit of a fallacy. Retirees it would seem take the tax free cash on retirement, spend it and eventually end up on the pension. Concurrently the wealthy and small business use it as tax minimisation vehicle and otherwise avoid taxes they perceive would have been payable if those assets had been invested or held in their own names.

Its primary design and purpose was to create wealth on retirement via a pension fund (the superannuation fund) or paid out as a lump sum payment. This was to take pressure off the pension system for a rapidly ageing population.

These issues are apparent when looking at this with hindsight:

- The wealthy use it to transfer income that would otherwise be taxed on a day to day basis and;
  - in the short term a greatly reduced high tax rate to any income earned; and
  - in the long term derive income in the superannuation fund tax free and then pay it out to themselves either
    - in transition to retirement phase from age 55 or 60 depending on when you were born (attracting some tax) where they annually pay between 4 and 10% of the value of the Fund; or
    - pay out tax free the whole amount or residual balance after the transition payments when they reach 65 years of age.
- The Government previously allowed taxpayers to move into superannuation funds in addition to the maximum compulsory contribution;
  - $1,000,000 to the fund.
  - When that was stopped the Government allowed taxpayers to contribute a non-deductible contribution of $150,000 in any one year but not exceeding $450,000 over three years.

  This means that now and in the future every 10 years capital totalling $1,500,000 that otherwise would have created tax revenue was further moved out of a taxing environment.
- Allowed as part of the CGT roll over provision amounts of up to $500,000 in your lifetime to be rolled into superannuation funds if you are under 55 years of age at the time of the transaction.
- By these measures taxpayers have been encouraged to shift billions of dollars from which income would have previously created revenue to Treasury to effectively a tax free environment for life.
- Treasury would now suggest that the collection of tax dollars has dramatically reduced and that the deficit has nothing to do with superannuation.

The Negative Gearing debate

Is negative gearing so bad? Our opinion is no and if utilised in the right circumstances it can assist in the wealth creation process.

In every system there are people that will abuse the system and with negative gearing that is definitely the case.

Some taxpayers use negative gearing as an income obliteration scheme. Many of those same taxpayers go from rags to riches then back to rags again because they are over geared and if the property market decreases or interest rates increase they tend to fall in a heap because the interest rates kill them or the lenders demand more security.

On the other side most people cannot afford to buy unencumbered capital assets and use borrowing to bridge the gap between savings (usually the deposit) and the capital sum being invested in either property or equities.

The Capital Gains Tax debate

It would be our view that in its simple reading CGT on capital assets is a fair and equitable tax. To this is added the benefit that if that tax is derived by an individual and the asset has been held for over 12 months then the gain is subject to a 50% discount.

If a taxpayer is earning in excess of $180,000 in that year then the tax on the gain is effectively 24.5% which is in reality not inequitable.

The problem here is that there is a very large number of taxpayers who buy homes, renovate and sell every 3 to 5 years or thereabouts and make substantial tax free capital gains on each sale as the residence is deemed to be their domestic residence. Some spouses even make a profession of domestic residence renovations and the tax free CGT gain in most instances is substantial.

A residence used “exclusively” as a domestic residence is exempt from CGT.

For the exemption to be effective the taxpayer must own and the taxpayer must be domiciled at the property for the whole time it is owned subject to some commercial latitude such as it being uninhabitable for some short time while renovations are occurring.

Postal addresses for your mail, electoral addresses, gas, telephone and mail all being at the domestic residence address are matters that the Commissioner looks at when determining residence.

If you claim “home office expenses” in your domestic residence then the property is not exclusively a domestic residence and the exemption will not apply. The exemption is only available to individuals not to companies and may with certain exceptions be available to a Trustee.

The provisions covering “exclusively” are regularly ignored by taxpayers who claim “home office expenses” because it is the place where there home and office is and in many cases the renovation is a de-facto business because of its tax free status.

Should capital gains on domestic residences be removed? We are of the opinion not, however the exemption of GST on domestic acquisitions and sales surely must be looked at in the same vein as the cash economy.

Currently

- A purchase of a new residence is subject to GST;
- A purchase or sale of an existing residence is exempt from GST; and
- Renovations to either new or existing residences are subject to GST.

Why not be consistent and apply GST to all purchases and sales BUT allow a deduction of the tax for the amounts paid on purchase and for all capital renovations? This would be a soft tax on domestic assets and be a tax on people trading in domestic residences.

Conversely or concurrently some consideration should be given to only exempting CGT on domestic residences that are held for more than 5 years. (It can and does in many instances take 2 to 3 years to plan and execute a major renovation).

SEPARATION AND DISSOLUTION OF A RELATIONSHIP

Even with cohabitation and prenuptial agreements this gets messy because there are usually children, egos and expectations involved with at least one of the parties with a broken heart.

The dissolution of a relationship involves effectively two elements.

- The first is an agreement covering care and maintenance of the children, their school fees and general well-being if applicable; and
- The second is a financial settlement.

The financial settlement can be entered into at any time and is not interdependent on both elements being completed at the one time. However, it seems in many cases the financial settlement turns into some sort of game where the spouse controlling the assets seems to take the view that what was a great business & valuable assets is now not doing so well and that in fact the valuable assets are now heavily mortgaged.

To suggest that accountants, lawyers and barristers give advice in this regard would be unprofessional however it is amazing how predictable some of these circumstances are. As a forensic expert we have to say the independence of advisers in these circumstances leaves something to be desired.

Advisers come in two forms: the first are litigants the second are negotiators and be very careful when selecting advisers to ensure you understand whether your adviser is a litigant or a negotiator.

If you pick the wrong the team the asset pool will be diminished heavily by their costs.

If you think you are heading towards a separation or dissolution then you need to identify and talk to someone who is objective, calm and understands the process that you are contemplating. They will explain to you what you are about to undertake and its ramifications to you, your partner and the family. That same adviser should direct you to professionals who can assist you.

During these times of emotional vulnerability the parties can be persuaded or strongly encouraged by others in ways that may not be in the best interest of the parties involved. When this happens the parties seem to lose sight that there is only one pot of gold to be shared and all the costs of lawyers, experts, and valuers etc. just diminish the size of the pot.

As easy as it is to say and as hard as it is to implement, the financial settlement in these circumstances is just another commercial contract to be negotiated.

Acknowledging this is incredibly difficult but if the parties can rationally work through the issues and try and leave out the emotions and advisers as much as possible then both parties will end up with more at the end of the day.

Perhaps consider that if you have made the decision to separate and have had some sound professional advice and you understand what is about to happen, maybe you could promote the concept of a rapid financial settlement. This is the area where large professional fees are consumed and if this can be resolved early then substantial gains will be achieved.

DISPATCHES (DEATH)

We refer you to our March 2015 Newsletter covering Wills, Memorandum of Wishes, Health Care Directives and Enduring Powers of Attorney.

When drafting your Will or discussing the issue with your partner it is important to understand that assets in your personal name are covered by your Will. The assets in the Trust's name are owned by the Trust are not your assets therefore cannot be dealt with in your Will other than by request to the Trustee. You cannot force the Trustee of a Trust to follow your wishes.

On your death a deceased estate (Trust) is established and in the year of death there will be two entities namely "the Estate of the late Deceased" and "the Deceased". A Deceased Estate has a Settlor and that is you and the terms of the Trust are set out in your will.

Wills would have to be among the most disputed documents ever created. There seems to always be a party who will state that "this not what they understood" or that "this is not what they were promised". Sadly a percentage of these as you will have read in the local press end up in Court and decided by the Judiciary. Equally there is a trend for 3rd parties to join the fray and seek entitlements under the Will even though they are not provided for in the document.

It is therefore very important that ***any*** and ***all*** parties be included in the document.

It used to be that to cover these circumstances many people wrote a memorandum of wishes and separately a Will. It seems that in a percentage of litigated matters the memorandum of wishes seems to get lost. For this reason it is becoming more accepted that the Will has a preamble within the same document which effectively is the Memorandum of Wishes or has been described as the objectives of the Will.

If people or parties are to be excluded for reasons that may be well known it is important that in the preamble to the Will the reasons why they are excluded are stated so that should the matter be litigated then your wishes are expressed clearly and concisely to the people who will be dealing with your Estate.

The Law in this area is changing continuously and one of the big changes is that giving gifts to children, particularly of substantial amounts, brings them to an entitlement to obtain further funds from your Estate.

Should you give your children e.g. $100,000 then this will give them a further entitlement from your Estate. This is applicable even if you state in your Will that prior to death I gave the child an amount and no further amount is to be paid to that child. If you want this to be somewhat effective then you need to incorporate into the preamble a whole lot of reasons why that should occur. Even with strong argument under the existing Law the child will still have a further claim of entitlement.

It is equally important if you do give money to a child and you want that money deducted against further amounts bequeathed in the Will it is important that your Will states clearly on a particular date that you gave to the child an amount of money and that if the children are to share in the residual estate then the advance previously made should be deducted before the residual amount is paid out.

Serious consideration should be given whether you want the beneficiaries to receive a capital sum now or income from the estate which will arise from the ongoing investments currently held by yourself and possibly the sale of certain assets which may include your domestic residence.

If you are to set up a Testamentary Trust by which some or all of the beneficiaries are to derive income from the Estate and / or sell assets it is important you get tax advice as to the consequences as to the sale of the assets. This is because it may well be that you leave 3 separate assets of the same gross value to 3 separate beneficiaries on the belief that the 3 assets have a similar value. However, one may have a mortgage attached to it, the other may have a large tax liability attached and the third may be worth its full value. What you are hoping to do and what you end up achieving may be two different outcomes.

Writing a Will is very complex. Most Lawyers will sit down and write a Will or you can go to one of the Trustee Companies or the post office and get a Will kit.

If you have substantial assets you need to sit down and identify your assets, what you want to do with them then identify people in the market place, both accountants and lawyers to explain to them what you have, what you are trying to do and what you are trying to achieve.

Sadly there are only a small number of professionals who are very good at this and if the assets are substantial it is more than likely prudent that the draft of the Will should be run by Counsel who is expert in this area.

At the end of the day if you want to achieve your outcome the best advice is cheap compared to savings made.